



STATE BOARD OF EQUALIZATION

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State Controller

RAMON J. HIRSIG  
Executive Director

September 5, 2008

Dear Interested Party:

Enclosed are the Agenda, Issue Paper, and Revenue Estimate for the September 16, 2008 Business Taxes Committee meeting. This meeting will address the proposed amendments to Regulation 1506, *Miscellaneous Service Enterprises*, and Regulation 1524, *Manufacturers of Personal Property*.

Action 1 on the Agenda concerns whether Regulations 1506 and 1524 should be amended to clarify the application of tax to charges by clothes cleaners and dyers for their alteration of new and used garments and when such persons are required to hold a seller's permit.

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 a materials preparation and review schedule arranged according to subject matter and meeting date.

Thank you for your input on these issues. I look forward to seeing you at the Business Taxes Committee meeting at **9:30 a.m.** on **September 16, 2008**, in Room 121 at the address shown above.

Sincerely,

Randie L. Henry, Deputy Director  
Sales and Use Tax Department

RLH:lrc

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. Steve Shea, Board Member's Office, Fourth District (via e-mail)  
Mr. Mark Ibele, Board Member's Office, Fourth District (via e-mail)  
Mr. Alan LoFaso, Board Member's Office, First District (via e-mail)  
Ms. Sabina Crocette, Board Member's Office, First District (via e-mail)  
Mr. Gary Qualset, Board Member's Office, First District (via e-mail)  
Ms. Mengjun He, Board Member's Office, First District (via e-mail)  
Ms. Amber Kemp, Board Member's Office, First District (via e-mail)  
Mr. Lee Williams, Board Member's Office, Second 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 (via e-mail)  
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. Jeff Vest (via e-mail)  
Mr. Robert Lambert (via e-mail)  
Mr. Randy Ferris (via e-mail)  
Mr. David Levine (via e-mail)  
Mr. Timothy Treichelt (via e-mail)  
Mr. Robert Tucker (via e-mail)  
Mr. Todd Gilman (via e-mail)  
Ms. Laureen Simpson (via e-mail)  
Mr. Bill Benson (via e-mail)  
Ms. Freda Orendt (via e-mail)  
Mr. Stephen Rudd (via e-mail)  
Mr. Robert Buntjer (via e-mail)  
Mr. Jeff McGuire (via e-mail)  
Mr. James Kuhl (via e-mail)  
Mr. Geoffrey E. Lyle (via e-mail)  
Ms. Leila Hellmuth (via e-mail)  
Ms. Lynda Cardwell (via e-mail)  
Ms. Cecilia Watkins (via e-mail)



**AGENDA — September 16, 2008 Business Taxes Committee Meeting**  
**Proposed amendments to Regulation 1506, *Miscellaneous Service Enterprises*, and Regulation 1524,**  
***Manufacturers or Personal Property*, to clarify the application of tax to alteration charges**

**Action 1 —  
Proposed  
amendments to  
Regulation 1506  
(b) and (c)**

**Regulation 1506. *MISCELLANEOUS SERVICE ENTERPRISES***

(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~~ customers in the regular course of business, and tax applies to the gross receipts from such sales.

~~(2) Rentals. Launderers and cleaners are consumers of linen supplies and similar articles, including towels, uniforms, coveralls, shop coats, dust clothes, 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 CLEANERS AND DYERS**

(1) CLOTHES CLEANING – IN GENERAL. Persons who provide clothes-cleaning services are consumers of the supplies and other materials used in performing their cleaning services, and tax applies to the sale to them of the supplies and other materials and not to their charges for such services.

(2) RENTALS. Clothes 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.

(3) CLOTHES DYEING – IN GENERAL. Persons who provide dyeing services are retailers, not consumers, when their charges are for the dyeing of new fabrics, garments, or other such items and tax applies to their gross receipts from such sales. Persons who dye new items are required to hold a seller's permit.

