



STATE BOARD OF EQUALIZATION

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Executive Director

April 18, 2008

Dear Interested Party:

Enclosed is the Discussion Paper on proposed revisions to Regulations 1506, *Miscellaneous Service Enterprises*, and 1524, *Manufacturers of Personal Property*, regarding the application of tax to alteration charges. Discussion regarding the proposed amendments to Regulations 1506 and 1524 is scheduled for the Board's **July 8, 2008 Business Taxes Committee** meeting.

However, before the issue is presented at the Business Taxes Committee meeting, staff would like to provide interested parties an opportunity to discuss the issue and present any suggested changes or comments. Accordingly, a meeting is scheduled in **Room 122 at 10:00 a.m. on April 29, 2008**, at the Board of Equalization; 450 N Street; Sacramento, California. Please note this is the only interested parties' meeting planned for this issue.

If you are unable to attend the meeting, but would like to provide input for discussion at the meeting, please feel free to write to me at the above address or send a fax to (916) 322-4530 before the April 29, 2008 meeting. If you are aware of other persons that may be interested in attending the meeting or presenting their comments, please feel free to provide them with a copy of the enclosed material and extend an invitation to the meeting. If you plan to attend the meeting on April 29, 2008, or would like to participate via teleconference, I would appreciate it if you would let staff know by contacting Ms. Lynda Cardwell at (916) 324-2924 or by e-mail at Lynda.Cardwell@boe.ca.gov prior to April 22, 2008. This will allow staff to make alternative arrangements should the expected attendance exceed the maximum capacity of Room 122 and to arrange for teleconferencing. In addition, please let Ms. Cardwell know if you wish to have future correspondence, including the issue paper and all attachments, sent to your e-mail address rather than to your mailing address.

Whether or not you are able to attend the above interested parties' meeting, please keep in mind that the due date for interested parties to provide written responses to staff's analysis is **May 16, 2008**. Please be aware that a copy of the material you submit may be provided to other interested parties. Therefore, please ensure your comments do not contain confidential information. Note that a second discussion paper is not planned for this topic, the next paper will be the issue paper that will be presented at the July 08, 2008 Business Taxes Committee meeting.

If you are interested in other topics to be considered by the Business Taxes Committee, you may refer to the "Business Taxes Committee" page on the Board's Internet web site (<http://www.boe.ca.gov/meetings/btcommittee.htm>) for copies of Committee discussion or issue



papers, minutes, a procedures manual and calendars arranged according to subject matter and by month.

Thank you for your consideration. I look forward to your comments and suggestions. Should you have any questions, please feel free to contact Ms. Leila Hellmuth, Supervisor, Business Taxes Committee Team at (916) 322-5271.

Sincerely,

Jeffrey L. McGuire
Chief, Tax Policy Division
Sales and Use Tax Department

JLM:lc

Enclosures

cc: (all with enclosures)
Honorable Judy Chu, Ph.D., Chair, Fourth District
Honorable Betty T. Yee, Vice Chairwoman, First District (MIC 71)
Honorable Bill Leonard, Member, Second District (MIC 78)
Honorable Michelle Steel, Member, Third District
Honorable John Chiang, State Controller, c/o Ms. Marcy Jo Mandel (via e-mail)
Mr. Mark Ibele, Board Member's Office, Fourth District (via e-mail)
Mr. Steve Shea, Board Member's Office (3 copies), Fourth District (via e-mail)
Mr. Alan LoFaso, Board Member's Office, First District (via e-mail)
Mr. Gary Qualset, Board Member's Office, First District (via e-mail)
Ms. Sabina Crocette, Board Member's Office, First District (via e-mail)
Mr. Mengjun He, Board Member's Office, First District (via e-mail)
Mr. Lee Williams, Board Member's Office, Second District (MIC 78 and via e-mail)
Mr. Erik Caldwell, Board Member's Office, Third District (via e-mail)
Mr. Ken Maddox, Board Member's Office, Third District (via e-mail)
Mr. Neil Shah, Board Member's Office, Third District (via e-mail)
Ms. Elizabeth Maeng, Board Member's Office, Third District (via e-mail)
Ms. Christina Rueck, Board Member's Office, Third District (MIC 77)
Ms. Melanie Darling, State Controller's Office (via e-mail)
Mr. Ramon J. Hirsig (via e-mail)
Ms. Kristine Cazadd (via e-mail)
Ms. Randie L. Henry (via e-mail)
Mr. Randy Ferris (via e-mail)
Mr. Jeff Vest (via e-mail)
Mr. David Levine (via e-mail)
Ms. Trecia Nienow (via e-mail)
Ms. Linda Frenklak (via e-mail)
Ms. Windie Scott (via e-mail)
Mr. Todd Gilman (via e-mail)
Ms. Lauren Simpson (via e-mail)

