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April 15, 1988

Mr. R. J. Sanford
Ventura County Assessor
800 South Victoria Avenue
Ventura, CA 93009

Attention: Mr. Jim Dodd
Appraiser Analyst

Dear Mr. Sanford:

This is in response to your March 1, 1988, letter to Mr. Richard Ochsner wherein you enclosed information concerning practices and activities of several oil tool companies, and you inquired as to the applicability of the business inventory exemption (Rev. & Tax. Code, § 129 and Property Tax Rule No. 133) to tools and equipment held by them.

N. L. Acme Tools. Tools consist of the more basic mechanical units used for fishing and drilling. The company also has blowout prevention equipment available. With few exceptions, tools and equipment are available for rental to other companies and individuals, and they are usually rented without operators, although an operator can be provided upon request. In most instances, N. L. Acme Tools' employees will accompany equipment to job sites and from job sites to its premises "to ensure that the equipment is in proper working order when it goes down hole, and that it is in similar condition when extracted."

The Tool Order is specifically a sale, rental, etc. document with sale, rental, etc., terms and conditions.

Baker Service Tools. The basic tool is a "packer", used in performing the oil well services of cementing, squeeze cementing, fracturing, and acidizing and which is rented with an operator "to ensure the proper placement, functioning and extraction of the tool" but "who does not physically handle the tool in the field." The tool is actually delivered to the proper well depth by the rig crew employed "by the entity contracting for the service which Baker Service Tools has the capacity to provide." The tool, when used in conjunction with one of the services Baker Service Tools provides, allows for various physical alterations and repairs to be made to the well.

Exempt from Inventory

The Sales & Service Invoice appears to be solely a sale and service document with sale and service terms and conditions. There are no references therein to rentals of tools.

N. L. McCullough. Tools consist of wireline, logging and perforation equipment which are provided with operators, who do not physically handle them. The tools are actually delivered to the proper well depth by the rig crew employed "by the entity contracting for the service which N. L. McCullough has the capacity to provide." When the equipment is in place the operator collects the data obtained through the use of the equipment. When sufficient data has been gathered for N. L. McCullough to fulfill its contractual obligations the equipment is removed from the well by the rig crew.

No order, invoice, etc. attached. General Terms and Conditions mention rental equipment and services.

As you know, section 129 states that "business inventories" include goods held for sale or lease in the ordinary course of business but do not include any goods actually leased or rented on the lien date or any goods held for lease which have been or are intended to be used by the lessor prior to or subsequent to the lease. See also Rule 133(b)(2)-(5). As stated in Question and Answer F1 in the April 25, 1980, Letter to Assessors No. 80/69, Business Inventory Exemption:

"F. Property Held for Lease

1. Are goods held for lease eligible for the business inventory exemption?

Answer: Yes, if the property is not actually out on lease on the lien date and is not used by or intended to be used by the lessor for some purpose other than the prospective sale or lease of that property. Also the property while on lease must be removed from the premises of the lessor and under the control of the lessee."

Accordingly, what must be ascertained is whether these companies are holding tools and equipment for lease and leasing them (exemption available), whether they are holding tools and equipment for lease, leasing them, and their customers are employing operators to operate them (exemption available), or whether they are holding tools and equipment and using them in the course of providing services to their customers rather than leasing them (exemption not available). See in this regard Mr. Lawrence A. Augusta's April 22, 1983, letter to Mr. Robert C.

McKee and Mr. Verne Walton's October 14, 1987, letter to Mr. Frank Seeley, copies enclosed.

Of course, exactly what the companies are doing and whether they are holding their tools and equipment for lease and leasing them or using their tools and equipment in the performance of services are matters of fact which must be ascertained and understood before section 129 and rule 133 can be applied thereto. In our view, further information and documentation is needed in these regards. Based on the information available, however, it appears that:

1. N. L. Acme Tools holds tools and equipment for lease and leases them without operators (exemption available). To the extent that it "rents" tools and equipment with operators, however, it is performing a service and using the tools and equipment in the course thereof (exemption not available). Having employees accompany equipment to and from job sites "to ensure that the equipment is in proper working order" does not alter the above if that is all that the employees really do.
2. Baker Service Tools apparently performs services and uses its tools in the course thereof (exemption not available). Tools are "rented" with operators, tools are used in conjunction with its services, and the Sales and Service Invoice does not refer to rentals.
3. N. L. McCullough performs services and uses its tools and equipment in the course thereof (exemption not available). Tools and equipment are provided with operators, and when the equipment is in place the operator collects the data used to perform the service contracted for. Although the General Terms and Conditions refers to "rental" equipment, as indicated, if the equipment is used in conjunction with a service, it is not held for lease and leased for purposes of section 129 and rule 133.

Finally, if a company were both renting tools and/or equipment and using them in its performance of services, the tools and/or equipment would not be held exclusively for lease and leased and would not be eligible for the exemption for this reason also. In such instances, records on an item-by-item basis would have to show that the tools or equipment were held

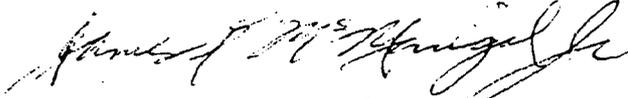
Mr. R. J. Sanford

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exclusively for lease and were only leased in order for them to be eligible for the exemption.

Very truly yours,



James K. McManigal, Jr.
Tax Counsel

JKM/rz

Enclosures

cc: Mr. Richard H. Ochsner