Dyers are consumers of the supplies and other materials used in dyeing used fabrics, garments, or other such items and tax applies to the sale to them of the supplies and other materials and not to their charges for their dyeing services.

(4) ALTERATION OF GARMENTS – IN GENERAL. For the purposes of this subdivision (c), alteration of garments means and includes any work performed upon new or used men's, women's and children's clothing to meet the requirements of the customer whether the work involves the addition of material to the garment, removal of material, refitting, or repairing. Alteration of garments does not mean or include the process of dyeing garments. Alteration of garments also does not mean or include work performed upon new or used personal or household items such as handbags, stuffed animals, bedding, and draperies. The application of tax to a clothes cleaner's or a dyer's charges for the alteration of personal or household items is explained in Regulation 1524.

**AGENDA — September 16, 2008 Business Taxes Committee Meeting**  
**Proposed amendments to Regulation 1506, *Miscellaneous Service Enterprises*, and Regulation 1524,**  
***Manufacturers or Personal Property*, to clarify the application of tax to alteration charges**

(A) Alteration of Garments by Clothes Cleaning or Dyeing Establishments. A clothes cleaning or dyeing establishment, including wet cleaners (e.g., launderers) and dry cleaners, means and includes a clothes cleaner or dyer who (1) operates a location or locations as a pickup and delivery point for garment cleaning, or (2) provides spotting and pressing services on the premises, but not garment cleaning, or (3) operates a garment cleaning or dyeing plant on the premises.

A clothes cleaner or dyeing establishment described above is the consumer of property used or furnished in the alteration of new or 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 a clothes cleaner or dyer is not an establishment as described or does not meet the requirements of this paragraph (A), tax applies to the clothes cleaner's or the dyer's charges for the alteration of garments as explained in Regulation 1524.

(B) Alteration of Garments by a Third Party. When a clothes cleaner or dyer who meets the requirements of subdivision (c)(4)(A) contracts with a third party such as a tailor for the alteration of garments instead of performing such alterations itself, the clothes cleaner or dyer is a consumer, not a retailer, of the alterations provided by the third party and may not issue a resale certificate to the third party for such alterations. Tax applies to the third party's charges to the clothes cleaner or dyer for such alterations as explained in Regulation 1524.

(5) MISCELLANEOUS SALE OF ITEMS. Clothes cleaners and dyers, whether or not they meet the requirements of subdivision (c)(4)(A), are retailers of any supplies, used items, or other tangible personal property such as lint brushes, abandoned garments, wood hangers, or novelty items, which they sell to customers 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.

(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 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.

**AGENDA — September 16, 2008 Business Taxes Committee Meeting**  
**Proposed amendments to Regulation 1506, *Miscellaneous Service Enterprises*, and Regulation 1524, *Manufacturers or Personal Property*, to clarify the application of tax to alteration charges**

