

205.0000 BUSINESS INVENTORY EXEMPTION

See Aircraft

State-Assessed Property

Timber Yield Tax

205.0010 Agricultural Enterprises. The following types of property are eligible for the exemption:

1. Farm commodities held in storage for future sale.
2. Seeds held by a farmer for planting to be used in the production of a crop grown primarily for sale.
3. Feed held by a farmer for feeding to animals that are subject to the livestock head-day in-lieu tax.
4. Commercially prepared by-products, such as sugar beet pulp, almond hulls, and cotton seed hulls, that are held by the farmer and used as feed for animals used in the production of food or fiber useful to man.
5. Mink and other commercially-raised, fur-bearing animals.
6. Farm animals held for breeding purposes if their offspring are normally used as food for human consumption or for the production of fiber useful to man.
7. Farm animals used to work the farm if they are used in the raising of crops which are held for sale, or for the feeding, breeding, or management of livestock.
8. Felled timber lying in the woods on the lien date.
9. Trout in trout farms.
10. Oysters being grown in oyster beds.
11. Bees.

The following types of property are ineligible:

1. Insecticides, fuel and fertilizer held by a farmer for use.
2. Farm equipment held for sale by the farmer as used equipment.
3. Unharvested fruit on the trees.
4. Seeds held by a farmer for planting in order to produce a crop that will be used as feed for eligible animals.
5. Strawberry plants held for planting by a grower to produce strawberries for sale.
6. Asparagus roots held for planting.
7. Medicine separately purchased for mixing in feed for eligible livestock.
8. Dogs and cats held as pets.
9. Stallions and mares held for the production of offspring.
10. Show horses and racehorses, except that show horses held for sale in the normal course of business of the owner are eligible.
11. Pack animals used by a guide to pack campers into the mountains, except that pack animals leased to campers, directly under their control, and not otherwise used by their owner are eligible.

12. Plants grown by nurseries for the production of cut flowers. LTA 4/25/80 (No. 80/69).

205.0015 Aircraft in Dealer's Inventory. Basically, the guidelines for exemption of aircraft are the same as for other properties, e.g., they must be held for either sale or lease as of the lien date.

Where a dealer is using an aircraft for pilot training or charter, Property Tax Rule 133 subdivision (b)(3) would exclude that aircraft from exemption. Additionally, Rule 133 subdivision (b)(5) and (6) would exclude from the exemption any aircraft held for lease that were used or were intended to be used for pilot training or charter. LTA 9/30/80 (No. 80/144).

205.0025 Animals. Although animals held for sale or lease or for food production are business inventory and entitled to exemption, those listed below continue to be taxable:

1. Rodeo stock and show horses used for commercial purposes.
2. Animals used in riding stable operations where the animals do not leave the stable operator's facility and remain under the control of the operator.
3. Animals used in pack station operations where control over the pack animals remains with the pack station operator.
4. Stallions or brood mares held for breeding purposes.
5. Any other animals not held for sale or lease; or not used in the production of food or fiber for human consumption; or not used in the feeding, breeding, or management of livestock.
6. Racehorses which continue to be taxed on the in-lieu basis of Revenue and Taxation Code section 5721. LTA 3/25/80 (No. 80/54).

205.0030 Boat and Equipment Rentals. A boat held for lease by a resort and equipment held for lease by an equipment rental yard are business inventories. C 12/18/79.

205.0040 Bulbs. Daffodil, lily, and iris bulbs held and used to produce cut flowers are perennials which, if planted on the lien date, are part of the land, but which, if not planted on the lien date, are personal property ineligible for the exemption. C 2/10/83.

205.0044 Demonstrations. Demonstration equipment in the possession of a potential customer may be eligible for the business inventory exemption depending on the length of the demonstration period, whether that period conforms to the prevailing period in the industry, whether it exceeds the economic life of the equipment, whether the equipment has been used by the holder prior to the execution of a lease, whether the customer is obligated to pay for maintenance or repairs or is receiving compensation for using the equipment, and whether the equipment will be sold following its demonstration. C 10/29/96.

