

**STATE BOARD OF EQUALIZATION**

1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 327-5428

June 20, 1990

Mr. H--- F---
N--- Corp.
P.O. Box XXXXX
--- ---, CA XXXXX

Dear Mr. F---:

Re: SR -- XX-XXXXXX-010

Enclosed is a copy of the Decision and Recommendation pertaining to the petition for redetermination in the above-referenced matter.

I have recommended that the determination be redetermined without adjustment as explained in the Decision and Recommendation.

There are three options available to you at this point.

1. If, after reading the Decision and Recommendation, you believe that you have new evidence and/or contentions, you should file a Request for Reconsideration. No special form is required to file the Request for Reconsideration, but it must be filed within 30 days from the date of this letter and clearly set forth any new contentions. If new evidence is the basis for filing the request, the evidence must be included. Direct any such request directly to me, with a copy sent to the State Board of Equalization, P.O. Box 942879, Sacramento, CA 94279-0001, Attn: Principal Tax Auditor. I will subsequently notify you whether the request has been taken under review or whether the request is insufficient to warrant an adjustment. If I conclude that no adjustment is warranted, I will then notify you of the procedure you can follow to request an oral hearing before the Board.

2. If, after reading the Hearing Decision and Recommendation, you find that there is no basis for filing a Request for Reconsideration, but nevertheless desire to have an oral hearing before the Board, a written request must be filed within 30 days with Ms. Janice Masterton, Assistant to the Executive Director, Board of Equalization, P.O. Box 942879, Sacramento, CA 94279-0001.

Mr. H--- F---
SR -- XX XXXXXX-010

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195.0925

3. If neither a request for Board hearing nor a Request for Reconsideration is received within thirty (30) days from the date of this letter, the Hearing Decision and Recommendation will be presented to the Board for final consideration and action.

Very truly yours,

Susan M. Wengel
Hearing Officer

SMW:te
Enc.

cc: D--- & T---
XXXX --- Blvd.
--- ---, CA XXXXX-XXXX
Attn: Mr. D--- W---
(w/enclosure)

Ms. Janice Masterton
Assistant to the Executive Director (w/enclosure)

Mr. Glenn Bystrom
Principal Tax Auditor (file attached)

--- -- District Administrator (w/enclosure)

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

195.0925

APPEALS UNIT

In the Matter of the Petition)	HEARING
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
N--- CORPORATION)	No. SR -- XX XXXXXX-010
)	
<u>Petitioner</u>)	

The above-referenced matter came on regularly for hearing before Hearing Officer Susan M. Wengel on February 13, 1990 in ---, California.

Appearing for Petitioner:

D--- -. W---
Certified Public Accountant

H--- -. F---
Certified Public Accountant

B--- -. I---
Certified Public Accountant
Manager of Accounting Services

N--- -. F---
Corporate Controller

Appearing for the Department
of Business Taxes:

Richard Hess
Supervising Auditor

Larry Rackley
Senior Tax Auditor

Protested Item

The protested tax liability for the period July 1, 1984 through June 30, 1987 is measured by:

<u>Item</u>	<u>State, Local and County</u>
(B)(1)(a) Counter and floor displays shipped with products.	\$ 859,891
(c) General supply items purchased for resale.	7,101
(B)(2)(c) General supply items purchased from out-of-state vendors.	2,112

Contentions of Petitioner

1. The counter “packers” and the floor “packers” are specially designed shipping cartons used to ship their trial-sized and regular-sized products.
2. The price value labels are not price tags but rather are informational stickers that become part of the product’s individual packaging once they are affixed to the outer cellophane wrapper which seals the boxed product.

Summary of Petition

Petitioner is a corporation engaged in business as a manufacturer and wholesaler of health and beauty products. During a routine audit the Department of Business Taxes (Department) ascertained that petitioner was sending its customers trial or sample sized products, as well as some of its regular sized products, in special packages. Petitioner refers to these special packages as “packers” or “prepacks”.

The petitioner will seasonally have a promotional period for each of its products. Each period lasts approximately two months and is designed so that the season of highest use relates to the time the product is promoted. For example, hand cream is promoted in winter. During these promotional periods, all orders for the products will be sent in the prepacks. No addition charge is made for the packers even though the cost is about \$3.00 to \$4.00 more than the conventional shipping, which is all cardboard with no colored pieces or advertising messages. The packers are used to fill all orders and reorders for the promoted product until the supply is depleted. Then all orders, even during the promotional period, are sent in the conventional manner. There are no extra products shipped with the packers that could be used to refill the tray.