<p><b>Action 1 — Proposed amendments to Regulation 1524 (a) and (b)</b></p>	<p><b>Regulation 1524. <i>MANUFACTURERS OF PERSONAL PROPERTY</i></b></p> <p><b>(a) IN GENERAL.</b> Tax applies to the gross receipts from retail sales (i.e., sales to consumers) by manufacturers, <u>producers, processors, and fabricators</u> 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, <u>producer, processor, or fabricator</u>, from which no deduction may be taken <del>by the manufacturer</del> on account of the cost of the raw materials or other components purchased, or labor or service costs <u>to create or produce the tangible personal property, or</u> of any step in the manufacturing, <u>producing, processing, or fabricating</u>, 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.</p> <p><b>(b) PARTICULAR APPLICATIONS.</b></p> <p>(1) <del>Alterations to New Clothing for Men, Women and Children.</del> <u>ALTERATION OF NEW AND USED ITEMS.</u></p> <p><del>(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.</del></p> <p><u>(A) Alteration of New Items means and includes any work performed upon new items such as garments, bedding, draperies, or other personal and household items to meet the requirements of the customer, whether the work involves the addition of material to the item, the removal of material from the item, the rearranging or restyling of the item, or otherwise altering the item, when such alterations result in the creation or production of a new item or constitute a step in the creation or production of a new item for the customer.</u></p> <p><u>Charges for the alteration of new items are subject to tax, except as provided in subdivision (c)(4) of Regulation 1506, regardless of whether the charges for the alterations are separately stated or included in the price of the item, or whether the alterations are performed by the seller of the item or by another person. Persons engaged in the producing, processing or fabricating of new items are retailers, not consumers, of the alterations provided to the customer and are required to hold a seller’s permit.</u></p> <p><u>(B) Alteration of Used Items means and includes the mending, shortening or lengthening, taking in or letting out, or otherwise altering used items such as garments, bedding, draperies, or other personal and household items when such alterations merely refit or repair the item for the use for which it was created or produced.</u></p> <p><u>Charges for the alteration of used items are not subject to tax. Generally, persons performing the alteration of used items are consumers, not retailers, of the supplies and materials furnished in connection with the alterations, and tax applies to the sale of the supplies and materials to such persons.</u></p> <p><u>Except as provided in subdivision (c)(4) of Regulation 1506, persons performing the alteration of used items are retailers, not consumers, of the supplies and materials furnished in connection with the alterations when the retail value of the supplies and materials is more than</u></p>
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**AGENDA — September 16, 2008 Business Taxes Committee Meeting**  
**Proposed amendments to Regulation 1506, *Miscellaneous Service Enterprises*, and Regulation 1524,**  
***Manufacturers or Personal Property*, to clarify the application of tax to alteration charges**

	<p><u>10 percent of the total charge for the alterations, or if the invoice to the customer includes a separate charge for such property. When such persons are retailers, not consumers, tax applies to the fair retail selling price of the supplies and materials to the customer.</u></p> <p><u>When the retail value of the supplies and materials is more than 10 percent of the total charge to the customer, the person performing the alterations must segregate on the invoice to the customer and in its records, the fair retail selling price of the supplies and materials from the charge for the alterations. "Total charge" means the combined total of the retail value of the supplies and materials furnished or consumed as part of the alterations and the labor charges for the alterations.</u></p> <p><del>(B) Application of Tax.</del></p> <p><del>(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.</del></p> <p><del>(2) Alterations by Clothes Cleaning or Clothes Dyeing Establishment. A person who operates a clothes cleaning or clothes dyeing establishment is the consumer of property used or furnished in altering new and used clothing, provided that</del></p> <p><del>— (A) 75 percent or more of the establishment's total gross receipts represent charges for garment cleaning or dyeing services and</del></p> <p><del>— (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.</del></p> <p><del>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.</del></p> <p><del>(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.</del></p>
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Issue Paper Number 08-005



- Board Meeting
- Business Taxes Committee
- Customer Services and Administrative Efficiency Committee
- Legislative Committee
- Property Tax Committee
- Other

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## Proposed regulatory amendments to clarify the application of tax to alteration charges

### I. Issue

Should Regulation 1506, *Miscellaneous Service Enterprises*, and Regulation 1524, *Manufacturers of Personal Property*, be amended to clarify the application of tax to alteration charges by clothes cleaners and dyers?

### II. Alternative 1 - Staff Recommendation

Staff recommends amending Regulation 1506 (see Exhibit 2) to clarify that:

- Unlike other garment-alteration establishments, clothes cleaners and dyers are consumers, not retailers, of their garment alterations (new and used alike) provided their alteration activities represent a small percentage of their business.
- Clothes cleaners are consumers of the supplies and other materials used in performing their cleaning services and tax applies to the sale to them of the supplies and other materials and not to their charges for their clothes-cleaning services.
- Persons who provide dyeing services are retailers, not consumers, when their charges are for the dyeing of *new* items, including garments, and tax applies to their gross receipts from such sales. They are consumers of the supplies and materials used in dyeing *used* items and tax applies to the sale to them of the supplies and materials and not to their charges for their dyeing services.
- When clothes cleaners and dyers who meet the requirements of Regulation 1506 contract with a third party such as a tailor for the alteration of garments instead of performing the alterations themselves, they are consumers, not retailers, of the alterations provided by the third party, and may not issue a resale certificate to the third party for such alterations.

