December 17, 1964

F--- P--- & S--- Co.
P.O. Box XXX
---, California XXXXX

Attention: Mr. O---. P. S---

Gentlemen:

Your letter of November 16, 1964, addressed to Mr. J. R. Couly, District Tax Administrator, has been referred to this office for reply.

It is our understanding that you sell carbide-tipped bits to well drillers. The manufacturer has a policy of repairing or replacing the bits if they are damaged in use. In either case, the customer is charged a percentage of the purchase price for the amount that the bit has been used.

Sometimes, the well driller needs a replacement drill immediately. He purchases a new one for the full purchase price. When the original bit has been repaired or returned by the manufacturer, the driller may keep the repaired bit or return it to you. If he returns it, you give him credit for the full purchase price, less the percentage charge for his use of the original bit.

Under the foregoing circumstances, sales tax is applicable with respect to the entire selling price of the original bit and the replacement bit.

In reply to your second question, if the original bit proves defective upon initial use, and the manufacturer authorizes you to issue a “no charge” replacement and you have already sold the driller a replacement bit, upon your refunding of the entire purchase price of the original bit, including sales tax reimbursement, you will be entitled to take deduction for defective merchandise on your sales tax return, pursuant to sales and use tax ruling 66, copy enclosed.

Very truly yours,

George A. Trigueros
Associate Tax Counsel

GAT:md
cc: --- – District Administrator