

**M e m o r a n d u m****515.0620**To: Los Angeles – District Principal  
Auditor (JTQ)

Date: June 28, 1965

See also new Reg. 1501.1 SPJarvis 10/6/03
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From: Tax Counsel (PM)

This is in reply to your memo of April 5 concerning the tax liability in connection with a prototype which the above company is developing for "X".

It is agreed in the contract between the parties that "T" "will design, develop and qualify a basic Prototype unit of equipment" for processing onions. "T" is to receive progress payments totaling \$62,500 plus an additional payment of \$12, 500 if the prototype is acceptable. The agreement further provides that if a successful prototype is developed "X" will place a \$200,000 order for at least four units of equipment, including the prototype, should "X" so elect. "T" does not hold a seller's permit and apparently does not qualify as a retailer on account of any other operations.

We believe it is clear that the contract between "T" and "X" calls for the sale of a specific item of tangible personal property rather than for the mere rendition of research and development services. Paragraph (6) of the contract entitles "X" to possession of the prototype whether or not it proves acceptable. Thus, in either event, "T" will make a sale of the prototype. Since it is engaged in the business of selling property of a type subject to tax, it is a "seller" under Section 6014 and is required to hold a seller's permit. However, it will not be liable for tax on any amounts received under the contract unless and until it becomes a retailer. If the prototype is unsuccessful, the consideration will be the total amount of progress payments after the adjustments provided for in paragraph (7).

PM:ls [1b]