Staff also recommends amending Regulation 1524 (see Exhibit 3) to clarify that tax applies to charges for the alteration of new items (e.g., garments, personal items, and household items) by persons who are in the business of providing alteration services, including clothes cleaners and dyers who do not meet the requirements of Regulation 1506. Labor charges for the alteration of used items are not taxable.

### III. Alternative 2 – Other Alternative Considered

Do not amend Regulations 1506 or 1524.

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#### **IV. Background**

As part of the Board of Equalization's (Board) education outreach efforts, staff contacted operators of dry-cleaning establishments to verify that the operators held a California seller's permit when their clothes cleaning and alteration operations were such that a permit was required. In response, representatives from an organization representing various dry cleaners expressed their understanding that dry cleaners are not required to hold seller's permits because they provide services and are consumers of products they use in their clothes cleaning and alteration activities. They explained that the provisions in the current version of Regulation 1524 are unclear and guidance is lacking regarding a dry cleaner's permit requirements. As a result, the matter was sent to the interested parties process to discuss the restructuring and amendment of Regulations 1506 and 1524 to clarify when a dry cleaner is required to hold a seller's permit and, when required, what portion of its sales or services would be subject to tax.

Interested parties and staff met on April 29, 2008, and July 17, 2008, to discuss staff's proposed amendments to Regulations 1506 and 1524. It was suggested that the amendments clarify how tax applies to alteration charges when a clothes cleaner or dyer (hereafter, "cleaner") meets the threshold requirements of Revenue and Taxation Code (RTC) section 6018.6, as well as when they do not. It was also suggested that the amendments clarify how tax applies to charges by a tailor or other third party who alters garments on behalf of the cleaner. Staff and interested parties agreed that the amendment of Regulation 1506 to clarify the application of tax to a cleaner's alteration charges should be limited to clarifying how tax applies when the threshold requirements are met. If a cleaner does not meet the threshold requirements, the cleaner would be referred to Regulation 1524 for guidance regarding how tax applies to its alteration charges. Regulation 1524 would be amended to clarify how tax applies to alteration charges in general.

#### **V. Discussion**

**Current statutory provisions regarding cleaners and alteration charges** – RTC section 6018.6, *Alterations, cleaning, or dyeing of garments*, provides that cleaners are consumers of property used in their cleaning operations and are not required to hold seller's permits. Unlike other garment-alteration establishments, the law provides that cleaners who provide garment alterations to their customers (whether the alterations are to new or used garments) are providing nontaxable services and, therefore, are the consumers of items furnished or used in altering the garments as long as 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.

RTC section 6018.6 defines cleaners as those who (1) operate a location or locations as a pickup and delivery point for garment cleaning; or (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.

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

- 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.

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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, charges for altering garments, charges for altering other personal and household items, charges for creating new items such as wearing apparel, *and* the cleaner's sales of miscellaneous products (e.g., lint brushes, abandoned clothing, or ties).

**Alteration of garments by a third party** – As explained, cleaners who fulfill the threshold requirements of RTC section 6018.6 are consumers, not retailers, of the property used or furnished in altering new and used garments alike. Therefore, when the cleaner contracts with a third party, such as a tailor, for the alteration of garments instead of performing the alterations themselves, the third party's charge to the cleaner for altering the garments is subject to tax as provided by Regulation 1524, proposed subdivision (b)(1). Even though the cleaner may hold a seller's permit due to its sales of miscellaneous items, since the cleaner is a consumer under RTC section 6018.6, it may not issue the third party a resale certificate for such alterations.