Mr. Dave Hayes (via e-mail)
Ms. Freda Orendt (via e-mail)
Mr. Stephen Rudd (via e-mail)
Mr. Joseph Young (via e-mail)
Mr. James Kuhl (via e-mail)
Mr. Geoffrey E. Lyle (via e-mail)
Ms. Leila Hellmuth (via e-mail)
Ms. Cecilia Watkins (via e-mail)
Ms. Lynda Cardwell (via e-mail)

DISCUSSION PAPER

Proposed revisions to Regulations 1506, *Miscellaneous Service Enterprises*, and 1524, *Manufacturers of Personal Property*, to clarify the application of tax to charges for garment alterations

Issue

Should Regulations 1506 and 1524 be amended to clarify the application of tax to the charges made by clothes-cleaning and clothes-dyeing establishments for garment alterations?

Background

As part of the Board of Equalization's (Board) education outreach efforts, operators of dry-cleaning establishments (hereafter, "cleaners") were contacted to verify that the operators held California seller's permits when required to do so. In response, representatives from an organization representing various cleaners expressed their understanding that, under the law, cleaners are not required to hold seller's permits because they provide services and are consumers of products they use in their cleaning and alteration activities. They also expressed concern that the significance of the percentage thresholds provided in Regulation 1524 is unclear and guidance regarding the method of calculation is lacking. As a result, staff proposes to clarify Regulation 1506, *Miscellaneous Service Enterprises*, and Regulations 1524, *Manufacturers of Personal Property*, so that a cleaner can easily determine when it is required to hold a seller's permit and, if required, what portion of its sales or services would be subject to tax.

Current law

Revenue and Taxation Code (RTC) section 6018.6, *Alterations, cleaning, or dyeing of garments*, provides that dry and wet cleaning establishments are consumers of property used in their cleaning operations and are not required to hold seller's permits (see Exhibit 3). Unlike other garment-alteration establishments such as department stores and tailors, the law provides that cleaners who perform garment alterations are considered to be providing nontaxable services and are the consumers of items used in altering garments provided the alteration activities represent a small percentage, as specified by law, of their business. When meeting this condition, cleaners are generally not required to hold seller's permits. However, cleaners who also sell miscellaneous items to customers such as lint brushes, abandoned clothing, ties, etc., are sellers of tangible personal property and are required to hold seller's permits to report the tax due from these selling activities.

RTC section 6018.6 defines cleaners as those who:

- Operate a location or locations as a pickup and delivery point for garment cleaning; or
- Provide spotting and pressing services on the premises but not garment cleaning; or
- Operate a garment cleaning or dyeing plant on the premises.

Cleaners that meet *one* of the three provisions above must also satisfy *both* of the following conditions for the exclusion to apply.

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Proposed revisions to Regulations 1506, *Miscellaneous Service Enterprises*, and 1524, *Manufacturers of Personal Property*, to clarify the application of tax to charges for garment alterations

- Seventy-five percent (75%) or more of the cleaner's total gross receipts must come from their clothes-cleaning or dyeing services.
- Twenty percent (20%) or less of the cleaner's total gross receipts during the prior calendar year came from the alteration of new and used garments.

For purposes of the calculation, *total gross receipts* include all charges made by cleaners, including the cleaner's charges for cleaning or dyeing customer items (e.g., clothing, fabrics, draperies, comforters, pillows, etc.), charges for altering new or used clothing, charges for altering other household items or miscellaneous items, *and* the cleaner's sales of miscellaneous products (e.g., lint brushes, abandoned clothing, jewelry, wood hangers, etc.).

Persons other than cleaners who perform alteration of new garments are regarded as manufacturing or fabricating personal property. As such, they are required to hold seller's permits and report the taxes due on charges to their customers for labor and material (Regulation 1524). Charges made for altering used garments are nontaxable repair or reconditioning labor.

Current regulatory provisions regarding cleaners and alteration charges

Regulation 1506 – Guidance regarding how tax applies to the gross receipts of persons operating a cleaning or laundering establishment is currently provided in Regulation 1506, subdivision (b)(1), which also provides guidance for “barbers,” “beauty shop operators,” and “shoe polishers.” The provisions explain that cleaners are consumers of the supplies and other property used in performing their cleaning services, and tax applies with respect to the sale of supplies and other property to the cleaners. The subdivision also provides that cleaners are retailers, however, of any such supplies, used items, or other tangible personal property, which they sell to their customers and tax applies to the gross receipts from such sales.

