

M e m o r a n d u m**495.0670**

To: Mr. Bruce E. Henline

Date: March 29, 1990

From: David H. Levine
Tax CounselSubject: B--- A--- S---, Inc.
SR --- XX-XXXXXX-020

This is in response to your memorandum dated February 27, 1990 regarding whether sales of horses are taxable sales in California or are exempt sales in interstate commerce.

Under the contract of sale, taxpayer retains title to each horse until all payments are received "and buyer accepts possession of same, and accepts all risk of loss, and agrees to pay for the care, maintenance, feeding, insurance, boarding and veterinary costs of the horse(s)." Most of the horses at issue in this audit were apparently held by taxpayer to be bred while others were held for conditioning or training. The purchaser may or may not want these services, and they are not required by the contract of sale. If such services are desired, the purchaser signs the standard contract and is billed separately by taxpayer for boarding, veterinary expenses, training charges, etc.

The contract of sale does not specify that delivery of the horses will be to an out-of-state location. You have explained to me that taxpayer did not necessarily retain possession of the horses until the sales price was fully paid. Rather, taxpayer delivered the horses pursuant to the purchaser's instructions without regard to whether the sales price was fully paid. Purchasers signed notes with respect to amounts not paid.

You state:

"The basic theory used by the staff is that a sale has taken place in California even though physical possession has not passed and the title retention by the seller is only to secure payment of notes receivable. Clearly something is taking place other than retention for sale. The question is whether tax should be assessed on either the sale or the use in California, or whether the transaction should be considered totally exempt."

When a seller retains title as security for payment of the sale price, a sale nevertheless occurs upon transfer of possession of the property to the purchaser or to some other person at the purchaser's direction. (Com. Code § 2401.) Since taxpayer retained legal title, the question to be answered is whether taxpayer transferred the right of possession to the purchaser prior to actual delivery. If so, we would regard the sale as one under a security agreement at the time the right to possession transferred to the purchaser.

As mentioned above, my understanding is that taxpayer treated the purchased horse as owned by the purchaser and would deliver it at any time pursuant to the purchaser's instructions even though the sales price had not yet been fully paid, provided a note had been executed by the purchaser. That is, the purchaser could have directed taxpayer to deliver the purchased horse to another stable which would provide the same services as provided by taxpayer. We believe that, at the time the purchaser acquired the right and power to direct taxpayer to transfer possession of the horse, the sale occurred. After that time, taxpayer has possession of the horse on behalf of the purchaser and by the grace of the purchaser. Based on my understanding, this time occurred when a purchaser executed both the contract and the note. If, pursuant to the purchaser's directions, taxpayer boarded and trained the horse, taxpayer did so on behalf of the purchaser. Since taxpayer sold the horse in California at that time and the horse was thereafter used by the purchaser in California, sales tax applied to the sale.

I note that I am not certain from our discussion whether a purchaser executed the contract and the note at the same time. If the purchaser executed the contract and not the note, and if taxpayer would not relinquish possession of the horse until the note was executed, we believe the sale did not occur until the note was executed. Until the note was executed, the purchaser had not obtained the right or power to direct taxpayer to transfer possession of the horse. Until that time, taxpayer retained possession of the horse for its own benefit and not for the benefit of the purchaser. Taxpayer would be regarded as having held the horse for resale provided any activities involving the horse were not such that, if no contract of sale had been entered into, taxpayer would be regarded as using the horse and not holding it for resale. We note a final point regarding the analysis above. My understanding is that it was not unusual for a purchaser to take possession of a purchased horse, after signing the contract and the note, prior to fully paying the sales price. If this understanding is incorrect, it would raise the question of whether the taxpayer would, in fact, relinquish possession prior to the sales price having been fully paid (that is, whether a sale had occurred).

Since, under the fact at issue, full payment of the sales price or the signing of the note would be the final action needed to constitute a sale, it is at the time the sales price is fully paid or the note is executed that we must examine in order to determine whether the sale is in interstate commerce. If the purchaser executed the note or fully paid the sales price and then directed taxpayer to deliver the horse out of state, and if the horse was delivered out of state, we would regard that sale as an exempt sale in interstate commerce. If the purchaser executed the note and then directed taxpayer to retain possession until further notice, the sale occurred in California and was not an exempt interstate sale. Sales tax would apply.

Mr. Bruce E. Henline

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If you have further questions, feel free to write again.

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