**Charges for altering garments and other items** – In general, whether tax applies to a person's charge for altering garments, personal items, or household items is dependent on whether the altered item is "new" or "used" at the time the alterations are performed. The Board has consistently held that the "processing" of "new" material furnished by a consumer is a sale as defined by RTC section 6006. This includes the altering of "new" garments, personal items, and household items. Altering "used" items has consistently been interpreted as repair or reconditioning labor and excluded from the definition of a sale under RTC section 6006.

Persons who alter "new" garments (except for cleaners who fulfill the requirements of RTC section 6018.6) or "new" personal and household items are regarded as manufacturing, producing, processing, or fabricating personal property. Accordingly, they are required to hold seller's permits and report the taxes due on charges to their customers for labor and materials.

Labor charges made for altering "used" garments, personal items, or household items are considered nontaxable repair or reconditioning labor. Except under certain circumstances (see Exhibit 2), the person altering the used item is the consumer of the supplies and materials furnished in connection with the alterations.

**What is "fabrication" or a "step in the process"** – When changes are made to "new" garments or other personal and household items by cutting and re-sewing the item into a slightly different shape or length, the person making the change is performing a step in the process (fabrication) of producing a "new" product. Consequently, if changes are made to a "new" item to make it suitable for the customer to wear or use, those changes constitute a part of the process of fabrication. This is true even when an item is not remade into a different type of item (i.e., change a coat into a cape).

Historically, the Board has considered an item "new" when the item is brought in by the customer without hems or cuffs, or with store tags or labels still attached, or the item is clearly new and unworn/unused to the observer. In essence, an item is considered new until such time the customer has worn or used the item for its intended purpose.

On the other hand, labor charges for mending, shortening or lengthening, taking in or letting out, or otherwise altering "used" garments or other personal and household items are not taxable when such alterations merely refit or repair the item for the use for which it was originally produced. An item is considered "used" when it has been worn or used for its intended purpose.

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**Current provisions in Regulations 1506 and 1524** – Guidance regarding how tax applies to the gross receipts of launderers and cleaners is currently provided in Regulation 1506, subdivision (b)(1), which also provides guidance for “barbers,” “beauty shop operators,” and “shoe polishers.” Subdivision (b)(2) discusses the application of tax to the charges made by launderers and cleaners for the rental of 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. Launderers and cleaners are consumers of the items rented.

Guidance regarding how tax applies to charges for altering new garments is provided in the current version of 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 altering garments and, essentially, restates the provisions of RTC section 6018.6.

## **VI. Alternative 1 - Staff Recommendation**

### **A. Description of Alternative 1**

Staff recommends that Regulation 1506 be amended to clarify how tax applies to charges made by cleaners for their cleaning and dyeing services and when such persons are required to hold a seller’s permit. The proposed amendments also clarify how tax applies to a cleaner’s alteration charges when the cleaner meets the threshold requirements of Revenue and Taxation Code section 6018.6. Cleaners that do not meet the threshold requirements would rely on Regulation 1524 for guidance regarding their alteration charges. Staff also recommends amending Regulation 1524 to clarify how tax applies to charges for the alteration of new and used items in general.

**Proposed Regulation 1506** – Staff recommends that a new subdivision (c) be added to Regulation 1506 and the current subdivision (c) be renumbered as subdivision (d). Proposed subdivisions (c)(1) and (c)(2) clarify how tax applies to a cleaner’s charges for its cleaning and rental services, and proposed subdivision (c)(3) clarifies how tax applies to charges for dyeing garments.

Staff also recommends that subdivision (b)(2) in Regulation 1524 (current version), which restates the requirements of RTC section 6018.6, be removed from the regulation and incorporated into proposed, renumbered subdivision (c)(4)(A) of Regulation 1506. A new paragraph (B) would also be added to subdivision (c)(4) to clarify how tax applies to the charges by a third party who alters the garments on behalf of the cleaner. Proposed subdivision (c)(5) would be added to Regulation 1506 to clarify how tax applies to a cleaner’s sales of miscellaneous items and the need for the cleaner to hold a seller’s permit when making such sales.

