

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Petition for Redetermination)
Under the Sales and Use Tax Law of:)
DATA PHYSICS CORPORATION) Account Number: SR Y GH 26-761104
Petitioner) Case ID's 425711 and 473226
San Jose, Santa Clara County

Type of Business: Manufacturer of computer chip testing equipment
Audit period: 01/01/04 – 12/31/06¹

<u>Item</u>	<u>Disputed Amount</u>
Withdrawals from resale inventory	\$113,878
Tax as determined for both determinations	\$9,606.37
Adjustment - Sales and Use Tax Department	<u>43.24</u>
Proposed redetermination	\$9,649.61
Less concurred	<u>- 241.15</u>
Balance, protested	<u>\$9,408.46</u>
Proposed tax redetermination	\$ 9,649.61
Interest through 11/30/11	<u>4,722.29</u>
Total tax and interest	\$14,371.90
Payments	<u>- 4,886.51</u>
Balance Due	<u>\$ 9,485.39</u>
Monthly interest beginning 12/01/11	<u>\$ 23.81</u>

UNRESOLVED ISSUE

Issue: Whether petitioner used certain equipment that was withdrawn from resale inventory for use other than demonstration and display. We conclude that it did and owes tax on that use.

Petitioner manufactures and sells equipment to test computer chips. During the audit period, petitioner employed sales personnel in California and hired independent contractors to sell its equipment outside California. Petitioner removed certain equipment from its resale inventory and

¹ To prevent the expiration of the statute of limitations for the year 2004, the Department issued a Notice of Determination for that year (case ID 425711) and subsequently issued a separate determination for the period January 1, 2005, through December 31, 2006 (case ID 473226).

1 provided the equipment to its employees and independent contractors, usually for six months to a year.
2 Petitioner recorded the cost of the equipment in a fixed asset account and depreciated that cost on its
3 federal and state income tax returns; it did not report or pay use tax on its cost of the equipment. When
4 the equipment was returned, petitioner either discarded the equipment as scrap or refurbished it. If
5 refurbished, petitioner either reused the equipment or sold it.

6 The Sales and Use Tax Department (Department) concluded that petitioner used some of the
7 equipment to train its employees and independent sales representatives, while other equipment was
8 used by the employees for various purposes, including the testing of other equipment for compatibility.
9 The Department therefore found that petitioner's use of the equipment was subject to tax because the
10 equipment was not used solely for demonstration and display while being held for sale in the regular
11 course of business. The Department stated that depreciation of property for income tax purposes
12 creates a presumption that the property is not held for sale in the regular course of business and that
13 petitioner had not provided sufficient evidence to overcome that presumption.

14 Petitioner contends that it did not make a taxable use of the equipment prior to sale and asserts
15 that depreciation of property is not an absolute bar to a finding that the use of the property was
16 nontaxable. Petitioner argues that the equipment was used primarily as demonstration units by its out-
17 of-state sales force, that the majority of the equipment was shipped out of California, and that it was
18 thereafter permanently located outside California. On that basis, petitioner asserts that it made no use
19 in California of the majority of the equipment. With respect to equipment used by its employees in
20 California, petitioner argues that the use of the equipment was not subject to tax because petitioner
21 trained its personnel without tearing down the equipment, and the compatibility testing was conducted
22 to determine if the withdrawn unit would be compatible with other equipment. Further, petitioner
23 alleges that all of the equipment was used by its employees and independent sales representatives
24 solely for demonstration to potential buyers and that the demonstration units were available for sale.

25 While tax is not applicable with respect to tangible personal property held for resale which is
26 not used except for retention, demonstration, or display, use tax does apply where a person removes
27 property from resale inventory and makes any use of the property other than for retention,
28 demonstration, or display while holding it for sale in the regular course of business. (Rev. & Tax.

1 Code, § 6244, subd. (a).) When a taxpayer withdraws property from a resale inventory account,
2 capitalizes the property in a fixed asset account, and depreciates the property for income tax purposes,
3 there is a strong presumption that the property is not held for sale in the regular course of business.
4 (Sales and Use Tax Department Audit Manual § 0408.28; see also *McConville v. State Board of*
5 *Equalization* (1978) 85 Cal. App. 3d 156,162.)

6 Petitioner capitalized and depreciated the equipment at issue, which is strong evidence that
7 petitioner was not holding the property for resale in the regular course of business. Petitioner does not
8 assert that the capitalization and depreciation were done in error, nor is there any evidence that such
9 was the case. Petitioner does not have records to show how the equipment was used after it was
10 withdrawn from inventory or to document where each of the various units were located. Further,
11 petitioner has not produced evidence to confirm that any of the units were shipped to the out-of-state
12 independent sales force or were used only outside California and only for nontaxable purposes. In
13 short, petitioner has not provided evidence showing that the subject equipment was used solely for
14 demonstration and display while being held for resale, and thus has not overcome the strong
15 presumption that the capitalized and depreciated equipment was withdrawn from inventory for taxable
16 use. Accordingly, we find that petitioner's use of the equipment was subject to tax.

17 **OTHER DEVELOPMENTS**

18 None.

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20 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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