The petitioner's manufacturing plant is located in --- --- and all the packaging and the finished goods are stored at this facility. The packers are designed by the petitioner's graphics department and manufactured by third parties. The actual placement of the products into the packers is done by petitioner's employees at petitioner's manufacturing plant.

Some of the packers are made entirely of cardboard and are designed to sit on a counter or shelf. They hold the trial-sized products and are constructed so that they can be removed from their corrugated shipping boxes and set on the counter in a display position by simply removing the liner and securing the header board, which has served as a lid over the products during shipping. (See Exhibit A) We note that these trial-sized products are sold to the customers and are not samples which are given away.

The prepacked units contain 12 to 18 products which are placed in paper, cardboard or plastic trays. The bases of the trays have slots where the various products can be placed. A cardboard liner is then placed over the products to secure their stability in the slotted tray during shipment. The tray, products and liners are all manufactured so that they can be securely slipped into a corrugated box for mailing or delivery.

In some of the larger packers, the unit will also include a header board and a sheet of instructions. (See Exhibit B) The header boards are made of colorful sturdy cardboard and show a picture of the product as well as a message which advertises the product. The header boards are wrapped in plastic to protect them during shipping. The floor displays contain a cardboard base which can be folded and assembled to form a base for the tray of products. (See Exhibit C)

The Department considered part of these packers to be shipping containers and the other parts to be promotional displays. The outer corrugated box and the inner corrugated liners were considered to be shipping containers. All the remaining portions, including the trays, stands, headers, and instructional materials, were considered to be promotional displays. The Department considered these displays to be marketing aids and the petitioner the consumer. Use tax was assessed measured by the cost of the displays.

The petitioner contends that the packers are shipping cartons designed and engineered to protect and house the products during shipment. Petitioner further notes that this is the only way the trial-sizes of their products are shipped.

The department further ascertained that petitioner was affixing a label to the product's individual box. (See Exhibit D) The label is the same color as the printing on the box to make it look like part of the printing. The label states something like "Save \$5.00" and "24.50 value for \$19.50". The label is placed on the box before the box is covered with cellophane. The Department considered these labels to be price tags and the petitioner the consumer of the

labels which were purchased for resale under resale certificates or ex-tax from out-of-state vendors.

Petitioner contends that the labels are designed to become part of the box and to show that the item is a promotional item. Petitioner has stated that it is less expensive for them to apply the label to their regular boxes than to print up special boxes for their promotional periods. Petitioner asserts that the label does not set a price because the retailer will set his own price. Rather, petitioner is of the opinion that the labels are used merely to attract attention and to show the customer that they are paying less for the product.

No penalties were assessed.

Analysis and Conclusion

The first issue to be addressed is whether the packers should be considered to be shipping containers in their entirety or whether a portion of them are more accurately classified as promotional displays.

Section 6364 of the Revenue and Taxation Code provides that tax does not apply to the storage, use or other consumption in this state of nonreturnable containers that are sold together with the contents. If the prepacks are classified as containers, they are nonreturnable containers which are sold with the contents and use tax will not apply.

Sales and Use Tax Regulation 1670 provides in subdivision (b) that manufacturers who provide marketing aids to persons engaged in selling their products without obtaining reimbursement equivalent to 50 percent of the purchase price of the aid are deemed to be the consumers of the property provided. In such case, use tax applies to the manufacturer purchasing the aid for distribution.

If the packers are found to be displays, the petitioner clearly made a taxable use of them when it received and stored them in California without separately billing the customer or increasing the price of its merchandise to cover the cost of the prepacks. In the case of Parfums Corday, Inc. v. State Board of Equalization (1986) 187 Cal.App.3d 630, the court held that Max Factor was the consumer of promotional displays it purchased from manufacturers under resale certificates. They stored the items in their Los Angeles warehouse, assembled them into prepacks, and shipped them to their customers without making a separate charge or increasing the cost of the merchandise placed in the prepacks.

The issue in the present appeal is whether petitioner's packers are displays, shipping containers, or both. The Department has taken the position as to the first type of packer that the brown corrugated outer box and the brown corrugated liner are nonreturnable shipping containers. We agree with this position as it is supported by Sales and Use Tax Annotations 195.0400 (4/18/50) and 195.0420 (3/2/60). Once the products have been shipped, the use of

these items is terminated. The remaining portions of the packers, however, must be classified as displays.

