

**STATE BOARD OF EQUALIZATION**

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August 13, 1983

Mr. K--- D---  
N--- G--- Studios  
XXX --- --- Blvd.  
--- ---, CA XXXXX

Re: SR -- XX XXXXXX

Dear Mr. D---:

Your letter of July 1, 1983, has been referred to the undersigned for reply. A copy of the contract utilized in the subject transactions was enclosed with your letter and is discussed below. We summarize the relevant statement of facts as follows:

N--- G--- Studios ("Studios") offers a thirty-week guitar course for a total price of \$369, payable as follows: \$69 at the time of enrollment, and the balance of \$300 payable at \$10 each week over the thirty-week course period. In addition to the course instruction, the contract provides that Studios will furnish "an acoustic guitar for home practice, complete with sheet music, picks, and strings necessary to course." Finally, the contract provides that the guitar remain the property of Studios if the student discontinues lessons at any time prior to completion of the course, and that, in such a case, the student must return the guitar within seven days of the last lesson taken; "students completing and paying for the [entire] course will own the guitar." No refunds are permitted on any portion of the contract price.

On July 1, 1983, you spoke to Tax Counsel John Murray with respect to the sales tax liability arising out of the transfer of the guitar. Your letter indicates that Mr. Murray suggested that the contract separately state the charge for the guitar, and that sales tax would be charged on that amount; the balance of the contract price would constitute a nontaxable service. Accordingly, you have added the following provision to the contract: "The actual price for the guitar is (\$64.76) plus a (6.5%) sales tax totals (\$69.00)." You have requested written confirmation that this provision is sufficient to clearly indicate that portion of the total contract price which is subject to sales tax. We presume that the cost to Studios for these guitars is less than or equal to this price. On July 6, 1983 you spoke to Tax Counsel Donald J. Hennessy and stated that you had received private legal advice to the effect that Studios is a "consumer" of the guitars. For the reasons set forth below, it is our position that Studios is the "retailer" of the guitars and that the provision which you have added to the contract is sufficient to indicate that portion of the entire contract price subject to sales tax.

Sales tax is imposed on the retailer for the privilege of selling tangible personal property at retail, the measure of tax being a percentage of the retailer's gross receipts from such sales in this state. (Revenue and Taxation Code Section 6051.) "Sale" is defined to include "[a] transaction whereby the possession of property is transferred but the seller retains the title as security for the payment of the price." (Section 6006(c).) Sales and Use Tax Regulation 1501 provides, in pertinent part, as follows:

"Persons engaged in the business of rendering service are consumers, not retailers, of the tangible personal property which they use incidentally in rendering the service. Tax, accordingly, applies to the sale of the property to them. If in addition to rendering service they regularly sell tangible personal property to consumers, they are retailers with respect to such sales and they must...remit tax measured by such sales.

"The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se. ...If the true object of the contract is the service per se, the transaction is not subject to tax even though some tangible personal property is transferred."

Under the subject contract, in addition to providing a service, i.e., the guitar lessons, Studios also sells guitars. The transfer of the guitar is clearly not incidental to the providing of the guitar lessons.

It is our position that with respect to the guitars, the subject transactions constitute taxable sales under which possession of the guitars is transferred upon delivery to the students with Studios retaining title thereto as security for the payment of the price. (Revenue and Taxation Code Section 6006(e).) Such installment payment under the contract, i.e., the initial \$69 plus the thirty \$10 payments is divided in pro-rata shares between the price being paid for the guitar and the lessons. Studios is liable for the total amount of sales tax due on the sale of the guitar in the quarter in which the guitar is delivered to the student. (Section 6006(e); Sales and Use Tax Regulation 1641(c), see BTLG Annos. 200.0220 and 200.0240.) Sales Tax will be measured by the separately stated sales price (\$64.76) stated in the contract. In this context we note that to total \$69.00, including 6-1/2 percent sales and transit tax, the guitar price should be \$64.79, plus \$4.21 tax. In the event that Studios should repossess a guitar because a student has not paid the entire contract price, Studios would be entitled to a bad debt deduction only if the wholesale value of the repossessed guitar is less than the net contract balance (after excluding unearned insurance and finance charges, if any) at the date of repossession. (Regulation 1642(f)(1).

The sheet music, picks, and strings furnished by Studios to its students are items which are incidental to the provision of the guitar lessons. Consequently, Studios is the consumer of these items and is not liable for sales tax upon their transfer to the students. (See BTLG Anno. 515.0015.) These items should be purchased tax-paid by Studios. If purchased from an out-of-state vendor not

Mr. K--- D---

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authorized to collect the tax, Studios should self report use tax measured by the purchase price of these items on line 2 of Studios' sales and use tax return. (Sections 6201 and 620.)

I hope this has been of assistance to you. If further questions arise, do not hesitate to contact us again.

Very truly yours,

John C. Adamo  
Tax Counsel

JCA:ba