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June 8, 1994

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*Executive Director*

Mr. J--- L---  
L--- Shelving & Filing Systems  
P. O. Box XXXXX  
--- ---, CA XXXXX

Re: SR -- XX-XXXXXX

Dear Mr. L---:

This is in response to your letter dated April 11, 1994, in which you state that L--- Shelving and Filing (L---) converted an existing filing system to a new filing system for its customer. You ask whether this transaction is taxable.

Our understanding of the transaction about which you inquired is that you: (1) sold file folders, back-up file folders, extra alphabetic letters, and labels to the customer; (2) wrapped three alpha labels, one name label, and a classification label on each new file folder; and (3) converted and shelved an old alphabetic file system in new file folders, as well as integrated an existing separate filing system into the new filing system. We assume that the freight charge stated in your letter is a charge for freight to your customer.

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by their gross receipts from retail sales of tangible personal property in this state unless the sale is specifically exempt by statute. A "retail sale" or "sale at retail" means a sale for any purpose other than resale in the regular course of business in the form of tangible personal property. (Rev. & Tax. Code § 6007.) This means that, in the performance of your contract, if you sell tangible personal property to your customer for any purpose other than resale, it is a retail sale. Based on our understanding of the facts, we regard you as the retailer of the new file folders,

back-up file folders, the extra alphabetic letters, and the labels. Your retail sale of such tangible personal property to your customer is subject to sales tax.

The next issue is whether the charge for the wrapping of three alpha labels, one name label, and a classification label on new file folders is includible within the taxable gross receipts of sale. Charges for the cost of materials used, labor or service cost, and any other expense as part of the sale, are not deductible from gross receipts unless specifically excluded by statute. (Rev. & Tax. Code §§ 6012(a)(2), and (b)(1).) Revenue and Taxation Code section 6006(b) defines "sale" to mean and include producing, fabricating, processing, printing, or imprinting of tangible personal property for consideration for customers who furnish materials used in producing, fabricating, processing, printing, or imprinting. As explained in Regulation 1526(b):

"Producing, fabricating and processing include any operation which results in the creation or production of tangible personal property or which is a step in a process or series of operations resulting in the creation or production of tangible personal property."

Business Taxes Law Guide Annotation 515.1180 (12/4/64) provides, in pertinent part, that:

"The application of classification labels, card pockets and a college name stamped in the book, are not [nontaxable] professional library services. They are mechanical processing included within the definition of sale in Section 6006(b) of the Sales and Use Tax Law and are subject to tax as part of the gross receipts."

This means that charges for steps taken in a series of operations or steps in the mechanical processing of the finished product are subject to tax. By analogy to the application to library books of classification labels, card pockets, and college stamps prior to putting the books into the library system, the wrapping of the file folders with alpha, name, and classification labels is a step in a series of operations or steps in the mechanical processing of the files which become a part of the new filing system. Thus, it is processing or fabrication labor necessary to the finished product. When performing processing or fabrication labor on the seller's property, the total charges for labor and materials or parts used in producing the finished article are included in the taxable gross receipts. (Rev. & Tax Code § 6012.) For example, tax applies to charges for assembling lockers and shelving sold by a retailer, as explained in Business Taxes Law Guide Annotation 435.0020 (7/19/50). (See also BTLG Annot. 435.0060 where charges of a retailer for assembling shelving on the customer's premises is taxed (3/15/66).) Even if the property is furnished by the consumer, charges for fabrication labor thereon are taxable. (Duffy v. State Board of Equalization (1984) 152 Cal. App. 3d 1156, 199 Cal. Rptr. 886; BTLG Annot. 435.0020, supra.)

Another issue is the taxability of charges for converting, integrating, and shelving existing filing systems into a new filing system, that is, transferring the contents of existing files into new files, which are then shelved. These tasks have the characteristics of a service which is part of a sale of the new filing system. In general, the charges for services a part of a sale must be included in the taxable gross receipts. Any service that a seller must perform to sell tangible personal property, or that a customer must pay for as a condition of the retail sale, is subject to tax. (BTLG Annot. 295.1690 (8/16/78).) If services are optional and not an integral part of the retail sale of tangible personal property, separately stated charges for these services are excluded from tax. (BTLG Annot. 295.1760 (1/17/51).)

