**State of California** **Board of Equalization**
**Legal Division**

# M e m o r a n d u m

**570.0438**

To : Mr. Tim Vincent
FHB Audit Supervisor

Date: February 5, 1993

From: John L. Waid
Tax Counsel

Subject: **Application of Section 6009.1**
**(Your Memorandum, March 11, 1992)**

I am writing this to modify advice which I gave you in my memorandum to you on the above topic dated May 7, 1992. I indicated that the taxpayer therein, J-- C-- I-- (JCI) was liable for use tax on tangible personal property it purchased from California retailers ex-tax upon issuing resale certificates which it subsequently withdraws from inventory for self consumption. Apparently JCI used some of the property in its out-of-state operations.

As you know, the rule is that when a person buys tangible personal property ex-tax for resale and withdraws some of it from resale inventory for self-consumption, he is liable for use tax measured by the cost of the property to him. It has now come to my attention that several years ago we decided that, where the taxpayer consumes the property out-of-state and at the time of purchase is unable to determine which items will be self-consumed and which resold, Section 6009.1 protects the withdrawal for out-of-state use from use tax liability. Thus, to the extent that JCI withdrew property from resale inventory for use in its out-of-state operations it is not liable for use tax on the cost of that property.

This modification is limited to the particular facts. JCI is liable for use tax on items withdrawn from resale inventory for consumption in California. It is also liable for use tax on items withdrawn from resale inventory and donated to entities operating out-of-state.

JLW:es

**State of California**

**Board of Equalization**
**Legal Division (MIC:82)**

# M e m o r a n d u m

**570.0438**

To: Mr. Tim Vincent
--- Audit Supervisor

Date: May 7, 1992

From: John L. Waid
Tax Counsel

Subject: Application of Section 6009.1

It was a pleasure making your acquaintance over the phone recently. I am writing this in response to your memorandum to me dated March 11, 1992, regarding the application of Section 6009.1 to purchases by California residents of tangible personal property ex-tax upon issuance of a resale certificate which they subsequently use out of state. You attached to your memorandum copies of your memorandum to Phil Kl- dated March 8, 1992, on this matter; a letter from James K--, Controller, of J-- C-- I--- (JCI) to Auditor Enrique ---, dated February 26, 1992, and a letter from Tax Counsel Robert J. Stipe dated July 11, 1988, on the standard to be applied in such cases.

Mr. K-- describes JCI's operations in his letter. In your memorandum to Mr. K---, you summarized Mr. K--'s account as follows:

> "As of September 1991, there were XXX J-- C-- Centres, XXX (63.8%) company owned and XXX (36.2%) franchisee owned. Company owned and franchisee centres are located throughout the United States.
>
> "Beginning December 1990, all purchases of printed material, supplies, food products, audio cassette tapes, etc. have been purchased ex-tax and shipped to a central warehouse owned and operated by JCI in ---, California. Many of these purchases are for resale from California vendors and resale certificates have been issued to such. The warehouse ships all supplies and food products to company and franchise centres as needed. Products and supplies sold to franchises are at JCI's cost plus 10%.
>
> "Prior to December 1990, JCI issued resale certificates to California vendors as described above, however, the vendors shipped the goods to N-- Distributors, a distribution company independent from JCI. N--- held the goods until they received shipping instructions from JCI.
>
> "Approximately 4.5 million of supply items are in question."

OPINION

Under Section 6009.1, property which is merely stored in California for the purpose of being subsequently transported outside the state is not subject to sales or use tax. Sections 6094 and 6094.5 provides that any person who purchases property ex-tax upon issuing a resale certificate knowing at the time of purchase that it will not be resold is liable to the state for the amount of that tax that would be due if the person had not given such resale certificate.

In the letter referred to above, Mr. Stipe discussed the interplay between these two statutes as follows:

> "Applying the above, it is our opinion that property purchased in California under a resale certificate and subsequently used outside of California, which at the time of purchase was contemplated to be resold, is excluded from tax pursuant to Section 6009.1. However, if at the time of purchase the purchaser knew that the property purchased for resale was not to be resold, then the purchaser is liable for tax under Section 6094.5."

Mr. Stipe's letter appears to have been written in the context where all of the property purchased was going to be used or resold. Here, we have a portion of the property which will be used and a portion which will be resold, but at the time of purchase JCI is presumably unable to identify exactly which of the items or property will fall into which category.

Mr. Stipe appears to have used the terms "contemplated" and "knew" synonymously. The "knowledge" at issue is of the fact that the property would be resold, not how much of it would be re-sold. At the time of purchase, JCI both knew and contemplated that a portion of the purchase would be used rather than resold. The fact that the property was stored in a warehouse operated by a third party does not alter that.

First of all, we reject Mr. K--'s claim that JCI is not subject to tax on the portion of the purchases represented by property it self-consumes. Under both Section 6094 and 6094.5, a purchaser who buys tangible personal property ex-tax by issuing a resale certificate and uses the property for anything other than retention, demonstration, or display while holding it for resale in the regular course of business, is liable for use tax on the purchase. Here, it is undisputed that JCI bought tangible personal property in California, ostensibly for resale, but in fact withdrew some of that inventory to consume in its own operations. The act of withdrawing the property from its inventory here is the act in California which caused use tax liability to attach. JCI therefore owes use tax on the property which it self-consumes measured by the cost to it of that property.

In other contexts, when a purchaser has purchased property some of which it knows will be self-consumed and some of which will be resold, but could not at the time of purchase identify which items fell into which category, we have concluded that it is appropriate to buy the

whole lot ex-tax on a resale certificate. The purchaser must then report and pay use tax on the property self-consumed.

JCI, then, may purchase all of the property at issue ex-tax upon issuing a resale certificate, as appears to be its normal practice. Under the above authority, it must pay use tax measured by the cost on the items which it withdraws from inventory and self-consumes.

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