205.0045 Demonstrators. Equipment used as demonstrators by salesmen employed to sell new equipment of the same type is eligible for the exemption. Equipment used as demonstrators by salesmen employed to lease equipment is ineligible, however, since the law applicable to leasing transactions does not permit exemption if there is any use other than leasing. C 12/15/76.

205.0050 Direct Billing. Business inventory that was previously included in the direct billing estimate of value must be removed from the assessment for 1980 and thereafter, the business inventory is exempted. LTA 4/25/80. (No. 80/69).

205.0055 Escaped Property. The exemption applies to escaped property enrolled under Revenue and Taxation Code sections 531.3 (failure to report cost accurately), 531.4

(inaccurate statement), and 531.5 (inaccurate information) for the 1975-76 through 1979-80 fiscal years, but it is denied to escapes to which the section 504 (25 percent) penalty is applied.

An assessment pursuant to Revenue and Taxation Code section 501 (failure to furnish information) along with the Revenue and Taxation Code section 463 penalty (failure to file statement) is eligible for the exemption. The exemption is applied prior to addition of the ten percent penalty. LTA 4/25/80. (No. 80/69).

205.0058 Forms Sold to Related Entities. Standardized office forms owned by a hospital corporation which sells the majority of said forms to independent, but related, entities which serve as support agencies to the hospital corporation are, to the extent they are held for sale, eligible for the exemption. The lack of a profit motive, the fact that the sales are made to closely related entities, and the fact that, in the hands of the purchasers, the forms become office supplies do not serve as bases for disallowing the exemption. C 1/25/74.

205.0059 Gas Cylinders. Gas cylinders available for the sale of their contents are not eligible for the exemption because they are not intended for sale or lease in the ordinary course of business. Rather, the cylinders are merely being provided by distributors as returnable containers used to facilitate the sales of the contents. C 12/4/84.

205.0060 Gas in Storage. Gas once extracted and held in storage, even if stored underground, is personal property eligible for the exemption if held for sale or lease in the ordinary course of business. C 4/16/80.

205.0061 Gas in Storage. Gas stored underground and used in the course of recovery of oil is not eligible for the exemption. C 7/23/84.

205.0062 Hospital Property. Hospital-owned properties such as foods held for sale in the hospital cafeteria and drugs held for sale in the hospital pharmacy are eligible for exemption, while properties such as foods for patients' meals, patients' drugs, sutures, bandages, tape, splints, gauze, slings, dressings, needles, syringes, etc. are not. The latter items are transferred to patients in the course of rendering professional services and are regarded as self-consumed supplies. C 10/20/88.

205.0065 Linen Rentals. Typically, a contract for linen service specifies an initial quantity of linens to be delivered to the customer-lessee and contains a schedule for exchange to enable the supplier to clean and recirculate linens that have been laundered. Usually, there is no contractual provision requiring the supplier to maintain a specific number of linens in reserve. The number is discretionary with the supplier.

The inventory exemption applies as follows:

1. Linens in the lessee's possession or those to which the lessee has a contractual right of control regardless of their location are not eligible for exemption because they are, in effect, out on lease.
2. Linens in the lessor's possession held for sale or lease, even if intended to be exchanged for those in a lessee's possession but which are not committed to a specific lessee, are eligible for exemption. LTA 9/27/91 (No. 91/68); C 9/5/95.

205.0066 Linen Rentals. Fungible linens furnished pursuant to "requirements clause contracts" are eligible for the business inventory exemption while they are on the lessor's premises, even if they are bundled and scheduled for delivery. The lessor's premises includes its delivery vehicles if the contract requires the lessor to deliver linen supplies to the lessee's premises. C 10/23/97.

205.0070 Machinery and Equipment. Machinery and equipment used in conjunction with animals for the production of food, e.g., milking equipment, is not business inventory and, therefore, may not receive the exemption. C 12/10/79.

