

**STATE BOARD OF EQUALIZATION**

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January 26, 1995

BURTON W. OLIVER
Executive Director

Mr. J--- C---
S--- T--- R--- Group
XXXXX --- Parkway North, Ste. XXX
--- ---, CA XXXXX

Re: Unknown Taxpayer
Manufacturing Equipment Exemption
Rev. & Tax. Code § 6377 (SB 671; 676)

Dear Mr. C---:

This is in response to your letter dated November 21, 1994 regarding the application of the Revenue and Taxation Code section 6377 partial sales and use tax exemption to your client's photocopying and computer printing business. We note that since your letter did not identify the taxpayer, this letter does not come within the provisions of Revenue and Taxation Code Section 6596.

Few facts were provided regarding your client's operations. You state that your client purchases photocopy machines and laser printers which are used to produce printed materials for customers. The copy machines range from standard black and white copiers to very elaborate units that are capable of producing photographic quality prints. You ask a series of questions as to whether your client's operations qualify for the partial sales tax exemption. For purposes of clarity, we have responded to each of your questions separately.

"1) In some cases, customers pay my client to produce copies or computer print-outs. My client's employees furnish all of the labor to make the copies or print-outs. This service is virtually identical to that provided by a standard printer.

a) Does your state provide a manufacturing or processing equipment exemption that applies to these printers or copiers?

b) If yes, please cite the applicable statute or regulation."

Before answering your specific question, an overview of the partial sales and use tax

exemption may be helpful in understanding our response. The sales tax imposed in California is comprised of several components. One is the state component which currently totals 6 percent. (Rev. & Tax. Code §§ 6051, 6051.2, 6051.3, 6051.5 (similarly, the state component of the use tax also totals 6 percent).) Another component is the tax imposed pursuant to the Bradley-Burns Uniform Local Sales and Use Tax Law, which is imposed at the rate of 1-1/4 percent. (Rev. & Tax. Code § 7200 et seq.) Any sales tax above 7-1/4 percent is imposed pursuant to the Transaction and Use Tax Law. (Rev. & Tax. Code § 7251 et seq.)

Revenue and Taxation Code section 6377 was originally enacted by SB 671. As enacted by SB 671, section 6377 provided an exemption from the state component of the sales and use tax, which is imposed at the rate of 6 percent. Even when a sale satisfies the exemption, the tax imposed above 6 percent (at least 1-1/4 percent, plus any transactions tax imposed in the relevant district) remains due. Section 6377 was recently amended by SB 676, which became operative on January 1, 1995. As of January 1, 1995, the exemption provided by section 6377 was reduced to tax imposed of 5 percent. Thus, if a sale meeting the requirements of the section 6377 exemption occurred in 1994 in a district where the sales tax rate is 7-3/4 percent, tax of 1-3/4 percent is due. If a qualifying sale occurs in that district in 1995, tax of 2-3/4 percent is due. For the remainder of this opinion, I will refer to the section 6377 exemption as a partial sales tax exemption (exemption from tax of 6 percent during 1994 and 5 percent thereafter).

The partial sales tax exemption applies to persons that commence a new trade or business (discussed below) in those lines of business described in codes 2000 to 3999 of the 1987 Standard Industrial Classification Manual (hereafter "SIC code"). A person meeting both these requirements is a "qualified person"; however, a "qualified person" does not include any trade or business that was used in any predecessor trade or business conducted by the taxpayer or any other person related to that person (within the meaning of Sections 267 and 318 of the Internal Revenue Code). The partial sales tax exemption generally applies to purchases of tangible personal property used primarily for manufacturing, processing, refining, fabricating, recycling, research and development (hereafter "qualified activity") and the repair of qualified property.

A new trade or business is one which a person (or any related person) has not engaged in within the preceding 36 months inside this state¹ or which is classified in a different division of the SIC code than that person's (or any related person's) current or prior trade or business activities in this state.² (Rev. & Tax. Code § 6377(b)(5)(A)(ii).) In addition, to qualify as a new trade or business for purposes of the partial sales tax exemption, it must commence such business operations inside the state on or after January 1, 1994. (*Id.*) Generally, we regard business operations to begin on the date a seller's permit is or should have been obtained for the business operation.

¹ SB 676 makes a distinction between persons engaged in a trade or business inside the state and those that are not. Persons engaged in business wholly outside the state who commence doing business in California after December 31, 1993 (other than by purchase or acquisition of an existing business) qualify as a new trade or business regardless of that person's prior trade or business activity. (Rev. & Tax. Code § 6377(b)(5)(A)(ii).)

² New trade or business status also includes persons who, under certain circumstances not applicable here, acquire the assets of another business.

As an alternate to the partial sales tax exemption, SB 676 provides an investment tax credit (Rev. & Tax. Code § 17053.49) for purchases of "qualified property"³ by persons engaged in those lines of business described in SIC codes 2000 to 3999. The investment tax credit allowed by SB 676 equals 6 percent (1 percent higher than the partial sales tax exemption contained in SB 676) and is allowed only where the qualified taxpayer does not elect to take the partial sales tax exemption. (Rev. & Tax. Code § 17053.49(a)(1); (b)(1)(B).) A copy of SB 676 is enclosed for your review.