**Proposed Regulation 1524** – Staff recommends that the provisions regarding the application of tax to alterations to “new” garments in the current version of Regulation 1524, subdivision (b)(1) be rewritten and expanded to clarify how tax applies to charges for altering “new” items in general, including garment alterations by cleaners who do not meet the threshold requirements of RTC section 6018.6. Proposed subdivision (b)(1)(B) clarifies how tax applies to the charges for altering “used” items and explains under what circumstances the person providing the alteration service would be a retailer of the supplies and materials furnished in connection with the alteration of the “used” item.

The proposed amendments to Regulations 1506 and 1524 are reflected in Exhibits 2 and 3, respectively.

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**B. Pros of Alternative 1**

The proposed amendments provide the clarification necessary for the cleaner to determine whether it is required to hold a seller's permit. When required, the proposed amendments assist the cleaner in properly reporting and remitting the taxes due on its alteration or dyeing charges, as well as its sales of miscellaneous items.

**C. Cons of Alternative 1**

None.

**D. Statutory or Regulatory Change for Alternative 1**

No statutory change is required. However, staff's recommendation does require the amendment of Regulations 1506 and 1524.

**E. Operational Impact of Alternative 1**

Staff will notify taxpayers of the amendments to Regulations 1506 and 1524 through an article in the Tax Information Bulletin (TIB). Staff will also publish a *Tax Fact* to provide additional clarification to cleaners.

**F. Administrative Impact of Alternative 1**

**1. Cost Impact**

The workload associated with publishing the regulations, TIB article, and *Tax Fact* is routine. Any corresponding cost would be absorbed within the Board's existing budget.

**2. Revenue Impact**

None. See Revenue Estimate (Exhibit 1)

**G. Taxpayer/Customer Impact of Alternative 1**

Overall taxpayer impact is minimal since the proposed amendments clarify rather than change the current application of tax.

**H. Critical Time Frames of Alternative 1**

Implementation will take place 30 days following approval of the regulations by the State Office of Administrative Law.

**VII. Alternative 2 – Do Not Amend**

**A. Description of Alternative 2**

Do not amend Regulation 1506 or Regulation 1524.

**B. Pros of Alternative 2**

None.

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**C. Cons of Alternative 2**

Representatives from the California Cleaners Association and the Korean Dry Cleaners Association have expressed their concern regarding the lack of clarification in the current versions of Regulations 1506 and 1524. Retaining the status quo and not amending the regulations will not take care of those concerns or provide the necessary guidance to cleaners and persons who perform alterations on the cleaner's behalf.

**D. Statutory or Regulatory Change for Alternative 2**

None.

**E. Operational Impact of Alternative 2**

None.

**F. Administrative Impact of Alternative 2**

**1. Cost Impact**

None

**2. Revenue Impact**

None – See Revenue Estimate (Exhibit 1)

**G. Taxpayer/Customer Impact of Alternative 2**

Currently, there is some misunderstanding within the industry regarding when a cleaner is required to hold a seller's permit and, when required, what portion of its sales or services would be subject to tax. Without clarifying language in Regulations 1506 and 1524, there will continue to be confusion and misunderstanding within the industry.

**H. Critical Time Frames of Alternative 2**

None.

**Preparer/Reviewer Information**

Prepared by: Tax Policy Division

Current as of: 08/28/2008

**REVENUE ESTIMATE**

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION



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**Proposed regulatory amendments to clarify the application of  
tax to alteration charges**

**Alternative 1 – Staff Recommendation**

Staff recommends amending Regulation 1506 to clarify that:

- Unlike other garment-alteration establishments, clothes cleaners and dyers are consumers, not retailers, of their garment alterations (new and used alike) provided their alteration activities represent a small percentage of their business.
- Clothes cleaners are consumers of the supplies and other materials used in performing their cleaning services and tax applies to the sale to them of the supplies and other materials and not to their charges for their clothes-cleaning services.
- Persons who provide dyeing services are retailers, not consumers, when their charges are for the dyeing of *new* items, including garments, and tax applies to their gross receipts from such sales. They are consumers of the supplies and materials used in dyeing *used* items and tax applies to the sale to them of the supplies and materials and not to their charges for their dyeing services.
- When clothes cleaners and dyers who meet the requirements of Regulation 1506 contract with a third party such as a tailor for the alteration of garments instead of performing the alterations themselves, they are consumers, not retailers, of the alterations provided by the third party, and may not issue a resale certificate to the third party for such alterations.