205.0075 Manufacturing. The following types of property are eligible for the exemption:

1. Manufacturing supplies, such as nuts, bolts, and screws that will be incorporated in a product that is to be sold.
2. Parts held by manufacturers so as to perform warranty service on products that sell, even though the parts are not sold outright.
3. Sand and gravel held by a licensed contractor for incorporation into a bridge or roadbed not for his own use.
4. Lumber held at a job site by a licensed contractor for incorporation into a building not for his own use.
5. Factory-built housing held for sale by the manufacturer if held for sale as individual sections of a building or if the manufacturer is a licensed contractor and assembles the sections at a building site and then sells the building.

The following types of property are ineligible:

1. Manufacturing supplies, such as drill bits, that are not physically incorporated into a product.
2. Catalytic materials which are not intentionally incorporated into a product.
3. Machinery and equipment held for use.
4. Dies, patterns, jigs, or tools held for use.
5. Unmined materials, such as iron ore. LTA 4/25/80 (No. 80/69).

205.0076 Manufacturing. Fuels stored at plant sites so that the plants can generate power on a continuous basis do not constitute business inventory even when the plants are used to generate electricity for sale. The fuel is consumed in the course of creating electrical energy and is not incorporated into the power being sold. C 9/28/89.

205.0077 Manufacturing. Tin deposited on the surface of glass during the manufacturing process to improve the weather- and stain-resistant qualities of the glass is eligible for exemption. C 9/16/93.

205.0082 Mobile Radios. Radio-telephone companies that provide radios to their customers may do so as part of providing a communication service and without a separate charge, may lease the radios at a fixed rate with communication service provided for a separate charge, or may sell the radios and separately bill for the communication service. To the extent radios in inventory are to be leased or sold rather than provided as part of the communication service and without a separate charge, they are eligible for exemption. C 5/12/80.

205.0085 Music Compilation Compact Discs. The taxpayer is a producer and distributor of music compilation compact discs (CDs). The taxpayer uses the CDs as storage media to digitally store a large customized collection of songs and jingles. When a client places an order, the taxpayer signs a licensing agreement for the selected CDs. The licensing agreement states a specified period of use and requires certain monthly payments. The taxpayer retains ownership of the CDs while they are in the hands of the client. As required

by the licensing agreement, at the end of the specified period of use, the client must return the CDs to the taxpayer.

Since the CDs leased and delivered to the lessees constitute tangible personal property owned by the taxpayer, they are a part of the taxpayer's business inventory while in the hands of the taxpayer. Thus, they are eligible for the exemption. Those CDs that are in the hands of clients on the lien date, however, are subject to property taxation. C 9/11/2000.

205.0090 Oil Well Tools and Equipment. To determine whether a given company is leasing oil well tools and equipment or providing a service that involves the use of tools and equipment, investigation must be made into the business practices of the company rather than placing reliance only on the contract forms employed.

Tools and equipment held for and leased without operators are eligible for exemption. Tools and equipment "rented" with operators are not. Here the owner is providing a service and using tools and/or equipment in the performance thereof. Tools and equipment held both for use in the performance of a service and for rental would be ineligible for exemption for failure to satisfy the "held exclusively for lease" requirement. C 4/15/88.

205.0100 Penalties.

1. (a) Revenue and Taxation Code section 219 allows the exemption for escaped inventory enrolled under Revenue and Taxation Code section 531, provided that the inventory should not be properly enrolled under other specific sections which disallow the exemption.

(b) Section 531 should not be used for willful evasion of personal property taxation. Escapes of that nature should be enrolled under Revenue and Taxation Code section 502.

(c) If Revenue and Taxation Code section 463 and Revenue and Taxation Code section 504 penalties are to be applied, enrollment should be under section 502, and the penalties will apply to the net amount after allowance for the exemption.
2. If a taxpayer with over \$30,000 inventory willfully under-reports feed and does not report feed stored at another location:

(a) The section 504 penalty would only apply to the amount of feed that escaped, and enrollment should be under Revenue and Taxation Code section 531.4 for the reported location.

(b) The feed stored at the second location should be handled as 1. (c), above. The section 504 penalty applies.

(c) No exemption is allowed under section 531.4, but the second location calls for penalties on the net amount.
3. If a taxpayer with over \$30,000 inventory at each of two locations receives and files a statement for only one of the locations:

(a) The escaped property at the second location should be enrolled under section 531 with the ten percent penalty.

