

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

330.2079.010

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition )  
for Redetermination Under the ) DECISION AND RECOMMENDATION  
Sales and Use Tax Law of: )  
)  
O. H. C---, INC. ) No. SR -- XX-XXXXXXX-010  
)  
)  
Petitioner )

The above-referenced matter came on regularly for hearing before Hearing Officer Janice M. Jolley on May 13, 1991, in Downey, California.

Appearing for petitioner: P--- J. L---, CPA  
L--- W--- Jr., CPA

Appearing for the Sales and Use Tax Department: Raymond L. Harispe, CPA  
District Principal Auditor  
Lena F. Ng  
Supervising Tax Auditor  
Rudy Cedeno  
Senior Tax Auditor

Protested Item

The protested tax liability for the period April 1, 1986 through March 31, 1989, is measured by:

<u>Item</u>	<u>State, Local and County</u>
A. Disallowed claimed exempt lease charges for mandatory service, delivery and return transportation	\$1,283,259

### Petitioner's Contentions

Service contracts are optional, not mandatory, and therefore not taxable.

### Summary

Petitioner is a corporation that leases chemical toilets. Most leases arise as the result of telephone calls from potential lessees. The contracts were oral contracts. Potential lessees often transmit their own purchase orders confirming the results of the oral conversations. Petitioner invoices the leases and separately states a charge for the rental of the toilet and for cleaning services. Affixed to each chemical toilet is a statement to the effect "this rental includes complete servicing, it will accommodate [ x ] for a normal workweek. Excessive use will result in unsatisfactory conditions before next servicing."

The Sales and Use Tax Department (hereinafter "the Department") contends that petitioner's method of operation, billing, and advertising do not indicate that cleaning services could be contracted from anyone else.

The Department stated that petitioner's yellow pages advertising was mute as to whether cleaning service charges were optional. It noted that petitioner advertised a flat charge of \$70 per month per rental unit in its advertising flyers. When petitioner billed for the rentals, however, that \$70 charge was broken out \$10 for the rental and \$60 for the cleaning service. Petitioner's daily receipts were entitled "Delivery Receipts/Service Agreement." The Department contends that due to the nature of petitioner's business, the cleaning of the chemical toilets required the lessor's technical expertise and special equipment.

On February 1, 1990, petitioner's representative transmitted petitioner's invoices No. 34118, 39027, 39711, 45002, 45030, 45031, 45268, and 45311. Each of the aforementioned invoices reflected that the toilet had been rented without the lessee contracting for cleaning services. The tax auditor traced each of these invoices to the sales journals and found that in all instances except two, these invoices were ultimately zeroed out and subsequent invoices were issued upon which services appeared. With regard to invoice 45002, the tax auditor noted that while that invoice was not zeroed out, another invoice to the same customer for the following month was issued with the related service charges for the same number of units leased. None of the rental time periods overlapped, and the preceding month's invoice to that customer also showed only one toilet rental and cleaning services billed. The tax auditor requested petitioner's accounts receivable ledger for that customer, but did not obtain any further documentation. The tax auditor contends that Invoice 45002 appears to be like the other transactions only that due to a clerical error by one of petitioner's employees, it was not zeroed out. The other invoice that did not appear to have cleaning services charged could not be corroborated by petitioner's business journals or an account card.

Numerous purchase orders issued by the lessees appear in the audit workpapers. In each instance, the invoice separately states a charge for the rent of the chemical toilet and for the cost of the cleaning. After the audit, petitioner prepared a letter that was sent to 364 lessees who were identified in the test sampling used by the Department to compute a percent of error. (Copy of one such letter appears as Exhibit A.) Two hundred six responses were received which equated to a 57 percent return. Of the 206 responses, 172 (83 percent) responded in the affirmative that they understood petitioner's cleaning services were optional. Twenty-six responses (13 percent) responded they did not understand the services to be optional. Eight (4 percent) were non-committal or non-responsive. The list of individuals contacted and the results were presented by petitioner at the hearing. Afterwards, the tax auditor attempted to contact 25 of the individuals, selected at random, who responded to petitioner's survey letter. Only 14 could be reached by phone. Eight of the 14 acknowledged that their answer to the questionnaire would be different if it were remailed now because they had a clearer understanding of the meaning of the question. The tax auditor felt that the consensus of the responses was that each lessee believes that the rental of the property and the cleaning services were elements of the same package. Most stated they would not have known whom to contact if the cleaning services had not been contracted with petitioner.

A note in the petition file indicates that petitioner acquired the cleaning chemicals ex-tax. If these items were self-consumed in optional maintenance contracts, use tax would be due on the cost.

According to a letter obtained by petitioner from the Department of Health Services of the County of Los Angeles, the toilets must be cleaned by individuals licensed to perform those services and a specialized truck is required to perform the cleaning. (Exhibit B.) Petitioner's representative stated that he believed that in some instances, when toilets were leased to individuals out of the normal service area, the items would be leased without cleaning services because an additional fee would have to be charged relating to the extra distance traveled to clean the toilet.

#### Analysis and Conclusions

Revenue and Taxation Code Section 6006(g) defines the sale to include "any lease of tangible personal property in any manner or by any means whatsoever, for consideration, ...." Revenue and Taxation Code Sections 6011(b)(1) defines the sales price to include any services that are part of the sale.