Regulation 1506, subdivision (b)(2), discusses the application of tax to a cleaner's rental charges for linen supplies and similar items, including towels, uniforms, coveralls, shop coats, and dust cloths rented to others when an essential part of the rental contract is the furnishing of the recurring service of laundering or cleaning the items rented. Cleaners are consumers of the items rented.

Regulation 1524 – Guidance regarding how tax applies to charges for the *alteration* of new garments is provided in Regulation 1524, subdivision (b)(1). The subdivision discusses the application of tax to alteration charges in general. Subdivision (b)(2) provides guidance regarding the application of tax to a cleaner's charges for alterations and, essentially, restates the provisions of RTC section 6018.6.

Discussion

Staff proposes to revise Regulations 1506 and 1524 to clarify the provisions relating to cleaners so that a cleaner can easily determine when it is required to hold a seller's permit and, if

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required, what portion of its sales or services would be subject to tax. The Business Taxes Committee is scheduled to discuss this topic at its meeting on July 8, 2008.

Staff's proposed revisions are attached as Exhibits 1 and 2 and would do the following:

Regulation 1506 (Exhibit 1)

Since Regulation 1506 applies to miscellaneous service enterprises, staff proposes to create a new subdivision (c) to consolidate and expand all regulatory provisions related to cleaners. Subdivision (c) defines the terms "clothes-cleaning and clothes-dyeing establishment," "alteration of new garments," and "alteration of used garments," specifies how tax applies to various activities performed by cleaners, and clarifies when a cleaner is required to hold a seller's permit.

Regulation 1524 (Exhibit 2)

Since this regulation primarily applies to manufacturers of personal property, staff proposes to delete subdivision (b)(2), regarding alterations by clothes-cleaning or clothes-dyeing establishments and incorporate into renumbered subdivision (c) of Regulation 1506. The information regarding the application of tax to alterations in general would remain in Regulation 1524; however, the reader would be referred to Regulation 1506 for more information regarding alteration charges by cleaners.

Additional resource for providing guidance to cleaners

In addition to amending the regulations, staff recommends a new *Tax Fact* be published to provide additional guidance to cleaners as part of the implementation process. The *Tax Fact* would help a person determine if it is a cleaner within the provisions of RTC section 6018.6, and clarify when charges for alterations are taxable and when the cleaner is required to hold a seller's permit. The *Tax Fact* could be translated into several languages so that it is easily understood.

Summary

Staff proposes amendments to Regulations 1506 and 1524 to clarify the application of tax to the charges made by cleaners for their services and the alterations to "new" and "used" garments. Staff welcomes any comments, suggestions, and input from interested parties regarding this issue.

Prepared by the Tax Policy Division, Sales and Use Tax Department

Current as of 04/16/2008

(NOTE: only the relevant subdivisions of the regulation are included in this Exhibit. Other than renumbering, the other subdivisions are not being amended.)

Regulation 1506. Miscellaneous Service Enterprises.

References: Sections 6006, 6007, 6015, 6018.1, [6018.6](#) 6018.7, 6358, 6358.4 and 6363, Revenue and Taxation Code.

(b) BARBERS, BEAUTY SHOP OPERATORS, AND SHOE POLISHERS, ~~Launderers and Cleaners.~~

~~(1) In General.~~ Barbers, beauty shop operators, and shoe polishers, ~~launderers and cleaners~~ are the consumers of the supplies and other property used in performing their services, and tax applies with respect to the sale to them of the supplies and other property. They are retailers, however, of any such supplies or of used articles or other tangible personal property, which they sell to consumers in the regular course of business, and tax applies to the gross receipts from such sales.

~~(2) Rentals. Launderers and cleaners are the consumers of linen supplies and similar articles, including towels, uniforms, coveralls, shop coats, dust cloths, and similar items, rented to others when an essential part of the rental contract is the furnishing of the recurring service of laundering or cleaning of the articles rented, and tax applies with respect to the sale to them of such articles.~~

(c) CLOTHES-CLEANING AND CLOTHES-DYEING ESTABLISHMENTS

(1) DEFINITIONS. For the purposes of this subdivision (c), the following definitions shall apply:

(A) Clothes-Cleaning or Clothes-Dyeing Establishment, including wet cleaners (e.g., laundrers) and dry cleaners, means and includes persons who:

1. Operate a location or location as a pickup and delivery point for garment cleaning.
2. Provide spotting and pressing services on the premises, but not garment cleaning, or
3. Operate a garment cleaning or dyeing plant on the premises.