(b) No enrollment for the second location under section 531.4 because no report was made for this property.

(c) If investigation indicated that the taxpayer willfully failed to disclose the second location, the procedure in 1. (a), above, should be used. C 2/25/80.

205.0110 Personnel and Equipment. Where a "lessor" provides his personnel to operate his equipment, he is providing a service rather than renting equipment, and the equipment would not be eligible for exemption even though the contract between the parties is denominated a "rental contract". C 2/16/83.

205.0118 Pheasants. Pheasants owned, claimed or possessed by gaming clubs are not business inventory. The primary business of such clubs is to provide places to hunt, in conjunction with which the birds are raised and released into the fields, not to raise birds for resale or for sale. C 5/20/82.

205.0130 Plants. The exemption does not apply to plants not held for sale, whether annual or perennial. The harvested products thereof are, however, entitled to the exemption. The exemption is likewise applicable to nursery plants held for sale as living plants by nurseries, which plants are subject to taxation as personal property. OAG 11/7/74 (No. CV 74-68, Vol. 57, p. 506).

205.0140 Printed Materials. Maps, tour books, and similar published materials in the hands of an automobile association are business inventory even though they are provided to members without a specific charge being made therefor. C 8/8/80.

205.0141 Printed Materials. Medi-Cal Provider Claim Forms held by a fiscal intermediary that operates a claims processing system under a contract with the State are consumed in the course of the rendering of a service and are not held for sale to the State so as to qualify as exempt business inventories. The forms could qualify as exempt, state-owned property if appropriate and specific title clauses were included in the cost reimbursement provisions of the contract. C 7/7/89.

205.0160 Professional and Service Enterprises. Goods transferred in the rendition of a professional service are not eligible for the exemption, while goods transferred in the rendition of a nonprofessional service are eligible. A profession is a vocation where the labor and skill is predominantly mental or intellectual, rather than physical or manual. A profession requires knowledge of an advanced type in a given field of science or learning gained by a prolonged course of specialized instruction and study. Examples of professional services are: law, ministry, medicine, military service, engineering, chemistry, industrial designing, accountancy, and economics. A nonprofessional service is generally defined as a vocation requiring skill of a manual or mechanical nature. Examples of nonprofessional services are: barber, beauty operator, carpenter, plumber, electrician, and embalmer.

The following types of property are eligible for the exemption:

1. Embalming fluids of a mortician.
2. Medicines held by a hospital pharmacy for issuance to patients at a separate charge.
3. Food held for sale in a hospital cafeteria.
4. Clothes hangers and plastic bags held by dry cleaners and delivered to customers.
5. Chlorine tablets held by a swimming pool service company.
6. Auto repair shop inventories of replacement parts.
7. Television repairman's inventory of tubes and electrical parts.
8. Spare parts stocked by airlines and bus companies for use in repairing both their own equipment and equipment belonging to others if the owner segregates the portion of these inventories held for sale (used to repair the equipment of others).

9. Airline "frozen food stuffs" located at an off-site warehouse.

The following types of property are ineligible:

1. Medicines that a doctor keeps on hand.
2. Food held for serving to hospital patients as part of the daily hospital service and not separately billed.
3. A stock of accounting books passed on to the clients of an accountant as part of his services.
4. Parts that have already been installed as of the lien date on equipment being repaired by a repair shop.
5. Supplies of tickets held by airlines and theaters. LTA 4/25/80 (No. 80/69).

205.0161 Professional and Service Enterprises. Hospitals are service enterprises that consume rather than sell most of the items they dispense in the course of patient treatment and care. Such noninventory items include medicines, IV fluids, casts, splints, wraps, crutches, bone screws and all record keeping, cleaning and maintenance materials. The exception would be, for example, major items that are affixed to and/or permanently attached to patients, such as body part replacements or prostheses.

Portions of a hospital providing nonprofessional services such as the gift shop, cafeteria and pharmacy do transfer property to customers in the regular course of business, and such properties held for sale constitute business inventory. LTA 6/21/90 (No. 90/45).

