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August 26, 1996

Mr. W--- L. L---
--- --- LLP
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--- ---, Suite XXXX
--- ---, CA XXXXX-XXXX

Re: Unidentified Taxpayer

Dear Mr. L---:

I am writing in response to your letter dated July 25, 1996 to Supervising Tax Counsel David H. Levine concerning optional maintenance contracts. As you know, since you do not identify your client this opinion letter does not qualify as written advice pursuant to Revenue and Taxation Code section 6596.

Your letter states that your client ("Taxpayer") is located in California and is engaged in the business of selling lump-sum optional maintenance contracts for office computer printers. Taxpayer does not sell the computer printers.

Taxpayer sells two types of optional maintenance contracts. The "standard optional maintenance contract" is a contract to maintain the printers, and may include repair labor and/or the furnishing of new parts to maintain the printers in working condition. The "bundled optional maintenance contract" is a contract to maintain the printers, just as in the standard contract, and to provide new disposable toner/ink cartridges for the printers as needed. We understand that both types of contracts are sold for fixed monthly, quarterly or yearly amounts, and that the fixed amount does not fluctuate due to the volume of either parts or cartridges needed.

You ask whether the gross receipts of either of these contract types are subject to sales tax or whether the parts furnished under these contracts are subject to sales and/or use tax.

Discussion

California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempted or excluded from taxation by statute. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax is imposed on the sales price of property purchased from a retailer for storage, use or other consumption in California. (Rev. & Tax. Code § 6201.) This tax is imposed on the person storing, using or otherwise consuming the property. (Rev. & Tax. Code § 6201.)

Regulation 1546(b)(3)(A) defines an "optional maintenance contract" as a maintenance contract which the buyer is free to purchase from anyone it chooses. Since Taxpayer is not the seller of the printers and its customers choose to purchase the contract from Taxpayer, the "standard optional maintenance contract" is an optional maintenance contract within the meaning of the regulation. (BTLG Annot. 315.0210 (8/23/90).) Regulation 1546(b)(3)(C) explains the application of tax to tangible personal property used in the performance of a lump-sum optional maintenance contract:

"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." (See also Reg. 1655(c)(3).)

Thus, Taxpayer is the consumer of the parts and materials furnished in the performance of its "standard optional maintenance contracts"; and tax applies to the sale of such items to Taxpayer, or to its use of such property. If Taxpayer purchases the property for resale, or otherwise acquires the property without paying tax or tax reimbursement, it must report and pay use tax on the actual cost of such property.

Taxpayer's "bundled optional maintenance contract" to maintain the printers and to provide new disposable toner/ink cartridges for the printers as needed is the sale of both an optional maintenance contract and of tangible personal property (the toner/ink cartridges) for a lump-sum price. As discussed earlier, the sale of an optional maintenance contract is not subject to tax. However, we view the toner/ink cartridges as supplies, not as parts or materials consumed in the maintenance and repair of the printers by Taxpayer. As such, Taxpayer's sales of the toner/ink cartridges are subject to tax.

In a situation where for a single price a taxable sale of tangible personal property is made along with the furnishing of property not subject to tax, an allocation between the taxable and the nontaxable charges should be made. Therefore, in regards to the "bundled optional maintenance contract," Taxpayer should segregate on the invoice to its customers, and in its records, the fair retail selling price of the toner/ink cartridges from the charges for the "standard optional maintenance contract."

Mr. W--- L. L---

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August 26, 1996
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I hope this information is of assistance. Please write again if we may answer any further questions.

Sharon Jarvis

Senior Tax Counsel

SJ/cmm

cc: San Francisco District Administrator (BH)