State of California

Board of Equalization
Legal Division

M e m o r a n d u m

315.0285

To : Mr. L. F. Ferreira
Oakland - Auditing

Date: July 7, 1992

From : David H. Levine
Senior Tax Counsel

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Subject: C--- M--- S---
SR --- XX-XXXXXX

This is in response to your memorandum dated June 17, 1992. You have attached a letter from C--- M--- which states:

> "A client wants to purchase a quantity of drums to guarantee himself/herself availability of same when needed during season. CMS sells those drums **raw** and client takes title and possession of same, paying corresponding sales tax. He also requests CMS to store them until needed, for which we charge a storage fee.
>
> "Some time later the client takes some drums and also requests CMS to recondition some drums for which he, the client, will pay a reconditioning fee. We understand this fee not to be taxable to the client. CMS would be responsible for new materials used, as usual."

You state that it is not certain if this would be an "arms length" transaction covered by Regulation 1546 or whether all the charges would be subject to tax. I am not sure what you mean by this since the question of arms length, in the context of application of sales tax, generally arises when there is a transaction between related parties. Perhaps by arms length you are theorizing that CMS is trying to make a fully taxable sales price partially nontaxable by itemizing its charges into separate components, some of which CMS then asserts are nontaxable.

The other possibility that I can think of is that you are questioning whether the initial sale transaction is legitimate. That is, there may be a different analysis applicable if the transaction CMS characterizes as the sale is not the true sale, that sale instead occurring when the purchaser physically takes the drums. Although this is certainly possible, I do not think it

likely. If the contract between the parties states that title passes to the purchaser when the contract is executed, the purchaser pays for that purchase at that time, and CMS reports the applicable sales tax with the return for that quarter, it would be very unusual to find that the sale did not occur when the contract said it did.

For purposes of this opinion, I assume that CMS sells the drums when it says it does. Based on this assumption, the charge for storage after that sale is not part of the taxable gross receipts from the sale as long as that storage is not mandatory. Whether the entire charge for "reconditioning" is subject to tax depends on whether it constitutes repair or instead constitutes fabrication labor.

If the drums were used drums, as opposed to new drums, and the reconditioning is for the purpose of restoring the drums to their original condition, then tax is applicable as provided by Regulation 1546. On the other hand, if the reconditioning prepares the drums for a new and different purpose, then the reconditioning is fabrication and the entire charge for that reconditioning is subject to sales tax. Furthermore, if the drums are new, the reconditioning is fabrication by definition. In this context, I note that CMS states that the drums are raw without explaining what that means. One thing that it could mean is that the drums had not previously been used. If this is the case, the reconditioning is taxable fabrication.

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

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