You do not provide enough facts for us to determine whether your client's business qualifies for the partial sales tax exemption. In particular, you have not disclosed whether your client (or any related person) was engaged in a trade or business inside this state during the preceding 36 months classified within a SIC code between 2000 to 3999. You also do not state whether your client obtained (or should have obtained) a seller's permit for its current business operations before January 1, 1994.

Even if the foregoing requirements are met, it appears that only a portion of your client's business would qualify for the partial sales tax exemption. Some of your client's business falls within the non-manufacturing SIC industry code of 7334 (Photocopying and Duplicating Services) defined as:

"Establishments primarily engaged in reproducing text, drawings, plans, maps, or other copy, by blueprinting, photocopying, mimeographing, or other methods of duplication other than printing or microfilming...."

Your client's computer printing operations, however, appear to fall within the qualified SIC industry code 2741 (Miscellaneous Publishing) as a "micropublishing" operation. The remainder of your client's business appears to fall within SIC industry code 5999 (Miscellaneous Retail Stores) based on its retail sales of copies and computer print-outs. Since only the micropublishing portion of your client's business falls within an appropriate SIC code, the remaining issue is to what extent, if any, your client may qualify for the partial sales tax exemption.

The Board is currently in the process of adopting a regulation to interpret and apply Revenue and Taxation Code section 6377. The proposed regulation, 1525.2, has not yet been adopted by the Board and its provisions are not yet final. Currently, however, Proposed Sales and Use Tax Regulation 1525.2 would allow the partial sales tax exemption where multiple activities occur at one physical location and other certain requirements are met. In particular, subpart (c)(5)(B)2a of the Proposed Sales and Use Tax Regulation provides:

³ "Qualified property" for purposes of the investment tax credit is defined in Revenue and Taxation Code section 17053.49(b)(6)(i).

"Where distinct and separate economic activities are performed at a single physical location, such as construction activities operated out of the same physical location as a lumber yard, each activity should be treated as a separate establishment where: (i) no one industry description in the classification includes such combined activities; (ii) the employment in each such economic activity is significant; and (iii) separate reports can be prepared on the number of employees, their wages and salaries, sales, or receipts, and other types of financial data such as financial statements, job costing, and profit center accounting. For purposes of this paragraph, whether or not employment in an economic activity is significant shall be based upon all of the facts and circumstances. Nevertheless, employment in an economic activity will be considered to be 'significant' for purposes of this paragraph whenever more than 25 percent of the taxpayer's total number of employees at a single physical location, or more than 25 percent of the taxpayer's total dollar value of payroll at a single physical location, is attributable to the economic activity being tested for separate establishment status."

Based on the foregoing, a portion of your client's business may qualify for the partial sales tax exemption provided its work in the micropublishing operations is "significant" (within the meaning of the Regulation when adopted), it is able to generate adequate and sufficient reports on these activities, and it otherwise qualifies as a new trade or business. Even if a portion of your client's business qualifies, only purchases of tangible personal property which will be used at least 50 percent of the time in the qualified activity are entitled to the partial sales tax exemption. (Rev. & Tax. Code § 6377(b)(3).)

"2) In other situations, my client allows customers to use the machines to make their own copies. These are typically referred to as 'self-serve' machines. The customer can pay in one of three ways:

- a) By purchasing a magnetic card that entitles the user to a certain number of copies,
- b) By inserting coins into a box on the machine, or
- c) By paying the cashier directly based on the number of copies made.

- a) **Does your state provide a manufacturing or processing equipment exemption that applies to these printers and copiers?**
- b) **If yes, please cite the applicable statute or regulation."**

As set forth above, that portion of your client's business relating to photocopying and retail sales does not qualify for the partial sales tax exemption. As such, we understand your question to ask whether the remainder of your client's business relating to micropublishing qualifies when customers generate their own micropublishing through the use of your client's "self-serve" laser printers.

To qualify for the partial sales tax exemption, tangible personal property purchased by a qualified person must be used by that person in any stage of the manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point any raw materials are received by the qualified person and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered property to its completed form. (Rev. & Tax. Code § 6377(a)(1).) Since your client's customers (and not your client) generate the micropublishing through the use of the "self serve" machines, we do not regard your client as using the printers in a qualified activity. Thus, your client cannot qualify for the partial sales tax exemption when it purchases laser printers used in this manner.

"c) Can the charge to the customer be considered a rental, and if so, can these machines be purchased for resale?"

A lease of tangible personal property includes rental, hire and license. (Rev. & Tax. Code § 6006.3.) However, a lease does not include a use of tangible personal property for a period less than one day for a charge of less than \$20 when the privilege to use the property is restricted to use on the premises or at a business location of the grantor of the privilege. (Id.)

Under the facts of your letter, we assume that your client's customers are subject to the above restrictions when using your client's photocopy and laser printing machines. As such, your client's charges to its customers may not be considered as rent for the lease of tangible personal property. We also regard your client as the consumer of the machines used by its customers when making photocopies or computer print-outs whether or not the machines were originally purchased for resale. This means that your client owes use tax measured by the purchase price of the machine unless it already paid sales tax reimbursement or use tax. (See Rev. & Tax. Code §§ 6201, 6202, 6401, 6051.)

If you have any further questions, please write again.

Sincerely,

Warren L. Astleford
Staff Counsel

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Enclosures - SB 671, 676

cc: --- District Office - -