

INITIAL DISCUSSION PAPER

Proposed Regulation Changes Regarding Food Containers Regulation 1589, Containers and Labels

Issue

Should Sales and Use Tax Regulation 1589, *Containers and Labels*, be amended to incorporate provisions of Revenue and Taxation section 6364(d) as illustrated in Exhibit 1?

Background

Staff proposes that the Board amend Regulation 1589, *Containers and Labels*, to incorporate the provisions of subdivision (d) of section 6364 of the Revenue and Taxation Code (RTC), which was added in 1999 by Senate Bill (SB) 1210 (Stats. 1999, Ch. 758).

Regulation 1589 was last amended in 1999, prior to the passage of SB 1210. On May 11, 1999, the Board authorized publication of proposed amendments to Regulation 1589. The regulation was amended on July 29, 1999, and became effective on October 15, 1999. The regulation had previously defined a returnable container as one that is customarily returned. The amendment added additional criteria to define when a container used for shipment or delivery of food for human consumption is not customarily returned by a buyer, as well as added an example.

These amendments to Regulation 1589 were industry sponsored and focused on two types of containers: reusable bins used to ship tomato paste and other food products, and reusable pallets for lease. Under the provisions of RTC section 6364 in effect at the time, when one of these containers is regarded as returnable, the initial sale or purchase of the container is subject to tax. However, when the container is regarded as nonreturnable, its sale is exempt if sold without contents to a person who places the contents in the container and sells the contents together with the container. The intent of industry's proposal was to entirely exempt the sale and use of both these types of containers without regard to whether they are returnable or nonreturnable. Accordingly, industry proposed to amend Regulation 1589 to exempt the sale or lease of all returnable containers when used to ship food products for human consumption. Industry also proposed to amend Regulation 1589 to define when containers are considered not to be customarily returned, in order to more fully explain when the containers would be regarded as nonreturnable.

Industry stated that 19 states exempted the sale and use of returnable containers. Industry argued that this placed California growers and food processors at a competitive disadvantage vis-à-vis growers and food processors in these other states and that there was thus a need to level the playing field by providing an exemption for the sale and use of reusable pallets and containers used to transport agricultural products. Industry noted that this would also encourage the use of reusable pallets and containers rather than disposable containers, thus aiding the environment by reducing the number of containers placed in landfill sites. However, the exemption provided by RTC section 6364 did not, at that time, extend to the initial sale and use of the subject returnable containers.

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To address industry's concerns to the extent permitted by the provisions of section 6364 then in effect, staff recommended amending Regulation 1589 to clarify the application of tax to leases of returnable containers. The amendment recommended by staff was to provide that in the case of a lease of a returnable container that is a continuing sale, the lessor's first lease of the container for filling is taxable for the full term of the lease or thirty (30) days, whichever is greater, and that any subsequent lease of the container for refilling is not subject to tax under subdivision (c) of section 6364. These amendments were incorporated into the regulation under subdivision (b)(1)(C).

To address industry's remaining concerns, staff recommended that it pursue a statutory change. Staff worked with industry to draft specific statutory language to accomplish its objective. Industry sponsored this legislative proposal as SB 1210, which the Board voted to support at its April 22, 1999 Board meeting.

Discussion

SB 1210 was signed by the Governor on October 7, 1999, and added subdivision (d) to RTC section 6364. This provision exempts from sales and use tax the sale or lease of a container to a person who places food products for human consumption in the container for shipment, provided the food products will be sold, whether in the same container or not, and whether the food products are remanufactured or repackaged prior to sale. This exemption became operative April 1, 2000.

With the adoption of SB 1210, RTC section 6364 now provides the following:

There are exempted from the taxes imposed by this part, the gross receipts from the sale in this state of and the storage, use, or other consumption in this state of:

- (a) Nonreturnable containers when sold without the contents to persons who place the contents in the container and sell the contents together with the container.
- (b) Containers when sold with the contents if the sales price of the contents is not required to be included in the measure of the taxes imposed by this part.
- (c) Returnable containers when sold with the contents in connection with a retail sale of the contents or when resold for refilling.
- (d) Containers, when sold or leased without the contents to persons who place food products for human consumption in the container for shipment, provided the food products will be sold, whether in the same container or not, and whether the food products are remanufactured or repackaged prior to sale.

