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(916) 323-7715

December 4, 1984

Mr. James W. Maples
Kern County Assessor
1415 Truxtun Avenue
Bakersfield, CA 93301

Attention: Mr. J. M. Ryan
Auditor-Appraiser

Dear Mr. Ryan:

This is in response to your August 23, 1984, letter to Mr. Verne Walton wherein you asked whether certain welding gas cylinders are eligible for the inventory exemption.

Per your letter, in part:

"Within size and pressure classes, cylinders are fungible type goods, and they have an indefinite useful life. Cylinders are identified by their class, not by serial number. Cylinders are not individualized in any way so to distinguish one from another.

"The cylinders are available for the sale of their contents, and there is no passage of title. Sometimes a cylinder deposit is required of a new customer, sometimes not. Much depends on how badly the distributor wants the customer's business. Cylinders are available for sale, but the sale documents are expressed in terms of a ninety-nine year lease rather than an outright sale. Cylinders owned by customers are not refilled and returned to the customer. Rather, if the customer presents a 'legal' cylinder, it is exchanged for a full one. 'Legal' cylinders are those with the distributor's identification collars (a ring of metal just below the

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valve assembly) and the distributor's records indicate that the cylinder was probably obtained by the customer legally. Cylinders with other distributors collars or with no collar are not acceptable for exchange.

"If the distributor's cylinders are not exchanged for full ones every month, most customers are billed for a demurrage charge, usually \$4.50 per tank."

As you are aware, Revenue and Taxation Code Section 129 provides that the inventory exemption is available only for goods intended for sale or lease in the ordinary course of business. It provides further that "business inventories" does not include any goods actually leased on the lien date or any item held for lease which has been or is intended to be used by the lessor prior to or subsequent to the lease. Property Tax Rule 133(a)(1) and (b)(4), (5), and (6) are to the same effect.

As indicated in Rule 133(a), important in instances involving containers and whether they are eligible for the exemption is whether title to the containers will pass to the purchaser or lessee of the product to be sold or leased therein:

"...Included in business inventories are containers..., whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein...."

Accordingly, as indicated in the May 10, 1983, Letter to Assessors No. 83/59, Applicability Of The Business Inventory Exemption To Returnable Containers, etc., copy enclosed:

"Passage of Title

If it is determined that the (returnable) item is a container within the meaning of Rule 133, the item is eligible for exemption only if it is held for sale, i.e., if, upon transfer, title to the item passes to the purchaser of the product...."

The Letter thereafter offers guidelines to assist in determining whether or not title passes to the purchaser of the product.

As to the above-mentioned cylinders then:

1. 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, there being nothing to indicate that they are intended for sale or lease, and because title thereto does not pass. Thus, resort to the guidelines in the May 10, 1983, Letter to Assessors No. 83/59 is unnecessary, although the fact that a deposit may or may not be charged based upon the distributor's need for business suggests that title to the cylinders is not intended to pass, (2), consistent with the fact that there is no passage of title; and although the fact that a demurrage charge is imposed if cylinders are not returned monthly suggests that title to the cylinders is not intended to pass, (6), also consistent with the fact that there is no passage of title.

You asked also with respect to these cylinders whether there is a trade level consideration under Property Tax Rule 10 where the distributor's customer is charged with and has possession of a distributor's cylinder for a long period of time, or whether the act of exchanging an empty cylinder for a full one every month reduces the holding period to a short term that removes the cylinders from trade level considerations.

Per Property Tax Rule 10:

"(e). Tangible personal property in the hands of a person who holds it for consumption shall be valued in accordance with sections 4, 6, and 8 of this subchapter. When, however, such property is leased or rented for a period of less than six months so that its tax situs, as provided in Section 204 of this chapter is at the place where the lessor normally keeps the property, it shall be valued in accordance with the last sentence of subdivision (d)."

As indicated above, there is nothing to indicate that these cylinders are intended for sale or lease, and while you have not forwarded a copy of the document, agreement,

etc., pursuant to which the distributor provides gas together with a cylinder to a customer, we assume that it does not purport to lease the cylinder to the customer. Rather, the cylinder is merely being provided by the distributor as a returnable container used to facilitate the sale of its contents. Such being the case, the "leased or rented" exception in Rule 10(e) is not applicable, and the cylinders should be valued in accordance with Rule 10(e), namely, at the retail level.

2.(a). New cylinders available for sale appear to be eligible for the exemption since they can be said to be intended for sale in the ordinary course of business if they have not actually been sold on the lien date.

As to the passage of title, as you refer to cylinders being available for sale and sale/lease documents, the sale/lease documents, presumably, contain title passing provisions, (1). Similarly, the distributor's accounting system should indicate that sales are being made, (5), and the distinctive marking identifying the cylinders as "legal" cylinders rather than as property of the distributor, (4), and the conditions of return, presumably set forth in the sale/lease documents and consistent with title passage provisions, (6), should be consistent with the fact that title to the cylinders passes to the customers.

(b). We do not believe that cylinders held for exchange for sale/lease cylinders are eligible for the exemption, however. In selling cylinders in terms of a 99 year lease, the distributor is, for all practical purposes, selling a cylinder to a customer for its lifetime. Thereafter, instead of refilling the customer's cylinder, as needed, for expediency the distributor provides another specifically marked cylinder, with gas, in exchange therefor. Since the customer is already the owner of his cylinder and is, in effect, merely using the distributor's cylinder while his own is being refilled, the distributor is not selling or leasing the cylinder provided to the customer and hence, cannot be said to be holding such cylinders for sale or lease in the ordinary course of his business. Rather, this aspect of his business consists of sales of cylinders and the providing of substitute accommodation cylinders while customers' cylinders are being refilled.

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Additionally, to the extent that these cylinders provided to customers were also used/comingled by the distributor in conjunction with the sale of contents, i., above, they would be ineligible for the exemption for that reason also.

Very truly yours,

James K. McManigal, Jr.
Tax Counsel

JKM:fr

Enclosure

cc: Mr. Verne Walton

bc: Mr. Gordon P. Adelman
Mr. Robert H. Gustafson
Mr. Lane Morrison
Legal Section