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RAMON J. HIRSIG
 Executive Director

October 25, 2005

Re: Business Inventory Exemption – Tomato Paste Bins

Dear Mr. _____ :

This is in response to your letters dated August 17, 2005, to Executive Director Ramon Hirsig and Supervising Tax Counsel Louis Ambrose, requesting clarification of Tax Counsel Rafael Icaza's letter dated April 1, 2005, to the _____ County Assessor regarding the eligibility of wooden tomato paste bins for exemption from property taxation. Based on the additional information you have provided in your letter, as well as my conversations with tomato paste producers Mr. _____, Controller of the _____ Tomato Company and Mr. _____, Plant Administrator of the _____ Company, we conclude that tomato paste bins should be considered business inventory eligible from exemption from property tax if title to the bins passes to the purchasers of the tomato paste in accordance with the provisions of Property Tax Rule 133.

Facts Presented

In his April 1, 2005 letter, Mr. Icaza summarized the following facts provided by Mr. _____, Auditor-Appraiser of the _____ County Assessor's office:

X Foods and _____, the owners of two _____ County tomato paste plants, package bulk tomato paste in Scholle foil bags and ship it to customers in large reusable plywood bins containing the foil bags. The cost of a new bin ranges from \$80 to \$135. This is the standard method of packaging and shipping tomato paste among producers in California. The sellers of the tomato paste encourage buyers to return the bins for reuse either by requiring the payment of a deposit for each bin, which is refunded when the bin is returned, or by paying the buyer of the product for each bin returned. In Colusa County, the amounts paid range from \$40 to \$60 if the bin is in good condition. It is to the advantage of the buyer to return bins to the seller, because the bins have no alternate use and take up much storage space.

For the foregoing reasons, it is estimated that 90 to 95 percent of the time the buyers of the paste disassemble the bins and return them to the sellers. The sellers then re-assemble and reuse them. In the process, the sellers receive an insignificant quantity of bins that were not originally their own. The bins are expected to last five to seven years.

XX Foods charges customers a \$60 deposit for each bin, which is paid back upon the return of the bin. XX Food's invoices bear the legend: 'Notice. The bin or drum in which this product is shipped is the property of XX Foods. If the bin or drum is not returned to XX Foods, the customer will be billed for the value of the bin or drum.' For its part, M adds the cost of a bin to the total cost of a tomato paste sales transaction and it pays \$41 for a bin returned in good condition and \$22 for a damaged bin.

Based on these facts, Mr. Icaza concluded that "the bins are portable platforms that are used to transport product[s] from one location to another. Here the actual "containers" are the Scholle foil bags that are filled with the tomato paste and put inside the bins. These bags are removed from the bins, which are then disassembled and returned to the producer. In our view, the bins are not containers because their primary use is to facilitate transportation and handling of the paste rather than the containment of the product, as Rule 133 contemplates. Therefore, the bins are taxable tangible personal property."

However, in your letter dated August 17, 2005, you provide the following additional information:

To ship tomato paste, processors fill 300-gallon bulk foil bags that are attached to the inside of 4' x 4' wooden bins. When full, the bags weigh about 2,800 pounds and cannot be shipped without the bins as they would be entirely unwieldy to handle and transport and would be prone to puncture or damage. The bins and paste are shipped to buyers who manufacture spaghetti sauce or other products.

Due to the high cost of purchasing new bins many (but not all) tomato paste processors offer to purchase bins back from their buyers. In most cases they repurchase their own bins, but in some instances they buy back bins that originally belonged to other paste processors. The bags are not reused. The bins, and the manner in which they are packed, sold, and repurchased, has not changed since 2000 when the California State Senate and BOE exempted these and other reusable food containers from sales tax.

Additionally, on October 12, 2005, I spoke to Mr. and Mr. regarding the process of filling, transporting, and emptying bags of tomato paste. Both stated that, prior to filling, bags are attached or laid into topless wooden bins held together by horizontal metal strapping. Next, the bags are filled with paste and sealed. Finally, the top is placed on the bin and vertical metal strapping is applied to attach the lid to the rest of the bin. Both also stated that the bins were handled and transported as an integral unit until delivered to the purchaser. Although neither had direct knowledge of how the purchasers handled the bin-bag combination, both stated from their experience in handling rejected batches that it was not possible to handle or remove the bags apart from the bins without damaging the bag. Mr. also mentioned that some tomato paste was packaged and shipped in bags inserted into 55-gallon drums of

plastic, fiberglass, or metal that provided the same support and protection function as the wooden bins.

