

**STATE BOARD OF EQUALIZATION**

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BURTON W. OLIVER
Executive Director

April 10, 1995

Re: ---

Dear Mr. ---:

This is in response to your letter dated January 30, 1995 requesting our opinion on the application of tax to the sales of goods and services related to the production of compact discs ("CD-ROM"). You state:

"Our business is a CD-ROM service bureau. We sell goods and perform services relating to the production of compact discs. While we do not ourselves manufacture compact discs, we offer such manufacturing services, which we subcontract to out-of-state manufacturers.

"Compact discs are manufactured by injecting molding, followed by the imprinting of artwork. Molds (known as `stampers') and silk screens are used in the manufacturing process, but are not components of the finished product. Industry practice is to charge customers a `mastering fee' for the fabrication of stampers and silk screens, although the terms of sale states that title to those items remains with the manufacturer. The manufacturer generally stores the master stampers and silk screens for a period of time, so that reorders can be processed without the imposition of new mastering fees. Depending upon the quantity of discs ordered, mastering fees are routinely reduced or waived entirely. Also, some customers are provided all-inclusive quotations for a given number of discs; such quotations do not separately itemize the mastering fee."

You ask a series of questions based on the above facts. Pursuant to your letter, we assume for questions 1(a) through 1(d) that your company sells the CD-ROMs to its customers inside this state and that your customers do not purchase these CD-ROMs for resale. Our responses to your questions are separately set forth below.

"1(a): If separately stated, are mastering fees for the fabrication of stampers and silk screens subject to the sales tax? Remember that title to the master remains with the manufacturer and that the

customer never takes possession of the master stampers or silk screens."

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 exempt 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 the storage, use or other consumption in California. (Rev. & Tax. Code §§ 6201, 6401.) Taxable gross receipts or sales price include all amounts received with respect to the sale, with no deduction for the cost of the materials, service, or expense of the retailer passed on to the purchaser, unless there is a specific statutory exclusion. (Rev. & Tax. Code §§ 6011, 6012.)

We understand that your company makes retail sales of CD-ROMs to its customers inside this state. To do so, your company contracts with a CD-ROM manufacturer to fabricate the CD-ROMs on your behalf. We understand that the CD-ROM manufacturer charges your company a separate "mastering fee" for the fabrication of goods (i.e., "stampers" and silk screens) which it uses in the process of manufacturing CD-ROMs. Title to these goods remains with the CD-ROM manufacturer. Upon completion of the manufacturing process, we assume that your company purchases the CD-ROMs extax for resale. (See Rev. & Tax. Code § 6007; Reg. 1668.) Your company then sells these CD-ROMs to its customers at retail and charges a separate amount as a "mastering fee" representing the manufacturer's charge to your company for fabrication of the "stampers" and silk screens.

Under these facts, the "mastering fees" are part of the manufacturer's cost of producing CD-ROMs for sale to your company. This cost is passed on to your company as part of its acquisition price of the fabricated CD-ROMs. Your company in turn passes this charge on to its customers as a separately stated fee. This "mastering fee," whether separately stated or not, is part of your charge for the retail sale of CD-ROMs. As such, this fee is included in your company's taxable gross receipts whether separately stated or not.

"1(b): We assume that when mastering fees are not separately stated, i.e. when customers are quoted a fixed price for a given number of compact discs, that sales tax applies to the entire sale amount regardless of the answer to question 1(a). Is this correct?"

Yes.

"1(c): If the answer to question 1(a) is that mastering fees are not subject to sales tax, then what latitude would we have in setting mastering fees so that they remain non-taxable? For example, we do not completely pass on to our customer the decrease in mastering fees that we obtain from the manufacturer as the number

of discs ordered increases. Would our imposition of a mastering fee be non-taxable even in cases where we paid no mastering fee to the manufacturer? Assume in your response that the fees are imposed for valid business reasons other than to avoid the payment of sales tax."

As set forth above, your entire charge for the retail sale of CD-ROMs is subject to tax, without regard to whether the charge is itemized among its various components or billed as a single price. This is true whether or not a mastering fee is paid by your company to the CD-ROM manufacturer.

"1(d): Are any of the above answers to the preceding questions contingent upon whether or not the stampers and silk screens are fabricated, used, and stored outside of state?"

No. The "mastering fees" you pass on to your customers (whether separately stated or not) are part of your company's charge for the retail sale of CD-ROMs inside this state and are included in your company's taxable gross receipts. The location of the stampers and silk screens does not affect the gross receipts your company receives from its retail sales of CD-ROMs.

"Our services include the fabrication of films from our customer's supplied artwork. We subcontract with companies to produce these films, and then ship the films to out-of-state vendors for use in preparing silk screens and printing plates for disc manufacturing and package printing. Our customers have title to these films, but generally don't take possession of them. Our second question regards the taxability of these films.

"2(a): When we produce films in California for a customer, but ship those films to an out-of-state location where they are then used, is the price we charge the customer (separately stated on the customer's invoice) for such films subject to the sales tax?"

We understand that your company purchases films from a subcontractor and then sells these films to its California customers.¹ Based on your statement that your company's customers "have title to these films," we assume that title passes to your customers in California. If so, sales tax applies on your company's sales of these films as a retail sale of tangible personal property inside this state unless an exemption otherwise applies.

¹ We assume that your company purchases these films extax from the subcontractor who produces the films. (See Rev. & Tax. Code § 6007; Reg. 1668.)