205.0180 Property Held on Consignment for Sale. When a boat is consigned for sale, its eligibility for exemption depends on the true intent of the owner. Individual facts such as length of the consignment, inclusion of the lien date, and location of the boat tend to indicate the intent but are not singularly controlling. C 11/20/96.

205.0200 Property Held for Lease. When an equipment lease is terminated either because of the lessee's default or the expiration of the lease period, the equipment is eligible for the exemption even though it is located on the lessee's premises, assuming all exemption requirements are met. The statute does not require that the property be located at the lessor's place of business, only that it be held for lease in the regular course of business.

Should the assessor receive late notice of the lease termination after assessing the equipment to the lessor and the lessee, statutory provisions concerning roll correction and/or cancellation should be implemented. Lease provisions concerning the tax responsibilities of the lessee are not binding on the assessor whose assessment authority is contained in Revenue and Taxation Code section 405. C 3/20/89.

205.0201 Property Held for Lease. The following types of property are eligible for the exemption:

1. Goods held for lease not actually out on lease on the lien date, and not used by, or intended to be used by, the lessor for some purpose other than the prospective sale or lease of such goods.
2. Linen supplies that are leased to customers if not out on lease on the lien date.
3. Ski rental equipment held for short-term rentals if not out on lease on the lien date.
4. Coin-operated pool tables, shuffle boards, but only when held for sale or rent.
5. Items held for lease by a person who has himself leased the items from someone else.

6. Raw materials, work in process, or finished goods if they will become part of or are themselves items of personalty held for sale or lease.
7. Boats held for rental purposes in the normal course of business. This applies even though the boat rental activity may be suspended during the winter.
8. Horses held by a riding stable for rent on an hourly or daily basis, provided the horses are removed from the stable's place of business and are not directly under the owner's control during the rental period and provided the horses are not used by the owner when not rented.
9. Tools held by a short-term rental business if not out on lease on the lien date.
10. Cable television converters held for sale or lease by a cable company.
11. Supplies of motor fuels held by a rental operation where the fuels will be provided to a customer with the rental of a machine.

The following types of property are ineligible:

1. Vending machines held in the owner's hands that are normally placed on site to dispense food, unless the machines are held for rent.
2. Merry-go-rounds and other amusement rides.
3. Golf carts held for short-term rental.
4. Supplies of motor fuels held by an equipment operator where the fuels are consumed by the operator's equipment during the performance of a job. LTA 4/25/80 (No. 80/69); C 11/8/95.

205.0202 Property Held for Lease. While the location of leased property on the owner's real property may be an indication that property is not on lease, the crucial element for deciding whether property is actually out on lease is control of the property by the lessee. C 11/8/95.

205.0203 Property Held for Lease. C 2/28/97. (Deleted 2003)

205.0220 Property Leased on Lien Date. Whether or not property in the hands of a non-owner is actually being used on the lien date is not determinative of its status as exempt inventory or non-exempt property out on lease. If a person has the right to possession and control of property, that property is to be considered rented or leased, even if no user payments are currently due and even if the owner has some non-interfering rights in the property. C 4/1/85.

205.0240 Repair Parts. Parts used by a taxpayer to repair its property and to repair property of others, which it operates pursuant to agreements whereunder repairs, replacements, or modifications are at the taxpayer's sole cost and expense are used by the taxpayer in the course of its business and hence, are not eligible for the exemption. C 4/30/99.

205.0245 Research and Development Costs. The business inventory exemption applies only to research and development costs that are related to a product that is held for sale or lease in the ordinary course of business. While such costs related to assessable tangible tools or machines are assessable, it does not necessarily follow that all other research and development costs are non-assessable simply because they are "consumed" as part of any research and development process intended to develop a product that eventually may or may not be held for sale. C 12/5/2008.

