



## Memorandum

To : Harold Hale, Principal Appraiser

Date: October 24, 1996

From : James M. Williams

Subject: Review of Audit Report

In your memo of September 20, 1996 to Larry Augusta, Assistant Chief Counsel, you asked us to review the Lien Date 1996 Draft Audit Report of the \_\_\_\_\_ in relation to the Business Inventory Exemption. We are also in receipt of Charlie Knudsen's similar response of September 26, 1996. Therein, he concurred with the method of allocation used to determine the escape assessment amount and with the brief note that there are no statutes or cases on point we would defer to his conclusion on that issue.

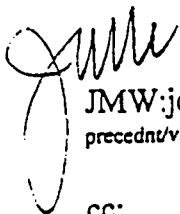
The primary purpose of the audit was to investigate a report by the company that the majority of their material and supplies for 1996 consisted of car parts purchased for resale per Sales and Use Tax Regulation 1668, and therefore are exempt per Section 219. Your audit found that \_\_\_\_\_ ordinary business is renting railcars to railroads and because the materials & supplies are used for maintenance of the cars, this property does not qualify for the business inventory exemption. \_\_\_\_\_ does sell some of these supplies to third parties, however, that does not substantiate a drop of approximately 83 percent of the amount reported for 1995.

Property Tax Rule 133 (a)(1) provides in pertinent part: "Business inventories" that are eligible for exemption from taxation under Section 129 of the Revenue and Taxation Code include all tangible personal property, whether raw materials, work in process or finished goods, which will become a part of ... personalty held for sale or lease in the ordinary course of business. Subdivision (d) of this rule specifically applies to Repairers and Reconditioners: Persons engaged in repairing or reconditioning tangible personal property with the intent of transferring parts and materials shall be regarded as holding said parts and materials as "business inventories." Your audit found that the materials and supplies in question are used for the maintenance and repair of private railcars (personality) that are ordinarily held for rent by railroads. Your report states that AB 1426 shifted the assessment of materials and supplies to the state-assessed roll for 1996 so Rule 133 would apply. It seems clear to us that these materials and supplies would qualify under the rule in either event: (1) sold to third parties or (2) used to repair the \_\_\_\_\_ cars.

Mr. Harold Hale

October 24, 1996

Since we conclude on the information presented that the exemption is proper, the penalty issue is no longer relevant.



JMW:jd

precednt/valuadiv/1996/96027/jmw

cc: Mr. Ramon Hirsig, MIC:61