Staff also recommends amending Regulation 1524 to clarify that tax applies to charges for the alteration of new items (e.g., garments, personal items, and household items) by persons who are in the business of providing alteration services, including clothes cleaners and dyers who do not meet the requirements of Regulation 1506. Labor charges for the alteration of used items are not taxable.

**Other Alternative Considered**

Do not revise Regulation 1506 or 1524.

Revenue Estimate

## **Background, Methodology, and Assumptions**

### **Alternative 1 – Staff Recommendation**

There is nothing in staff recommendation regarding amendments to Regulation 1506 and Regulation 1524 that impact sales and use tax revenue. Proposed amendments to Regulation 1506 clarify how tax applies to a cleaner's charges for cleaning and rental services and clarify how tax applies to charges for dyeing garments. In addition, these proposed amendments clarify that clothes cleaners and dyers are consumers of their garment alterations (new and used alike) provided their alteration activities represent a small percentage of their business. The proposed amendments also clarify how tax applies to the charges by a third party who alters the garments on behalf of the cleaner. Further, these amendments clarify how tax applies to a cleaner's sales of miscellaneous items and the need for the cleaner to hold a seller's permit when making such sales.

Proposed amendments to Regulation 1524 rewrite and expand the provisions regarding the application of tax on alterations to "new" garments to clarify how tax applies to charges for altering "new" garments in general. This includes garment alterations by cleaners who do not meet the threshold requirements of Revenue and Taxation Code section 6018.6. In addition, these amendments clarify how tax applies to charges for altering "used" items and explain under what circumstances the person providing the alteration service would be a retailer of the supplies and materials furnished in connection with the alteration of the "used" item.

### **Alternative 2 - Other**

There is nothing in the alternative 2 that would impact sales and use tax revenue.

## **Revenue Summary**

Alternative 1 – staff recommendation does not have a revenue impact.

Alternative 2 – alternative 2 does not have a revenue impact.

## **Preparation**

Mr. Bill Benson, Jr., Acting Manager, Research and Statistics Section, Legislative and Research Division, prepared this revenue estimate. Mr. Jeff McGuire, Tax Policy Manager, Sales and Use Tax Department, reviewed this revenue estimate. For additional information, please contact Mr. Benson at (916) 445-0840.

Current as of August 28, 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~~ customers 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 CLEANERS AND DYERS

(1) CLOTHES CLEANING – IN GENERAL. Persons who provide clothes-cleaning services are consumers of the supplies and other materials used in performing their cleaning services, and tax applies to the sale to them of the supplies and other materials and not to their charges for such services.

(2) RENTALS. Clothes 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.

(3) CLOTHES DYEING – IN GENERAL. Persons who provide dyeing services are retailers, not consumers, when their charges are for the dyeing of new fabrics, garments, or other such items and tax applies to their gross receipts from such sales. Persons who dye new items are required to hold a seller's permit.

Dyers are consumers of the supplies and other materials used in dyeing used fabrics, garments, or other such items and tax applies to the sale to them of the supplies and other materials and not to their charges for their dyeing services.

(4) ALTERATION OF GARMENTS – IN GENERAL. For the purposes of this subdivision (c), alteration of garments means and includes any work performed upon new or used men's, women's and children's clothing to meet the requirements of the customer whether the work involves the addition of material to the garment, removal of material, refitting, or repairing. Alteration of garments does not mean or include the process of dyeing garments. Alteration of garments also does not mean or include work performed upon new or used personal and household items such as

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handbags, stuffed animals, bedding, and draperies. The application of tax to a clothes cleaner's or a dyer's charges for the alteration of personal or household items is explained in Regulation 1524.