Sales and Use Tax Annotation 195.0340, dated February 4, 1953, provides that counter display cards which are primarily used for advertising and display purposes are not exempt as "containers" because their use in shipping the articles was merely incidental to the primary use. The tray portion of the sample packer has slots that hold the product. The depth of the slots have been designed so that the name of the product is always visible. If the design was focused on securing the product during shipping, the slots would be deeper so that the product would be more secure. Likewise, the top of the packer has been designed so that it will form a "header" once the packer is opened and displayed. The back has tabs which will interlock to secure the header in an upright position. The material used in the tray and header section is a light weight cardboard upon which colored photographs and printing have been placed. Clearly when the packers were designed, they were designed with the display of the product in mind. A customer can easily open a packer and set it up on its counter. This ease of assembly makes use of the packer by a customer more certain and hopefully will aid in selling more of petitioner's products. While the packer does have a certain amount of utility as a shipping container, that is not the purpose for which it was designed.

The second type of packer has the same outside corrugated mailing box and inside corrugated liner. Like the previous packer, these items are nonreturnable containers and are considered to be sold with the product.

The tray in this packer is a colored, formed piece of plastic that not only has slots for the product but has a sample of the product affixed that can be used by the purchasing public to sample the product. (See Exhibit B) Once again the slots are of an angle and depth so that the product's label is clearly visible and the words "free offer" are repeatedly visible to the buying public. The tester product, which is labeled as a "tester", has a shelf in the tray so that any spills from the tester will stay on the tray and not make a mess of the customer's shelf or counter. The tester product is firmly affixed to the tray to prevent theft.

Quite clearly, this product was meant to be used by the buying public. The header is separately packaged in plastic and enclosed with the plastic tray. It easily attaches to the back of the plastic tray and is made of a heavy duty cardboard that once attached to the tray will stand by itself without extra support. The header is likewise covered with colorful advertising of petitioner's product.

Like the packers for trial-sized products, these packers were also designed for display purposes and must be classified as displays. Once again, the trays do have a limited value as a shipping container, however shipping was not the purpose for which it was designed. This finding is supported by the fact that the packers cost \$3.00 to \$4.00 more than petitioner's conventional shipping packages.

The third type of packer is similar to the first two discussed above, however, it also has a fold out cardboard stand. (See Exhibit C) The stand, tray, products and header board

are all enclosed in a heavy cardboard box which has been considered to be a shipping container by the Department. Likewise, the brown cardboard dividers or spacers have also been classified as part of a shipping container.

The stand, tray, and header board of this packer are all made of heavy cardboard that has been painted and bears some type of advertising. Once assembled, the unit stands about 4-1/2 feet tall and conveniently displays the products. This unit was clearly designed for display purposes and must be classified as a display. While the tray portion does have some value as a shipping container, the main purpose for the packer is to display the product.

The second issue presented in this appeal is whether certain stickers which are affixed to the box before the outer cellophane wrapper which seals the individually boxed product is applied should be classified as price tags or considered part of the packaging.

The facts show that the stickers are designed to look like they are part of the box. They are all the same color as the box and contain the regular selling price of the product, the sale price of the product and amount saved if the product is purchased. These stickers are used because petitioner has found out that it is cheaper to place the sticker on their regular boxes instead of printing up new boxes for the two-month promotional period.

Petitioner contends that the stickers become part of the packaging because they are affixed to the box before the box is wrapped in cellophane. Petitioner further asserts that these are not price tags because the retailer can set his own price, which could be less than the prices listed on the sticker. Rather the stickers are meant only to provide information to the buyer of the savings available if the promoted product is purchased. Petitioner, therefore, is of the position that the stickers should be classified as "labels" and that the provisions of Sales and Use Tax Regulation 1589(b)(2)(B) should apply. This regulation states that tax does not apply to sales of labels if the purchaser affixes them to nonreturnable containers of property to be sold. The Department contends Regulation 1589(c)(1) is applicable as this section provides that tax applies to the sale of price tags used in connection with the sale of property.

We must conclude that the Department has correctly classified these stickers as price tags. We find petitioner's argument that the stickers are labels as unpersuasive because the sticker does not describe the contents of the container or explain the benefits of the product to the customer. It contains only information regarding selling price and money saved. Sales and Use Tax Annotation 195.2060 (March 24, 1988) specifies that a label is primarily a price label when it can be said that wording on the label other than the price is merely incidental.

Recommendation

It is recommended that the liability be redetermined without adjustment.

Susan M. Wengel, Hearing Officer

May 23, 1990

Date