



This Week in State Tax (TWIST)

September 22, 2025



California: Repair parts used in products shipped outside the state are taxable in California

A California Superior Court held that a taxpayer was liable for \$6.6 million in use tax on repair parts incorporated into medical equipment that was repaired in California and shipped out of state for subsequent use. The taxpayer sold medical equipment and offered optional maintenance contracts under which out of state customers shipped equipment to the taxpayer's national service center in California for repair. The taxpayer performed the repairs, including replacement of parts when needed, then shipped the equipment back to the out of state customers. Customers paid a lump-sum fee covering all repairs and parts, rather than paying for individual repair work.

The central issue was whether the taxpayer was exempt from California use tax on the repair parts it incorporated into the equipment that was subsequently returned to customers outside California. Under California sales and use tax law, the terms "storage" and "use" exclude any property kept or retained in California solely for subsequent transport and use outside the state, or for the purpose of being processed, fabricated, or manufactured into, attached to or incorporated into other property to be transported and used solely outside California. Additionally, California provides that when repairs are performed pursuant to a lump-sum maintenance contract that includes parts, materials, and labor, the person making the repair is deemed the consumer of parts and materials furnished.

The taxpayer argued that its use of repair parts was exempt because they were "incorporated into" equipment that was shipped and used exclusively outside California. The Department of Tax and Fee Administration (CDTFA) disagreed, asserting that the parts were consumed in California during the repair process, and the equipment was present in-state for functional purposes and not merely for storage or transit. The court agreed with the CDTFA, emphasizing that the exemption applies only when property has no functional use in California beyond transit. The court rejected the taxpayer's reliance on statutory language referencing property "processed, fabricated, or manufactured into" other property," clarifying that this language does not create a broad manufacturing exemption. Rather, it protects property in California solely for transit from being taxed due to its attachment to something else while in California.

The court also concluded that the CDTFA properly assessed a negligence penalty in this matter. In three prior audits, the CDTFA had assessed use tax against the taxpayer based on the same issue. The court found that the taxpayer knew, or should have known, the transactions were taxable. For more information on [Olympus Am. Inc. v. Cal. Dep't of Tax & Fee Admin.](#), contact [Jim Kuhl](#).

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