(A) Alteration of Garments by Clothes Cleaning or Dyeing Establishments. A clothes cleaning or dyeing establishment, including wet cleaners (e.g., launderers) and dry cleaners, means and includes a clothes cleaner or dyer who (1) operates a location or locations as a pickup and delivery point for garment cleaning, or (2) provides spotting and pressing services on the premises, but not garment cleaning, or (3) operates a garment cleaning or dyeing plant on the premises.

A clothes cleaner or dyeing establishment described above is the consumer of property used or furnished in the alteration of new or 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 a clothes cleaner or dyer is not an establishment as described or does not meet the requirements of this paragraph (A), tax applies to the clothes cleaner's or the dyer's charges for the alteration of garments as explained in Regulation 1524.

(B) Alteration of Garments by a Third Party. When a clothes cleaner or dyer who meets the requirements of subdivision (c)(4)(A) contracts with a third party such as a tailor for the alteration of garments instead of performing such alterations itself, the clothes cleaner or dyer is a consumer, not a retailer, of the alterations provided by the third party and may not issue a resale certificate to the third party for such alterations. Tax applies to the third party's charges to the clothes cleaner or dyer for such alterations as explained in Regulation 1524.

(5) MISCELLANEOUS SALE OF ITEMS. Clothes cleaners and dyers, whether or not they meet the requirements of subdivision (c)(4)(A), are retailers of any supplies, used items, or other tangible personal property such as lint brushes, abandoned garments, wood hangers, or novelty items, which they sell to customers 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.

**(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 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.

## 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, producers, processors, and fabricators 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, producer, processor, or fabricator, 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 to create or produce the tangible personal property, or of any step in the manufacturing, producing, processing, or fabricating, 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.~~ ALTERATION OF NEW AND USED ITEMS.

~~(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.~~

(A) Alteration of New Items means and includes any work performed upon new items such as garments, bedding, draperies, or other personal and household items to meet the requirements of the customer, whether the work involves the addition of material to the item, the removal of material from the item, the rearranging or restyling of the item, or otherwise altering the item, when such alterations result in the creation or production of a new item or constitute a step in the creation or production of a new item for the customer.

Charges for the alteration of new items are subject to tax, except as provided in subdivision (c)(4) of Regulation 1506, regardless of whether the charges for the alterations are separately stated or included in the price of the item, or whether the alterations are performed by the seller of the item or by another person. Persons engaged in the producing, processing or fabricating of new items are retailers, not consumers, of the alterations provided to the customer and are required to hold a seller's permit.

(B) Alteration of Used Items means and includes the mending, shortening or lengthening, taking in or letting out, or otherwise altering used items such as garments, bedding, draperies, or other personal and household items when such alterations merely refit or repair the item for the use for which it was created or produced.

Charges for the alteration of used items are not subject to tax. Generally, persons performing the alteration of used items are consumers, not retailers, of the supplies and materials furnished in

connection with the alterations, and tax applies to the sale of the supplies and materials to such persons.

Except as provided in subdivision (c)(4) of Regulation 1506, persons performing the alteration of used items are retailers, not consumers, of the supplies and materials furnished in connection with the alterations when the retail value of the supplies and materials is more than 10 percent of the total charge for the alterations, or if the invoice to the customer includes a separate charge for such property. When such persons are retailers, not consumers, tax applies to the fair retail selling price of the supplies and materials to the customer.

When the retail value of the supplies and materials is more than 10 percent of the total charge to the customer, the person performing the alterations must segregate on the invoice to the customer and in its records, the fair retail selling price of the supplies and materials from the charge for the alterations. "Total charge" means the combined total of the retail value of the supplies and materials furnished or consumed as part of the alterations and the labor charges for the alterations.

~~—(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 Establishment. A person who operates a clothes cleaning or clothes dyeing establishment 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.~~

(32) 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.