

STATE OF CALIFORNIA
BOARD OF EQUALIZATION
BUSINESS TAXES APPEALS REVIEW SECTION

295.0421

6/8/94

In the Matter of the Petition)
for Redetermination Under the)
Sales and Use Tax Law of:)
)
)
)
)
Petitioner)

DECISION AND RECOMMENDATION
No. ----

The Appeals conference in the above-referenced matter was held by Elizabeth Abreu, Staff Counsel on March 2, 1994 in --- California.

Appearing for Petitioner:

Appearing for the Sales and Use Tax Department:

Protested Item

The protested tax liability for the period April 3, 1988 through April 6, 1991 is measured by:

| <u>Item</u> | <u>State, Local and County</u> |
|--|--------------------------------|
| A. Claimed exempt sales not allowed based on a test of November 1990 untaxed sales | \$618,257 |
| Less: Approximate measure with which petitioner agrees | <u>612,235</u> |
| Disputed measure related to paper activation fees | \$6,022 |

Petitioner's Contention

Petitioner's activation fees for paging units are charges for nontaxable services.

Summary

Petitioner operates nine discount membership department stores in "X" California. The stores sell a variety of merchandise, including "Y" pagers which petitioner purchases from "Z" an air carrier. Although there is a notation on the back of the packaging for the pagers that states "Activation Not Required," the pagers are useless unless activated by an air carrier. A purchaser may go to any air carrier for activation, but petitioner's sales clerks encourage customers to complete a written service and rental agreement with "Z". Under these agreements, the customers agree to pay a monthly fee for airtime and a one time \$10.00 activation fee.

If a customer enters into a service and rental agreement at the time of purchase, petitioner's sales clerk faxes the agreement to "Z" for immediate approval. "Z" generally gives approval and activates the pager within thirty minutes after receipt of the fax. If a customer does not obtain activation from "Z" through petitioner, the customer must directly request "Z" or another air carrier to activate the pager which generally takes seven to ten days.

Petitioner charges and collects the \$10.00 activation fee from customers who enter into the service and rental agreements at petitioner's stores. A customer who does enter into an agreement is not charged the fee. Petitioner remits the activation fees to "Z". Petitioner asserts that "Z" does not reimburse petitioner for this service. "Z" does, however, give volume discounts based upon the number of pagers sold by petitioner.

According to petitioner, activation does not involve modification, alteration, electronic data input, or other activity which modifies a pager. Rather, activation involves entry of certain information into the computer system of the air carrier selected by the owner of a pager. This information identifies the pager and its owner for billing and paging purposes.

During the audit, the auditor performed a test for the month of November, 1990 of claimed exempt sales. Included in the disallowed sales were the charges for the activation fees. The auditor determined that because a pager is useless without activation, the activation fee is a charge for a service that is part of the sale of a pager. Thus, these fees may not be deducted or excluded from the measure of tax. (Rev. & Tax. Code § 6012 (b) (1).)

Petitioner's contentions are set forth in detail in a letter from its attorney dated February 14, 1992. (Copy attached as Exhibit A.) Its contentions may be summarized as follows:

1. Activation fees are separately tariffed by the PUC and are prohibited by law from being treated by the seller as a part of an equipment sale.
2. The activation fees are charges for services which are not necessarily associated with the purchase of a paging unit.
3. The services for which the activation fees are charged involve the carrier's switch and do not involve modification of the paging unit. The services are not services the seller must perform as a condition to the buyer's using the paging unit. Paging units are often sold by non-utilities for use on any number of systems.

Analysis and Conclusions

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers from retail sales of tangible personal property. Sales tax is measured by gross receipts which includes charges for services which are part of the sale of the property. (Rev. & Tax. Code § 6012(b) (1).) The issue in this case is whether the activation of a pager is a taxable service that is part of the sale of the pager.

The Board has recognized that certain contracts may be mixed sales and service contracts in which only separately stated charges for tangible personal property are taxable. To determine whether a contract is a mixed sales and service contract or whether the service is part of the sale of tangible personal property, the following analysis is generally used:

1. Is the service optional? If the tangible personal property may not be acquired without the service, the service is part of the sale, and the charges for the service are taxable.
2. Are the charges for the service included in a lump-sum amount or are the charges for the service and property separately stated? Generally, charges for services which are included in a lump-sum amount are taxable.
3. Is the service necessary to put the property into the form contracted for by the customer or to have the property furnished in a specific place or manner? Fabrication and assembly labor are always taxable unless the sale of the tangible personal property is otherwise exempt or excluded from tax. Charges for services such as pumping gas are also taxable because the customer has contracted to have the gas dispensed into a specific place.

In the present case, the service for activation of a pager is optional, and petitioner charges the same price for the pager whether a customer pays for the service or declines the service. As shown on a copy of a sample receipt which petitioner submitted at the Appeals conference, petitioner separately states the charges for activation fees on its sales receipts.

Finally, according to petitioner, activation does not modify or alter the pager in any manner. In other words, activation does not involve fabrication or assembly of the pager. Nor does activation affect where the pager is furnished by petitioner. Based on these representations by petitioner, we conclude that charges for the activation fees are not taxable, and we recommend that these charges be eliminated from the test sample for Audit Item A.

Recommendation

Redetermine by deleting the activation fees from the test sample for Audit Item A.

Elizabeth Abreu, Staff Counsel

6/8/94
Date

W/Exhibit "A"