205.0250 Retailing. The following types of property are eligible for the exemption:

1. Gold held by a dealer for sale in the ordinary course of business.

2. Merchandise in vending machines.
3. Consigned goods held for sale.
4. Farm or construction equipment, previously used by a farmer or contractor, under consignment to an auctioneer for sale.
5. Trading stamps in the hands of the trading stamp company.
6. Display items, unless they have been altered to the point where it is unlikely that they will be sold.
7. Returnable soft drink bottles or beer kegs held by the bottler when title to the bottles or kegs passes to the retailer.
8. Nonreturnable bottles and other containers if title thereto passes to the purchasers.
9. Salesmen's samples, if items are sold from the samples or if the samples are periodically rotated and returned to stock for sale.

The following types of property are ineligible:

1. Gold held by individuals or dealers as an investment in anticipation of price increases.
2. Merchandise from a discontinued business stored in a garage.
3. Merchandise from a discontinued business stored while the owner attempts to have the manufacturer accept return of the merchandise.
4. Farm or construction equipment held and advertised by a farmer or contractor for sale as a means of disposing of old or excess equipment.
5. Trading stamps held by a retailer for distribution with the sale of his goods.
6. Returnable soft drink bottles or beer kegs held by the bottler when title to the bottles or kegs remains with the bottler.
7. Office equipment that is removed from inventory and used by the retailer for a period of time. The equipment remains ineligible for the exemption until such time as the retailer is no longer using the equipment and returns it to an inventory for sale status. LTA 4/25/80 (No. 80/69).

205.0270 Returnable Containers. Pallets and rigid delivery cases are not normally containers within the meaning of Property Tax Rule 133, since their primary use is to facilitate transportation and handling of groups of products rather than containment of products as the rule contemplates, but they can be. For example, pallets containing manufactured bricks sold to and consumed by bricklayers are the primary containers of the bricks, and such pallets are eligible for the exemption if title to the pallets passes to the bricklayers.

Title provisions in a written contract, cost or value of containers vis-a-vis deposit amounts, conditions of return of containers, inclusion of sales tax reimbursement on containers, distinctive marking or construction of containers, and the merchant's method of accounting, where applicable, should be considered when determining whether title to returnable containers passes to the purchaser of the product. LTA 5/10/83 (No. 83/59).

205.0290 State Assessee. Property held by a public utility also licensed as a contractor and participating in the construction of its facilities is not eligible for the exemption. Such construction activity is not in the ordinary course of the utility's business. Furthermore, such property which is to be incorporated into power plants, etc., is held for the utility's use, not for sale or lease. C 2/11/80.

[205.0300](#) **Subsidiary Sales to Parent Company.** If a legitimate business purpose exists, separate corporate entities must be recognized as such, even though they may be related, sales by them may be made primarily or exclusively to related entities, and such sales may be at cost or without an intent to make a profit. Parts or finished goods held by a subsidiary corporation for sale to a parent corporation or to a related company are eligible for exemption. C 2/6/84.

[205.0310](#) **Subvention.** In determining the yearly amount of the business inventory subvention payable to a redevelopment agency, the actual tax rate is to be used for the computation. OAG 7/26/83 (No. 83-301, Vol. 66, p. 231).

[205.0315](#) **Tomato Paste Bins.** *If* title to tomato paste bins passes to the purchasers of the tomato paste in accordance with the provisions of Property Tax Rule 133(a)(1), then the bin or drum may be considered part of the container of the tomato paste and is eligible for the business inventory exemption. Rigid delivery cases can be considered containers eligible for exemption when the products that they hold, enclose or contain are placed on or in the rigid delivery cases at the time of manufacture and are not removed until the products are ready to be used or consumed by the purchaser. In shipping tomato paste, each foil bag is attached to or placed in a bin or drum prior to being filled with tomato paste, and the foil bag is not removed from its bin or drum until the tomato paste is ready to be utilized by the purchaser of the paste. C 10/25/2005.

[205.0320](#) **Trout Farms.** Fish grown in a trout farm are properly classified as inventory, not as growing crops, because they cannot meet the test of growing crops as defined by California courts. C 3/1/78.

[205.0340](#) **Video Cassettes.** Video cassettes held exclusively for sale or rent are eligible for the exemption. LTA 8/14/86 (No. 86/60).