STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ENROLLED BILL ANALYSIS

Date Amended:	**Vetoed**	Bill No:	**AB 659**
Tax:	**Sales and Use**	Author:	**Hayashi**
Related Bills:		Position:	**Support as Sponsor**

BILL SUMMARY

This bill would provide that, until January 1, 2013, specified garment cleaning establishments shall be regarded as consumers, rather than retailers, of tangible personal property they sell, provided those sales do not exceed one-half of one percent of their total gross receipts for the preceding calendar year.

ANALYSIS

CURRENT LAW

Under California's Sales and Use Tax Law (Part 1, Division 2 of the Revenue and Taxation Code, commencing with Section 6001), except where specifically exempted by statute, sales tax is imposed on all retailers for the privilege of selling tangible personal property at retail in this state.

Under the law, sales of services are generally not subject to the sales or use tax unless, among other reasons, the services relate to the fabrication of tangible personal property. A service relating to the fabrication of tangible personal property would include such activities as alterations to new clothing.

With respect to garment cleaning establishments, Section 6018.6 of the Sales and Use Tax Law contains special provisions relating to their charges for alterations. 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 under existing law.

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 two conditions for the exclusion to apply:

- 75 percent or more of the cleaner's total gross receipts must come from their clothes cleaning or dyeing services.
- 20 percent 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, 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 collar stays).

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board's formal position.

PROPOSED LAW

This bill would amend Revenue and Taxation Code Section 6018.6 to provide that, until January 1, 2013, garment cleaning establishments, as described in existing law, shall be regarded as consumers and not retailers of other tangible personal property they sell, provided such sales are less than one half of one percent of their total gross receipts.

The bill would specify that if the sales of other tangible personal property by a garment cleaning establishment exceed one half of one percent or more of the establishment's total gross receipts during the preceding calendar year, establishment shall be regarded as a retailer of the tangible personal property and sales tax shall apply to the gross receipts from those sales.

As a tax levy, the bill would become effective upon enactment, but operative on the first day of the calendar quarter commencing more than 90 days after the enactment date.

COMMENTS

1. **Sponsor and purpose.** This bill is sponsored by the Board in order to relieve dry cleaning establishments from the burdensome and time-consuming task of maintaining records and filing sales tax returns for negligible sales of tangible items. Some dry cleaners make incidental sales of items such as lint brushes and collar stays simply as a matter of convenience to customers with very little profit margin, and the burden associated with complying with the tax law far outweighs the economic benefit to California.
2. **Amendments.** The August 17, 2009 amendments were technical changes related to the sunset provisions. The July 15, 2009 amendments added a sunset date of January 1, 2013. The May 11, 2009 amendments made minor nonsubstantive changes.
3. **What brought this issue to light?** The bill stems from the Board's education outreach efforts wherein 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 the industry 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. Consequently, even though a small percentage of these establishments make infrequent sales of inexpensive items, such as lint brushes and collar stays as a matter of convenience to customers with little markup, some of the establishments were unaware of their tax reporting obligations.
4. **The Legislature has recognized the uniqueness of dry cleaning establishments.** Through enactment of a 1983 measure specifically directed towards dry cleaning establishments and their charges for alterations (AB 1997, Stats. 1983, Ch. 605), the Legislature recognized the need for special tax treatment for this industry. It recognized that these are traditionally service establishments, rather than retail outlets, and that most are small businesses where sales tax compliance costs and necessary recordkeeping are unduly burdensome. Enactment of this measure would further support this concept by simply classifying these establishments as consumers of any incidental sales of tangible property they make, provided they do not exceed the limitations set forth in the bill. As consumers, the dry cleaning establishments would be required to pay tax on their purchases of any

tangible personal property sold, and the subsequent sales of these items would be excludable from tax.

COST ESTIMATE

Enactment of this bill would eliminate the need for the Board to register a large portion of the estimated 1,200 dry cleaning establishments that are not currently registered that sell tangible personal property (see revenue estimate below: 8,000 establishments x 15%), and process an equivalent amount of sales tax returns. As such, the workload savings would more than likely offset the $12,257 potential revenue loss estimated below.

REVENUE ESTIMATE

BACKGROUND, METHODOLOGY, AND ASSUMPTIONS

The Sales and Use Tax Department staff examined sales and use tax returns of those garment cleaning establishments it was able to identify that are registered with the Board in 2006. Taxable sales of miscellaneous items reported on those returns were about $190 per year. Based on discussions with the California Air Resources Board and the cleaner associations, staff estimates that there are 8,000 dry cleaners in California (4,000 dry cleaning plants and 4,000 pick-up/drop-off stores). The Korean Dry Cleaners and Laundry Association estimates that 15% of garment cleaners sell tangible personal property, such as lint brushes, collar stays, and abandoned clothing. Using this estimate, the annual taxable sales of tangible personal property by garment cleaning establishments would be about $228,000 (8,000 establishments x 15% x $190 = $228,000).

This bill would classify these establishments as consumers of tangible personal property they sell. As consumers, these establishments would only pay tax on their purchases of any tangible goods sold; their sales of these items would no longer be subject to tax. According to representatives of the industry, the mark up on sales to consumers of convenience items (such as lint brushes and collar stays) is low. We estimate that mark up to be 20%. With respect to abandoned clothing, the mark-up would be 100%.

If we assume that half of the sales are convenience items at a 20% markup and the remaining half is abandoned clothing at a 100% markup, we can compute the decrease in taxable measure attributable to this measure, as follows:

$228,000 x 50% x 20%	= $ 22,800
$228,000 x 50% x 100%	= 114,000
Total	$136,800

At an average statewide sales and use tax rate of 9%, the annual sales and use tax loss would amount to $12,312 ($136,800 x 9%).

REVENUE SUMMARY

This bill would result in an annual state and local revenue decrease of $12,257 as follows:

	Revenue Loss
State (6.00%)	$ 8,208
Fiscal Recover Fund (0.25%)	342
Local (2.00%)	2,736
Special District (0.75%)	1,026
Total Annual Revenue Loss	$12,312

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