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(e) For purposes of this section, “returnable containers” means containers of a kind customarily returned by the buyer of the contents for reuse. All other containers are “nonreturnable containers.”

However, Regulation 1589 does not yet include a provision incorporating the exemption added by subdivision (d) of RTC section 6364. As relevant here, Regulation 1589 provides in subdivision (b)(1):

Tax does not apply to sales of:

(A) Nonreturnable containers when sold or leased without the contents to persons who place the contents in the container and sell the contents together with the container.

(B) Nonreturnable containers when sold without the contents to persons who place food products for human consumption in the containers for subsequent sale.

(C) Returnable containers when sold with the contents in connection with a retail sale of the contents, or when resold for refilling. In the case of a lease of a returnable container that is a continuing sale, the lessor’s first lease of the container for filling is taxable for the full term of the lease or thirty (30) days whichever is greater. The lessor’s subsequent lease of the container for refilling for sale with the contents is not taxable.

(D) All containers when sold or leased with the contents, if the sales price of the contents is not required to be included in the measure of the sales tax or the use tax.

Tax applies to all other sales of containers except sales for the purpose of resale to other sellers of containers who purchase them for resale without the contents. Operative April 1, 1998, tax does not apply to the sale or to the storage, use, or other consumption of any container used to collect or store human whole blood, plasma, blood products, or blood derivatives held for medical purposes, including, but not limited to, blood collection units and blood pack units.

To date, staff has received no comments from industry on the proposed amendments to Regulation 1589. The Business Taxes Committee is scheduled to discuss this issue at its meeting on April 17, 2002.

Staff proposes amending Regulation 1589 to incorporate the provisions of subdivision (d) of RTC section 6364 by adding subdivision (b)(1)(E) as shown in Exhibit 1. This will update the regulation to accurately reflect the current provisions of RTC section 6364.

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Summary

Staff proposes amending Regulation 1589 to incorporate the exemption provided by subdivision (d) of RTC section 6364. Staff welcomes any comments, suggestions, and input from interested parties regarding the issues raised in the discussion paper.

Prepared by the Program Planning Division, Sales and Use Tax Department

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Regulation 1589. CONTAINERS AND LABELS.

Reference: Sections 6007, 6008, 6009, 6012, 6364, and 6364.5, Revenue and Taxation Code.

(a) DEFINITIONS. The term “containers” as used herein means the articles in or on which tangible personal property is placed for shipment and delivery such as wrapping materials, bags, cans, twines, gummed tapes, barrels, boxes, bottles, drums, carboys, cartons, sacks, pallets and materials from which such containers are manufactured.

The term “returnable containers” as used herein means containers of a kind customarily returned or resold by the buyers of the contents for re-use by the packers, bottlers or sellers of the commodities contained therein. A container, title to which is retained by the seller or for which a deposit is taken by such seller, is a returnable container.

A container used for shipment or delivery of food for human consumption is not customarily returned by the buyer when:

1. The container is sold together with the contents;
2. No deposit is charged on the container;
3. Title to the container is not retained;
4. There is no obligation to repurchase the container;
5. The container is of the type that is fungible; and
6. The container is repurchased without regard to whether it is the same container originally sold.

Example: A tomato paste processor purchased a new or used container. The processor fills the container with tomato paste or other processed food. The tomato paste, together with the container, is sold to a spaghetti sauce manufacturer. No deposit is charged on the container, title to the container is not retained, and there is no obligation to repurchase the container. The container is of a type that is fungible. The spaghetti sauce manufacturer sells the container to a warehouse or a food processor who in turn sells containers that may or may not include the original container to a tomato paste processor that may or may not be the original purchaser. This container is not customarily returned by the buyer.

Examples of returnable containers are: registered dairy products containers, steel drums, certain types of beer and soft drink bottles, wine barrels, chemical carboys, and gas cylinders.

