

Memorandum

515.0015

To: Mr. J. D. Dotson

March 31, 1980

From: Gary J. Jugum

Subject: Course materials included in
lump-sum charge for educational services

In conjunction with the decision of the referenced topic scheduled for April 5, 1980, we believe it appropriate to undertake a fundamental review of the issues which arise in connection with the question as to whether sales tax applies to some fractional amount of lump-sum charges made in connection with the performance of educational services.

The basic references are three:

Revenue and Taxation Code Section 6006

“Sale” means “any transfer of title...of tangible personal property for a consideration.”

Regulation 1501

“The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service.”

Revenue and Taxation Code Section 6012

“‘Gross receipts’ means the total amount of the sale price...[with only limited specified deductions.]”

The principal secondary references are BTLG Anno. 175.0020, 295.0140, and 480.0040, which provide as follows:

“An out-of-state agency which sells correspondence school courses is a retailer of the lesson materials and books regularly sold to its students and is liable for collection of use tax on the fair retail selling price of the materials and books.” [175.0020 11/19/65.]

“Tax applies to books and lesson materials furnished to students in connection with a correspondence course. If the price of the books and materials is not separately stated, the tax applies to their fair retail selling price. The school may purchase all such books and materials for resale. Tax does not apply to books and materials mailed to an out-of-state student.” [295.0140 10/23/53.]

“An out-of-state agency which sells correspondence school courses is a retailer of the lesson materials and books regularly sold to its students and is liable for collection of use tax on the fair retail selling price of the materials and books.” [480.0040 11/19/65.]

Historically, the fundamental question to be asked has been - - is there a taxable sale or is there a service? If a transaction has been classed as a “sale,” the all the receipts from the transaction have been regarded as taxable except those specifically excluded by Section 6012. If a transaction has been classed as a “service” transaction, then the transaction has been treated as nontaxable. In other words, the historical rule has been a rule of all-or-nothing insofar as application of the tax is concerned.

Lately, there have been various situations which the Board has classified as combination sale and service transactions. In most instances in these cases there has been a segregation, by the seller and the buyer, of a price (separate charge) identified to the tangible personal property transferred. In some cases the Board has treated the seller as the retailer of the property transferred and measured the tax by the separate charge indentified and agreed to by the parties.

Recently, the Board has treated certain transactions as combination sale and service transaction, but has not taxed the entire contract price, even though the contract price has been a lump-sum amount with no itemization of the tangible personal property transferred. In other words, the Board has unilaterally determined the price at which the property was sold by announcing that the measur of tax will be some artificial amount usually described as “fair retail value.” In some cases this hybrid approach has resulted from practical necessity. In other cases it appears as though the staff has generalized the rule of exception into a rule of universal applicability. That is, it would appear that we have lost sight of our basic test – the true object test – and created a substitute test – the two object test – which essentially nullifies an extended history of reasonably uniform administrative interpretation.

On April 13, 1979, the Board distributed to interested parties a proposed amendment to Regulation 1506, "Miscellaneous Service Enterprises," intended to make specific application of the sales tax to course materials provided by schools. The proposed amendment defined a school as "an institution or place for instruction or education which provides educational materials in connection with significant instructional services. [Emphasis added.] The amendment provided that "Schools which make a charge to students are retailers of learning aides, such as texts, books, kits, tools, test equipment, cassette tapes, and other similar educational materials title to which is transferred to students, whether or not a separate charge is made for such materials." The regulation further provides that "Persons who sell educational materials without providing significant instructional services are retailers of tangible personal property, and tax applies to their sales, "- meaning that tax applies to the entire charge made to the student in cases of this type. [Emphasis added.]

We are of the opinion that while the basic distinction drawn in the regulation – between schools that provide significant instructional services and persons who do not provide significant instructional services – is sound, the application of the distinction to the various factual situations is incorrect. That is, the distinction between schools which provide significant educational services and persons which do not provide significant educational services is a restatement of the distinction between those transactions where the object of the transaction is a service and those transactions where the object of the transaction is a sale. Generally, in the situation where actual classroom instructions is provided and the student is furnished with printed matter or special instructional sound recordings without separate charge, we think the object of the transaction is properly a service and that the school is properly the consumer of the materials furnished to the student. The true object of the contract test is inherently a factual test and each case must be looked at individually for the purpose of weighing the significance of the property to the service. However, as a general rule, and consistent with 40 years of administrative practice, where classroom instruction takes place, it seems appropriate under the Board's own regulation and the court cases to apply the all-or-nothing rule.

The correspondence school case may be distinguished in that the degree of service – providing a physical place for instruction and providing instructors who are physically present- is markedly less. It is true a service is performed in mailing the property and in grading the matter, but the service is not so "significant" as to result in our viewing the transaction as a service transaction. If the transaction is not a service transaction, then either tax applies to the entire charge or the hybrid fair retail value should be applied. Since we have utilized the hybrid rule for 27 years there seems to be little reason the chage that rule at this date.

In the situation where a school conducting actual classroom instruction provides its students with test equipment or kits for building television sets, the school might arguably be treated as the retailer of the item even though no separate price can be made. The problem is in determining the selling price of the property. In the case where the property is purchased from an outside source it would appear appropriate for purposes of the efficient administration of the sales tax ordinarily to treat the school as selling the property at cost, since the hypothetical

markup would be speculative and since the basic conclusion would already have been reached that the school is performing a service, not retailing tangible personal property. That is, once it is concluded that tax does not apply to all receipts collected from the student there seems little reason to relate a portion of the school's overhead and profit to the property transferred only incidentally to the performance of the true object of the contract, the educational service. In the rare case where the school is the manufacturer of the equipment items transferred to the student, then a computed price would be appropriate as required by necessity.

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