Business Taxes Law Guide Annotation 330.2080 provides as follows:

**“Chemical Toilet Units.** Tax on the leasing of chemical toilet units is measured by the entire rental price provided that no service is given. If cleaning service is provided at the option of the lessee, a separately stated cleaning charge can be excluded from the measure of tax. Leases of these units to California state parks are subject to tax.”

Sales and Use Tax Regulation 1546(3) provides as follows:

**“(3) LUMP-SUM MAINTENANCE CONTRACTS.**

**“(A) In General – Definitions.** ‘Mandatory maintenance contract.’ A maintenance contract is mandatory within the meaning of this regulation when the buyer, as a condition of the sale, is required to purchase the maintenance contract from the seller. ‘Optional maintenance contract.’ A maintenance contract is optional within the meaning of this regulation when the buyer is not required to purchase the maintenance contract from the seller, i.e., he is free to contract with anyone he chooses.

**“(B) Mandatory Maintenance Contracts.** If the repair work is performed under a mandatory lump-sum maintenance contract providing for the furnishing of parts, materials, and labor necessary to maintain the property, the repairer is regarded as the retailer of the material furnished. Accordingly, if the property upon which the maintenance will be performed is sold at retail, the measure of tax includes any amount charged for the lump-sum maintenance contract, whether or not separately stated. The sale of the parts and materials to the repairer furnishing them under such a contract is a sale for resale and is not taxable.

**“(C) Optional Maintenance Contracts.** 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.”

Initially, I note there is not a written contract between the parties. However, regulations under similar circumstances have looked to the bill instead of to the contract to determine if the item was separately stated. A separately stated charge must appear either on a separate billing or as a separately stated item on the billing in which the tangible personal property is also billed. [See: Sales and Use Tax Regulation 1540(b)(4)(a).] It appears that petitioner’s invoicing procedure complies with that requisite. However, the decision to break out various aspects of the contractual terms as separately stated items on the invoices is a unilateral decision by one party to the contract. Therefore, merely separately stating the charge does not provide satisfactory evidence that the parties negotiated for an optional service contract. The application of tax depends upon the factual substance, rather than some form which is artificial. Cedar-Sinai Medical Center v. State Board of Equalization (1984) 162 Cal.App.3d 1182. Application of the tax laws will not be held hostage to an artificial form over substance. [Northrup Corp. v. State Board of Equalization (1980) 110 Cal.App.3d 132, 139.]

Petitioner relies on two indicators that the lessees were aware that they could obtain separate services for cleaning. First, prior to receiving petitioner's invoice after the toilet was delivered, numerous purchase orders appearing in the audit workpapers, which were generated by the lessees, reflect separately stated charges for the unit and for the cleaning services. In order to do this, petitioner would apparently have had to have identified that these were separate contractual terms. This factor alone is not conclusive on the issue of mandatory versus optional service contracts. Petitioner's position is bolstered by the results of its letter solicitation, which is its second indicator that the cleaning services were optional. (Exhibit A.) That inquiry letter I believe fairly states its purpose in neutral terms and allows the responding party to answer either yes or no. Based upon a 57 percent return consisting of 206 responses, I believe that the trend established by the responses demonstrates that petitioner did attempt to clarify that the cleaning services were optional. The Department has clearly noted that the survey is not statistically perfect and was susceptible to interpretation errors. While some errors may have occurred, the overwhelming majority of lessees replied that they perceived they were offered an option to perform the cleaning services themselves or obtain the services from someone else. Nevertheless, this after-the-fact type of solicitation placed these lessees on notice that they had potential exposure for increased taxes as lessees. The responses were self-serving to the extent that if the response was that services were optional, no taxes would be due for past or future rentals where a majority of the expense (\$60) was allocated to services.

There is no dispute that this is an unpleasant task or that it is required to be done by individuals licensed to perform these services. The task requires specialized equipment. The county ordinances place the burden of this duty on the lessee, not the lessor, however. In a letter from the County Health Department (Exhibit B), it is noted that this is a totally delegable duty. That letter in the footnote also implies that these services can be separately obtained from licensed individuals. This perhaps explains why petitioner's advertising does not disclose why it is licensed to perform such cleaning services. It appears that petitioner serviced its own equipment, but did not wish to avail the general public of its cleaning services. Nevertheless, petitioner's track record of never leasing units without contracting for cleaning services is strong evidence of being a mandatory service contract. Petitioner's statement on its stickers that it affixes to each unit that the rental includes servicing, reflects its understanding of the terms of the agreement. The affixing of the sticker occurs at or about the time of performance of the terms of the lease. Basic principles of contract interpretation construe ambiguous terms against the party that drafted the document. Petitioner's statement on the stickers is contrary to its position in this dispute, but it is contemporaneous to its performance under each contract, all of which included cleaning services. Petitioner has not met its burden of proof.

Recommendation

Reaudit to determine on ex-tax purchases of supplies used in performing the cleaning services. Items provided with the leased property should be regarded as resold as part of the leasing charge.

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Janice M. Jolley, Staff Counsel  
(w/Exhibits A and B)

Oct. 31, 1991

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Date