(B) Alteration of New Garments means and includes any work performed upon new garments to meet the requirements of the customer, whether the work involves the addition of material to the garment, the removal of material from the garment, the rearranging or restyling of the garment, or otherwise altering the new garment when such alterations result in the creation or production of new garments or constitute a step in the creation or production of new garments for a consumer. Alteration of new garments does not mean or include the process of dyeing new garments.

(C) Alteration of Used Garments means and includes the mending, shortening or lengthening, taking in or letting out, or otherwise altering used garments when such alterations merely refit or repair the garment for the use for which it was originally produced.

(2) APPLICATION OF TAX

(NOTE: only the relevant subdivisions of the regulation are included in this Exhibit. Other than renumbering, the other subdivisions are not being amended.)

(A) Clothes-Dyeing Services. Persons who operate a clothes-dyeing establishment are retailers, not consumers, when their charges are for the dyeing of new fabrics or garments, and tax applies to their gross receipts from such sales. While the dyeing of fabrics or garments is fabrication, dyeing does not constitute alteration within the meaning of this regulation. Persons who dye new fabrics or garments are required to hold a seller's permit.

Clothes-dyeing establishments are consumers of the supplies and other materials used for the dyeing of used garments, and tax applies to the sale of the supplies and materials to such persons. Tax does not apply to their charges for dyeing used garments.

(B) Clothes-Cleaning Services. Clothes-cleaning establishments are consumers of the supplies and other property used in performing their cleaning services, and tax applies with respect to the sale to them of the supplies and other property and not to their charges for such services.

(C) Rentals of Items by Clothes-Cleaning Establishments. Clothes-cleaning establishments are the consumers of linen supplies and similar items, such as towels, uniforms, coveralls, shop coats, dust cloths, rented to others when an essential part of the rental contract is the furnishing of the recurring service of laundering or cleaning of the items rented, and tax applies with respect to the sale to them of such items.

(D) Miscellaneous Sale of Items. Clothes-cleaning and clothes-dyeing establishments are retailers of any supplies, used items, or other tangible personal property, such as lint brushes, abandoned garments, wood hangers, novelty items, which they sell to consumers in the regular course of business, and tax applies to the gross receipts from such sales. As retailers of tangible personal property, such persons are required to hold a seller's permit.

(F) Alteration of Garments – In General. A clothes-cleaning or clothes-dyeing establishment is the consumer of property used or furnished in the alteration of new garments and the alteration of used garments provided that:

1. Seventy-five percent (75%) or more of the establishment's total gross receipts represent charges for garment-cleaning or dyeing services, and

2. No more than twenty percent (20%) of the establishment's total gross receipts during the preceding calendar year were from the alteration of garments.

If both requirements are not met, the clothes-cleaning or clothes-dyeing establishment's charges for the alteration of new garments are subject to tax. The establishment's charges for the alteration of used garments are not subject to tax. Tax applies to the supplies and materials furnished in the alteration of used garment as provided by Regulation 1546.

(ed) CIRCULATING LIBRARIES. When circulating libraries, which are engaged in the business of renting books to others, pay tax measured by the purchase price of such books either

(NOTE: only the relevant subdivisions of the regulation are included in this Exhibit. Other than renumbering, the other subdivisions are not being amended.)

to the person from whom the books are purchased or to the board, tax does not apply to the amount charged for the rental of such books. Such libraries are retailers of new or used books, which they sell to consumers in the regular course of business, and tax applies to the gross receipts from such sales.

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Regulation 1524. Manufacturers of Personal Property.

Reference: Sections 6011, 6012, and 6018.6, Revenue and Taxation Code

(a) In General. Tax applies to the gross receipts from retail sales (i.e., sales to consumers) by manufacturers of tangible personal property the sale of which is not otherwise exempted. The measure of the tax is the gross receipts of, or sales price charged by, the manufacturer, from which no deduction may be taken by the manufacturer on account of the cost of the raw materials or other components purchased, or labor or service costs of any step in the manufacturing process, including work performed to fit the customer's specific requirements, whether or not performed at the customer's specific request, or any other services that are a part of the sale. In addition, no deduction may be taken on account of interest paid, losses or any other expense.

(b) Particular Applications.

(1) Alterations to New Clothing for Men, Women and Children.

(A) Definition of Alteration. "Alteration," as herein used, means and includes any work performed upon new clothing to meet the requirements of a customer, whether the work involves the addition of material to the garment, the removal of material from the garment, the rearranging or restyling of the garment, or any other change therein.

(B) Application of Tax.

1. In General. Charges for alterations to new clothing are subject to tax. It is immaterial whether the charges for the alterations are separately stated or are included in the price of the garment. It also is immaterial whether the alterations are performed by the seller of the garment or by another person.