We regard the converting, integrating, and shelving of the finished filing system listed in the "Acceptance" agreement signed by both parties as services. You have not provided us enough information to determine whether these services are part of the sale. If L---'s customer can obtain the filing system without these services, we would not regard them as part of the sale, and the charge for them would not be taxable. If so, they should be stated separately. If, on the other hand, these are services L---'s customer must purchase in order to obtain the filing system, they are services part of the sale, and the charges for them are taxable as part of the gross receipts from the sale of the filing system.

On one of the documents enclosed with your inquiry, which is entitled "Invoice," there is a separately stated charge for freight on which sales tax reimbursement is not computed. You do not indicate whether the freight charges you mention are for delivery by common carrier or by your own facilities. Transportation charges are excluded from the measure of tax only under certain conditions. Regulation 1628 explains the application of tax to transportation charges:

"(a) Except as provided in paragraph (c) below<sup>1/</sup>, in the case of a sale, whether by lease or otherwise, tax does not apply to 'separately stated' charges for transportation of property from the retailer's place of business or other point from which shipment is made 'directly to the purchaser,' provided the transportation is by other than facilities of the retailer, i.e., by United States mail, independent contract or common carrier. The place where the sale occurs, i.e., title passes to the customer or the lease begins, is immaterial, except when the property is sold for a delivered price or the transportation is by facilities of the retailer, as explained in (b) below.<sup>2/</sup> The amount of transportation charges excluded from the measure of tax shall not exceed the cost of the transportation to the retailer.

"Transportation charges will be regarded as 'separately stated' only if they are separately set forth in the contract for sale or in a document reflecting that

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<sup>1/</sup>Transportation of landfill material.

<sup>2/</sup>Transportation by retailer's facilities or when property is sold for a delivered price.

contract, issued contemporaneously with the sale, such as the retailer's invoice. The fact that the transportation charges can be computed from the information contained on the face of the invoice or other document will not suffice as a separate statement. If a separately stated charge is made designated 'postage and handling' only that portion of the charge which represents actual postage may be excluded from the measure of tax.

"Property will not be considered delivered 'directly to the purchaser' if it is shipped to the retailer, to the retailer's agent or representative, or to anyone else acting in the retailer's behalf. Any separately stated charges by the retailer for the transportation of property to, rather than from, the retailer's place of business, or to another point from which the property will then be 'delivered directly to the purchaser,' are included in the measure of tax. Such charges represent incoming freight and are taxable as part of the cost of the property sold by the retailer.

"(b) ... .

"(2) Except as provided in paragraph (c) below<sup>3/</sup>, when transportation is by facilities of the retailer or the property is sold for a delivered price, tax applies to charges for transportation to the purchaser unless (a) the transportation charges are separately stated, (b) are for transportation from the retailer's place of business or other point from which shipment is made directly to the purchaser and (c) the transportation occurs after the sale of the property is made to the purchaser. When the sale occurs before the transportation to the purchaser commences, the tax does not apply to separately stated charges for the transportation. The amount that may be excluded from the measure of the tax cannot exceed a reasonable charge for transportation by other than facilities of the retailer." (Footnotes added.)

This means that if transportation is by common carrier, the charges are taxable unless two conditions are satisfied: (1) the charge must be separately stated to the purchaser, that is, specifically set forth in the contract of sale or an invoice reflecting that contract, and (2) the charge must be for transportation of the property directly to the purchaser. If transportation is by facilities of the retailer, the charges are taxable unless the two conditions mentioned above are satisfied and, in addition, transportation must occur after the sale of property to the purchaser. It is not clear from the information provided us whether the transportation was by common carrier or by your own facilities, whether the charge is for transportation directly to the purchaser, or if transportation occurred after sale of the property to the purchaser. Without more information

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<sup>3/</sup>Transportation of landfill material.

Mr. J--- L---

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June 8, 1994  
515.1450

about your freight charges, we are unable to determine whether they may be excluded from the measure of tax.

If you have further questions, feel free to write again.

Sincerely,

Pat Hildebrand  
Staff Counsel

PH:cl

cc: Santa Ana District Administrator