Legal Analysis

As stated in Mr. Icaza's April 1, 2005, letter, business inventories exempt from property taxation include "goods intended for sale or lease in the ordinary course of business." (Rev. & Tax. Code, § 129.) Property Tax Rule (Rule) 133,¹ which implements and interprets section 129,² specifies that business inventories exempt from taxation include "[c]ontainers or container material such as kegs, bottles, cases, twine and wrapping paper, whether returnable or not, if title thereto will pass to the purchaser or lessee of the product to be sold or leased therein." (Rule 133, subd. (a)(2)(A).) Thus, to qualify as exempt business inventory, packaging material must be considered a container, and title to the container must pass to the purchaser or lessee of the product.

Bins and Drums are Containers

Further guidance is provided in Letter to Assessors No. 83/59, *Applicability of the Business Inventory Exemption to Returnable Containers, and Definition of Containers and Container Materials*, May 10, 1983 (LTA 83/59), which provides that:

Rule 133 does not offer any examples of items which are not to be classified as containers. However, the limited description of containers and container materials offered in the rule – kegs, bottles, cases, twine, and wrapping paper – should be considered indicative as to the types of containers that are eligible for the inventory exemption, namely, packaging materials that hold, enclose, or include products.

Most pallets and rigid delivery cases are portable platforms that are used to transport products from one location to another. A carton (container) of products may be loaded onto a pallet at the time of manufacture, but the carton is likely to be removed from the original pallet and loaded onto other pallets during the various phases of manufacture, storage, transportation, and distribution. Since the primary use of pallets and rigid delivery cases is to facilitate transportation and handling of groups of products rather than containment of products as Rule 133 contemplates, such items are not normally containers within the meaning of the rule.

Pallets and rigid delivery cases can be containers, however. Bricks, concrete blocks, and other masonry items are commonly placed on pallets (are not otherwise contained by packaging materials) at the time of manufacture and stay on those pallets until they are 'consumed' by the bricklayer. When used in this manner, the pallet or delivery case is the primary container of the products and

¹ Title 18, California Code of Regulations, section 133.

² Unless otherwise noted, section references are to the Revenue and Taxation Code.

therefore is eligible for the inventory exemption if title to the container passes to the purchaser of the product.

Thus, pallets and rigid delivery cases are not generally considered containers when their primary purpose is to transport groups of already-contained products, or when products are likely to be moved from pallet to pallet (or case to case) between the time the manufacturing process is finished and the time that product is used or consumed by the purchaser of the product. However, pallets and 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 pallets or 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.

Based on the information provided, it appears that each foil bag is attached to or placed in a wooden bin or 55-gallon drum prior to being filled with tomato paste, and that 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. Moving the foil bags without the support and protection provided by the bins or drums would subject the foil bags to a significant risk of puncture or damage. Under these circumstances, we consider that a bin or drum is part of the container of the tomato paste,³ and is eligible for exemption from taxation if title to the bins passes to the purchaser as described below.

Passage of Title

Bins and drums (bins) that qualify as "containers" of the tomato paste are nevertheless subject to taxation unless title to the bins passes to the purchaser of the tomato paste. (See Rule 133, subd. (a)(1).) LTA 83/59 provides guidance regarding the determination of whether title to a returnable or reusable container passes to the purchaser or lessee. The factors to be considered include:

- Title transfer provisions contained in a written contract;
- Deposit amount compared to the cost or value of the containers;
- Inclusion of sales tax reimbursement, where applicable;⁴
- Distinctive markings on or construction of the container;
- Seller's method of accounting for the containers; and
- Conditions imposed on the return of the container.

Because determination of title transfer requires a fact-specific analysis, and I have not reviewed any specific contracts, I cannot give an opinion whether any of the wooden tomato paste bins, even if they are considered containers, would qualify for the business inventory exemption under Rule 133.

³ The foil bags are the other part of the container.

⁴ We note that whether a transaction is subject to taxation for sales or use tax purposes is not determinative of its qualification for an exemption from property taxation. For example, business inventory that is exempt from property taxation when held by the retailer is generally subject to sales or use tax when sold to the consumer.

The views expressed in this letter are only advisory in nature. They represent the analysis of the legal staff of the Board based on present law and the facts set forth herein. They are not binding on any person or entity.

Sincerely,

/s/ Carole F. Ruwart

Carole F. Ruwart
Senior Tax Counsel

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cc:

County Assessor

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