

Memorandum

Legal Division MIC: 85

435.0150

To : Mr. Norman Jung
San Jose Auditing (GH)

Date: January 21, 1994

From : Rachel Aragon
Staff Counsel

Subject: R--- W. C---

SR -- XX-XXXXXX

This is in reply to your memorandum dated December 10, 1993, in which you ask how tax applies to the purchase and sale of tapes and reels. You state:

“The above taxpayer provides processing services and specializes in surface mount device tape and reeling. Surface mount device tape and reel service involves placing customer provided semiconductor chips onto a special carrier tape. The carrier tapes contain recesses where the chips are placed. A clear film is then placed over the carrier tape to prevent the chips from falling out. The filled carrier tape is then rolled up on a reel. The reel containing the filled carrier tape is then packaged and shipped to the customer or their agent (subcontractor).

“The customer or the subcontractor would then load the reel onto an assembly machine. The carrier tape from the reel is fed into the assembly machine similar to a machine gun belt. The assembly machine would remove the chips from the tape and stamp the chips onto circuit boards. The carrier tape is emptied and discarded by the customer. The reel is also discarded when it becomes empty. Semiconductor chips are expensive sensitive devices. As such, they cannot be loaded onto an assembly machine by simply dumping the chips into a hopper. The carrier tape and reel enables the chips to be loaded into the assembly machine without the possibility of physical damage. The assembly machines are designed to accept these semiconductor chips via the tape and reel system. Without the tape and reel system, the semiconductor chips cannot be loaded into the assembly machine.

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“The taxpayer will include the taping service, various levels of inspection of the semiconductor chips. The fee for the tape and reel service varies with the level of the inspection service chosen by the customer.

“All tapes and reels are purchased by the taxpayer ex-tax (for resale).

“The taxpayer believes that he is providing an exempt service.”

You note that an argument might be made that the reels and tapes qualify as nonreturnable containers. The exemption relevant to this question is found in Revenue and Taxation Code section 6364 which states in part:

“There are exempted from the taxes imposed by this part, the gross receipts from sales of and the storage, use, or other consumption in this State of:

“(a) Nonreturnable containers when sold without the contents to persons who place the contents in the container and sell the contents together with the contents.”

This provision is not applicable because the taxpayer does not sell the property without contents, nor does the purchaser resell the property together with the contents. Rather, the property is used and then discarded by the manufacturer.

Your next question is whether the taxpayer is providing tangible personal property to its customers or transferring tangible personal property incidental to a service. 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. (Reg. 1501.)

Here, the tapes are put on an assembly line where they are fed onto the circuit boards. It seems evident that the manufacturer is purchasing the tapes and reels which are used in the manufacturing process to keep the chips from being damaged. It is our opinion the taxpayer is selling tangible personal property (the reels and tapes) to be used as manufacturing aids and that any services provided, such as chip placement and inspection, are incidental to that sale.

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This analysis is confirmed by subdivision (a) of Regulation 1525, which states that tax applies to the sale of tangible personal property if the tangible personal property is purchased for use in manufacturing, producing, or processing tangible personal property and not for the purpose of physically incorporating it into the property. (Accord Reg. 1526(b).) As discussed herein, the tapes and reels are used as manufacturing aids, and their sale is therefore taxable.

If we can be of further assistance please feel free to write again.

RA:jlh