(2) Alterations by Clothes-Cleaning or Clothes-Dyeing Establishments. An exception to the general rule above applies to a person who operates a clothes-cleaning or clothes-dyeing establishment when such establishments meet certain statutory requirements. For more information regarding alteration charges by clothes-cleaning and clothes-dyeing establishments see Regulation 1506, subdivision (c). ~~is the consumer of property used or furnished in altering new and used clothing, provided that~~

~~—(A) 75 percent or more of the establishment's total gross receipts represent charges for garment cleaning or dyeing services and~~

~~—(B) No more than 20 percent of the establishment's total gross receipts during the preceding calendar year were from the alteration of new and used garments.~~

~~If both requirements are met, sales tax shall not apply to the operator's charges for alterations of new or used clothing. However, that person is a retailer of any other tangible personal property sold to consumers in the regular course of business, and sales tax shall apply to the gross receipts from those sales.~~

(3) Painting, Polishing, Finishing. Tax applies to charges for painting, polishing, and otherwise finishing tangible personal property in connection with the production of a finished product for consumers, whether the article to be finished is supplied by the customer or by the finisher. Tax does not apply to charges for painting or finishing real property.

History: Effective July 1, 1939.

Adopted as of January 1, 1945, as a restatement of previous rulings.

Amended and renumbered August 4, 1970, effective September 5, 1970.

Amended April 8, 1987, effective August 8, 1987. In subdivision (b)(1)(2), added reference to application of tax to persons who operate clothes cleaning or clothes dyeing establishments.

6018.6. Alteration, cleaning, or dyeing of garments. (a) Any person who receives no more than 20 percent of his or her total gross receipts from the alteration of garments during the preceding calendar year is a consumer of, and shall not be considered a retailer within the provisions of this part with respect to, property used or furnished by that person in altering new or used clothing, provided both of the following apply:

(1) That person operates a location or locations as a pickup and delivery point for garment cleaning, or provides spotting and pressing services on the premises but not garment cleaning, or operates a garment cleaning or dyeing plant on the premises.

(2) Seventy-five percent or more of that person's total gross receipts represent charges for garment cleaning or dyeing services.

(b) Sales tax shall not apply to the charges for alterations specified in subdivision (a). However, that person is a retailer of any other tangible personal property sold to consumers in the regular course of business and sales tax shall apply to the gross receipts from those sales.

(c) For the purpose of this section:

(1) "Cleaning" means wet cleaning and drycleaning.

(2) "Wet cleaning" means the process of cleaning a garment by immersion in water, or by applying manually or by any mechanical device, water, or any detergent and water, or by spraying or brushing the garment with water or water and any detergent, or water vapor, or steam, and includes self-service or coin-operated equipment in whole or in part.

(3) "Drycleaning" means the process of cleaning or renovating wearing apparel, feathers, furs, hats, fabrics, household items, or textiles by immersion and agitation, spraying, vaporization, or immersion only, in a volatile, commercially moisture-free solvent or by the use of a volatile or inflammable product, applied either manually or by means of a mechanical appliance and including self-service or coin-operated equipment in whole or in part.

(4) "Dyeing" means the process of coloring wearing apparel, feathers, furs, hats, fabrics, or textiles by the use of aniline dyes, mordants, or acids, with or without steam, excluding, however, the use of any dye or combination of dyes which is directly soluble or dispersible in water and which does not require chemical alteration of its structure for application, where that dye or combination of dyes is applied to cotton, viscose rayon, or cuprammonium rayon other than wearing apparel.

(5) "Spotting" means the process of removing spots or stains or localized areas of soil from a garment, either before or after, and with or without drycleaning or wet cleaning, by brushing, spraying, or other means of manual or mechanical application, other than immersion, with water, detergents, and volatile or inflammable solvents, chemicals, or any, or all of them.

(6) “Pressing” means the process of restoring the garment to the original shape, dimensions or contour thereof, or to those in which the same was received from the customer, or as directed by the customer, and the removal of wrinkles, stresses, bulges, and impressions, imprint marks and shine, from a garment by the application of pressure, heat, moisture, water vapor or steam, or all of them, whether applied manually, or by any mechanical means.

History.—Added by Stats. 1983, Ch. 605, in effect August 31, 1983, operative January 1, 1984. Stats. 1986, Ch. 308, added definitions for “cleaning”, “wet cleaning”, “drycleaning”, “dyeing”, “spotting”, and “pressing”

Note.—Sec. 24, Stats. 1986, Ch. 308, states that the amendment to Section 6018.6 of the Revenue and Taxation Code does not constitute a change in, but is declaratory of, the existing law.