

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
916/ 445-6493

May 1, 1984

Mr. A--- H---
Controller
S--- Inc.
XXX --- Way
---, CA XXXXX

SY -- XX XXXXXX

Dear Mr. H---:

Your letter of April 2, 1984, has been referred to me for reply. You ask our opinion as to the correct application of tax to the sale of you "service/supply kit."

We understand that your firm sells photocopy machines and related services and supplies. For a lump-sum price, you also sell an optional service/supply kit. The kit is optional when sold with the copier, and the customer can buy additional kits at a later time. The kit consists of all the service and supplies, except paper, that is necessary to run the copier for a fixed number of copies. Apparently, you are able to estimate the amount of supplies required to produce a certain number of copies, and the customer is furnished that amount upon purchase of the kit. You initially load the customer's copier and leave the balance of the supplies with the customer. If any additional supplies are needed under the particular service/supply agreement, the customer receives them at no additional charge. The amount of "service" required to maintain the machine for the required number of copies under the agreement is not determinable at the time the kit is purchased. Presumably, the "service" you provide under the service/supply kit consists of the furnishing of labor and materials (i.e., parts) necessary to maintain the copier for the required number of copies.

In our view, the sale of the service/supply kit is a sale of both an optional maintenance service contract and tangible personal property for a lump-sum price. As provided under Sales and Use Tax Regulation 1546(a) (copy enclosed), charges for repair labor or services are not subject to tax. Subsection (b)(3)(C) of this regulation further provides that if the repair work is performed under an optional lump-sum maintenance contract providing for the furnishing of parts, materials, and labor necessary to maintain the property, the repairer is regarded as the consumer of the parts and materials furnished. Accordingly, a charge for an optional maintenance contract is nontaxable. In a situation where both taxable and nontaxable items are sold for a single price, an allocation between the taxable and exempt charges should be made. Therefore, with regard to future sales of the service/supply kit, you must segregate on the invoice to your customer and in your records the fair retail selling price of the supplies initially furnished under the contract from the charges for the

Mr. A--- H---

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optional maintenance contract. Tax only applies to the fair market value of supplies initially furnished to the customers under the service/supply agreement. Since you are considered the consumer of the parts and materials under the maintenance contract to repair the copier, the sale of such items to you is subject to tax.

With regard to past sales of the service/supply kits, we suggest that you file a claim for refund with the Board on taxes paid with respect to the portion of the lump-sum charges for the optional maintenance contract. The amount which is subject to a refund is determined as above, i.e., the lump-sum charge for the kit less the fair market value of the supplies furnished to the customer.

If you have any additional questions, please write this office.

Very truly yours,

Charles J. Graziano
Tax Counsel

CJG:ba