

**STATE BOARD OF EQUALIZATION**

April 23, 1969

G--- O--- T--- Company
Main Office and Plant
XXXX East --- Avenue
--- ---, CA XXXXX

Attention: Mr. A--- A. S---

Gentlemen: Re: SY -- XX XXXXXX

On November 20, 1968, we wrote to you concerning the application of sales tax to sales of cutters, blades, etc., under a "bill of usage" agreement. In that letter we concluded that such sales constituted "sales on approval" within the meaning of the Commercial Code, that title to the cutters and blades did not pass until they were used outside California and that, accordingly, sales tax was not applicable.

We have reconsidered the opinion expressed in that letter and, after consulting with the Attorney General's office, have concluded that sales tax does apply to the transactions in question. We will restate the facts and specify the basis for our conclusion.

Your customers require the use of drilling equipment in their offshore operations outside of California. They order the equipment from you and the equipment is delivered to them in California under a "bill of usage" agreement. At this time, no invoice or purchase order is issued, but they assume the risk of loss.

Your customers then transport the equipment to an offshore drilling platform and use it as needed. While the equipment is stored on the platform, it is carried on your books as "well site inventory."

As soon as the equipment is used on the platform, you are notified and the billing procedure begins. Your customers issue a purchase order to you or your supply house to cover the equipment used. The supply house performs billing functions for you. You may send a copy of your billing notice to the supply house. The supply house then makes up the invoice for billing purposes. On receipt of this bill, your customers pay the supply house, which deducts its commission and remits the balance of the payment to you.

Upon completion of an operation, your customers return any unused equipment to you, and you transfer it on your books from "well site inventory" to "warehouse inventory."

It is our understanding that the transactions in question were not devised for the sole purpose of avoiding sales tax. On the contrary, you engage in the same type of transaction with respect to equipment used in California.

In determining when title passes for sales and use tax purpose, we rely primarily on the provisions of the Commercial Code.

The basic provisions in the Commercial Code that deal with the passage of title are contained in section 2401. That section provides in part as follows:

“2401. Each provision of this division with regard to the rights, obligations and remedies of the seller, the buyer, purchasers of other third parties applies irrespective of title to the good except where the provision refers to such title. Insofar as situations are not covered by other provisions of this chapter and matters concerning title become material the following rules apply:

“(1) ... Any retention or reservation by the seller of the title (property) in goods shipped or delivered to the buyer is limited in effect to a reservation of a security interest. Subject to these provisions and to the provisions of the division on secured transactions (Division 9) title to goods passes from the seller to the buyer in any manner and on any conditions explicitly agreed on by the parties.

(2) Unless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods, despite any reservation of a security interest....”

Accordingly, unless some other provision in the Commercial Code is applicable, title to the drilling equipment in question passes when it is delivered to your customers in California, any reservation of the title by the seller after delivery being limited in effect to a reservation of a security interest. Under these circumstances, the sale would occur for sales tax purposes at the time of delivery. (Rev. & Tax. Code §§6006(a), 6006(e).)

The only other provisions in the Commercial Code that require consideration are those relating to “sales on approval.” These provisions are contained in sections 2326 and 2327 of the Commercial Code. After close analysis of those sections, we have concluded that they do not apply to the facts before us.

Section 2326 provides in part that:

“2326. Unless otherwise agreed, if delivered goods may be returned by the buyer even though they conform to a contract, the transaction is (a) a “sale on approval” if the goods are delivered primarily for use...”

The Official Comments in the Commercial Code shed light on the scope of section 2326. Comment 1 on the section states that a sale on approval "involves a contract under which the seller undertakes a particular business risk to satisfy his prospective buyer with the appearance or performance of the goods in question. The goods are delivered to the proposed purchaser but they remain the property of the seller until the buyer accepts them." The facts that we are here concerned with show that you do not deliver the drilling equipment for the purpose of satisfying your customers with the "appearance or performance" of the drilling equipment.

Section 2327 provides in part that:

"(1) Under a sale on approval unless otherwise agreed

"(a) Although the goods are identified to the contract the risk of loss and the title do not pass to the buyer until acceptance; and

"(b) Use of the goods consistent with the purpose of trial is not acceptance but failure seasonably to notify the seller of election to return the goods is acceptance, and if the goods conform to the contract acceptance of any part is acceptance of the whole...."

The language of section 2327 is not consistent with the nature of the "bill on usage" agreement that here concerns us. Under the bill on usage agreement the drilling equipment is not delivered for the purpose of "trial," nor does the agreement contemplate that use or "acceptance" of any of the equipment constitutes acceptance of all of them.

In summary, it is our conclusion that the transactions in question are not "sales on approval" within the meaning of section 2326 or 2327 of the Commercial Code, and that under section 2401, accordingly, the sales occur when the equipment is delivered to your customers in California. Sales tax therefore applies to the sales.

Very truly yours,

T. P. Putnam
Tax Counsel

By _____
Gary J. Jugum

GJJ:ab