M e m o r a n d u m

290.0150

To: Inglewood – Auditing (JKI) Date: August 14, 1978

From: Tax Counsel (GJJ) – Headquarters

Subject: T--- Manufacturing Co., Inc. SR -- XX-XXXXXX

This is in response to your memorandum of June 28, 1978. You have raised certain questions with respect to the proper application of the tax to transactions involving --- --- --- [U], a common carrier of goods. Mr. James Mahler of our staff wrote to you on September 20, 1977, in regard to this subject. See memorandum of that date concerning M--- S---E---, Inc.

Before considering the facts at hand a few general comments are in order. As you are aware, Regulation 1629 explains the application of tax insofar as "goods damaged in transit" are concerned. This regulation concerns itself with the proper application of the tax to payments made to retailers insofar as damaged goods are concerned. The regulation does not purport to explain the application of the tax to sales of replacement goods by a retailer to his customer or by a retailer to a carrier for delivery to a retail customer.

As you are aware Annotation 290.0060 does state a rule concerning sales of replacement goods <u>to carriers</u>. The rule is that a sale to a carrier for purpose of the carrier's replacing an item damaged in transit in settlement of a claim filed by a consignee against the carrier is treated as a retail sale and not a sale for resale.

Turning to the facts of this case as outlined in Mr. E. C. M---, Jr.'s memorandum to you of April 25, we understand that there are two methods of filing claims for damaged merchandise where delivery is made by U. We note that the taxpayer in this case, T--- Manufacturing Co., Inc., is a manufacturer of lighting fixtures who sells the fixtures to retailers for the purpose of resale.

In Method 1 the merchandise is shipped by T--- and billed to its retail customer. The merchandise is damaged enroute. The customer is given credit for the damaged merchandise and

the replacement is shipped by T--- and billed to the retailer under a separate invoice. U is then billed for the damaged merchandise.

It is clear that tax does not apply to the charges made by T--- to its retail customer. As to the merchandise originally shipped, full credit is given; as to the replacement merchandise, the sale is a sale for resale. The question is – how does tax apply to charges made to U for the damaged merchandise? We assume that U acquires possession and title to the damaged merchandise. Tax applies to that portion of the total amount paid to T--- representing the fair retail value of the goods in the damaged condition unless U issues to T--- a resale certificate. If U purchases the damaged merchandise solely for the purpose of reselling it, the sale to U is not a retail sale and is not taxable. If the merchandise is damaged beyond use and will be thrown away by U, no portion of the charge is taxable since the fair retail value of goods in their damaged condition would be zero.

In Method 2 the merchandise is shipped by T--- and billed to its retail customer. The merchandise is damaged enroute. T--- ships a replacement via U and bills U "for the merchandise." We assume that the billing to U is for the replacement item. In accordance with the analysis contained in Mr. Mahler's memorandum of September 20, 1977, and the conclusions stated in Annotation 290.0060, tax applies to the charge to U for the replacement item.

The updated letter from Mr. G--- P. S--- of U accompanying your memorandum does not change this conclusion. That letter concerns itself with ownership of the original merchandise, not the replacement merchandise.

j:alicetilton

cc: Mr. J. E. Mahler