All other containers are “nonreturnable containers.” Examples of nonreturnable containers are: wrapping and packing materials, paper bags, twine, cartons, cans, medicine and distilled spirits bottles.

The term “deposit” as used herein means an amount charged to the purchaser of the contents of the container with the understanding that such amount will be repaid when the container or a similar container is delivered to the seller. The term “deposit” as used herein does not include amounts representing redemption or recycling values of beverage containers pursuant to division 12.1 (commencing with Section 14500) of the Public Resources Code whether or not such amounts are separately stated to the purchaser of the contents of the container.

(b) APPLICATION OF TAX.

(1) CONTAINERS. Tax does not apply to sales of:

(A) Nonreturnable containers when sold or leased without the contents to persons who place the contents in the container and sell the contents together with the container.

(B) Nonreturnable containers when sold without the contents to persons who place food products for human consumption in the containers for subsequent sale.

(C) Returnable containers when sold with the contents in connection with a retail sale of the contents, or when resold for refilling. In the case of a lease of a returnable container that is a continuing sale, the lessor's first lease of the container for filling is taxable for the full term of the lease or thirty (30) days whichever is greater. The lessor's subsequent lease of the container for refilling for sale with the contents is not taxable.

(D) All containers when sold or leased with the contents, if the sales price of the contents is not required to be included in the measure of the sales tax or the use tax.

(E) Operative April 1, 2000, returnable and nonreturnable containers, when sold or leased without the contents to persons who place food products for human consumption in the containers for shipment, provided the food products are sold. If these conditions are satisfied, the exemption applies without regard to whether the food products are sold in the same container (or whether the container itself is resold) or whether the food products are remanufactured or repackaged prior to their sale.

Tax applies to all other sales of containers except sales for the purpose of resale to other sellers of containers who purchase them for resale without the contents

Operative April 1, 1998, tax does not apply to the sale or to the storage, use, or other consumption of any container used to collect or store human whole blood, plasma, blood products, or blood derivatives held for medical purposes, including, but not limited to, blood collection units and blood pack units.

Deposits as defined herein are not taxable.

(2) LABELS. Tax does not apply to sales of labels or name-plates if:

(A) The purchaser affixes them to property to be sold and sells them along with and as a part of such property, as, for example, sales of name-plates of manufacturers or producers which are permanently affixed to each unit of products sold, such as automobiles and machinery.

(B) The purchaser affixes them to nonreturnable containers of property to be sold, or to returnable containers of such property if a new label is affixed to the container each time it is refilled. Examples are sales of labels to be affixed to fruit boxes, cans, bottles and packing cases, to growers, packers, bottlers and others who place the contents in the containers.

(c) PARTICULAR APPLICATIONS.

(1) **PRICE TAGS.** Tax applies to sales of such items as price tags, shipping tags and advertising matter used in connection with the sale of property or enclosed with the property sold.

(2) **FEED ANALYSIS TAGS.** Tax does not apply to sales of feed analysis tags to be attached to containers of feeds and sold along with the container and contents.

(3) **FEED BAGS.** Feed bags sold to feed dealers who place feed in the bags and sell the feed together with the bags are nonreturnable containers,¹ and the sale of such bags to feed dealers is not taxable. It is immaterial whether the bags are made of burlap, cotton, paper, or other material, or whether there is a brand name or dealer's name imprinted on the bags.

If, however, any feed dealer charges a deposit to customers to secure the return of the bags, or otherwise requires his customers to return the bags to him, the bags become returnable containers and tax applies to the sale of the bags to the feed dealer.

(4) **GIFT WRAPPING.** Tax applies to the entire charge for "gift wrapping" (i.e., furnishing the materials and labor required to wrap an item for a customer so as to be suitable for use by him as a gift), whether or not the person who does the gift wrapping is the seller of the contents. If the person who does the gift wrapping is the seller of the contents, the gift wrapping is considered sold together with the contents, whether or not a separate charge is made for the gift wrapping. The person who does the gift wrapping may purchase the materials free of tax for resale.

However, tax does not apply to charges for gift wrapping exempt food products sold by the person who does the gift wrapping, unless the value of the gift wrapping exceeds the value of the food products.