The only basis for an exemption to this particular transaction is the one set forth in Revenue and Taxation Code section 6396. That provision exempts sales in this state from sales tax when goods are shipped outside the state to a specific location under certain conditions. These conditions are explained in Sales and Use Tax Regulation 1620(a)(3)(B) as follows:

"Sales tax does not apply when the property pursuant to the contract of sale, is required to be shipped and is shipped to a point outside this state by the retailer, by means of:

1. Facilities operated by the retailer, or
2. Delivery by the retailer to a carrier, customs broker or forwarding agent, whether hired by the purchaser or not, for shipment to such out-of-state point. As used herein the term `carrier' means a person or firm regularly engaged in the business of transporting for compensation tangible personal property owned by other persons, and includes both common and contract carriers. The term `forwarding agent' means a person or firm regularly engaged in the business of preparing property for shipment or arranging for its shipment. An individual or firm not otherwise so engaged does not become a `carrier' or `forwarding agent' within the meaning of this regulation simply by being designated by a purchaser to receive and ship goods to a point outside this state"

Thus, sales tax applies to your company's sales of films unless, pursuant to your company's contract of sale with its customers, your company (or the third-party film manufacturer on your company's behalf) actually ships the films outside the state or directly sends the goods to a carrier, customs broker or forwarding agent for out-of-state shipment and neither the customer nor its agent obtains possession of the property inside California.

This exemption does not mean, however, that no tax would ever apply to this type of transaction. As set forth above, use tax applies to the storage, use, or consumption of property purchased from a retailer for use inside this state. (Rev. & Tax. Code §§ 6201, 6401.) This tax is imposed on the person actually storing, using, or otherwise consuming the property within the state. (Rev. & Tax. Code § 6202.) A retailer engaged in business in this state is required to collect the applicable use tax from the purchaser at the time of the sale of property to be used inside the state. (Rev. & Tax. Code § 6203.)

Since your company's customers own the film when it is delivered to the out-of-state CD-ROM manufacturer, the delivery of the film to the CD-ROM manufacturer is made on behalf of

your company's customer. Under these facts, it is presumed that the film is purchased by your company's customers for use inside this state if your company knows that its customer is a California resident. (Rev. & Tax. Code § 6247; Reg. 1620(b)(3).) Unless your company rebuts this presumption, your company is required to collect use tax from its customers at the time of the sale of the films. (See Rev. & Tax. Code § 6203.) This presumption can, however, be overcome by a statement in writing from your customer (and retained by your company) that the film is not purchased for use in California or by other evidence satisfactory to this Board that the films were not purchased for storage, use, or other consumption inside this state. (Rev. & Tax. Code § 6247.) Where your company overcomes this presumption, its customers will owe use tax on the films if they are subsequently brought into this state within 90 days after their purchase, unless the films are used or stored outside California one-half or more of the time during the six-month period immediately following their entry into this state. (Reg. 1660(b)(3).)

"2(b): When we produce films outside California and ship those films to an out of state location where they are then used, is the price we charge the customer for such films subject to the sales tax?"

If the films are manufactured outside California and are shipped to a location for use outside this state, title to these films passes, and hence the sale occurs, to your company's customers outside this state and California sales tax does not apply. (See Rev. & Tax. Code §§ 6010.5, 6006(a), 6051; Cal. U. Com. Code § 2401.) Your company may be obligated, however, to collect use tax from its customers as set forth above.

"2(c): If a sale of films is non-taxable by 2(a) or (b) above, then what happens if at a later time the customer requests that we forward the films to an address within California? Would we then need to collect sales tax, or would the customer or other consignee be responsible for paying use tax on the value of the films?"

We assume that a customer may request the delivery of the films to a California address sometime after the initial sale of the film to the customer and after the use of the film in a printing activity outside this state. If so, your company is not required to report California sales tax provided the sale of the film was not subject to tax for the reasons set forth in our responses to questions 2(a) and 2(b) above. Your company may, however, be required to collect use tax from its customers as set forth in our response to question 2a above. However, if your company is not required to collect use tax from its customer because the customer provides an affidavit as set forth in section 6247, the customer will owe use tax if it is regarded as purchasing the property for use in California. (Rev. & Tax. Code §§ 6201, 6401.)

"3) If it turns out that we have been paying sales tax on sales not subject to tax, can we obtain a refund? How far back can we go in

claiming a refund? If our customers reimbursed us for the sales tax, do we have any legal obligation to claim a refund and pay it to them?"

If you believe your company paid tax on amounts that are not subject to tax, it may submit a claim for refund to the Board in letter form. (See Rev. & Tax. Code § 6904.) The letter should specify the amount of the claim, the relevant dates, the basis for the claim, and should be accompanied by a copy of this letter. Please note, however, that claims for refunds must be made within three (3) years from the last day of the month following the close of the quarterly period for which the overpayment was made. (Rev. & Tax. Code § 6902(a)(1).) Any such claim should be sent to:

Board of Equalization
450 N Street, MIC 39
P.O. Box 942879
Sacramento, CA 94279-0039
ATTN: Audit Review and Refunds Section

A refund of overpaid tax would only be granted if your company refunds this amount to those customers who paid it. (Rev. & Tax. Code § 6901.5.)

If you have any further questions, please write again.

Sincerely,

Warren L. Astleford
Staff Counsel

WLA:plh

Enclosure - Reg. 1620

cc: San Jose District Administrator - GH