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November 23, 1993

BURTON W. OLIVER  
*Executive Director*

Mr. T—H--  
--- & ---  
XX --- Street  
--- ---, CA XXXXX-XXXX

Re: N--- P--- Company, Ltd.  
XXXX --- Street, Suite XXX  
--- ---, CA XXXXX

Dear Mr. H---:

This is in response to your letter of August 31, 1993, which requested our opinion on the application of sales tax to sales by your client, N--- P--- Company, of plastic pattern transfer film to manufacturers. Your questions concerned whether the tangible personal property was to be purchased for use in the manufacturing process, or was to be purchased for incorporation into the finished product being manufactured.

You state as follows:

"The client manufactures two types of film. The first product (hereafter designated as Product 1) is a film with lettering and designs on it. This film is transferred to products in its entirety with no plastic residue. The second product (hereafter designated as Product 2) has a pattern imprinted on the film which is transferred to a product leaving the patternless film as a residue. Samples of both types of film are enclosed.

"Our clients sell the film to manufacturers. The manufacturers incorporate the patterns into products that they produce. These manufacturers then sell the finished products. We believe that both film products may be purchased from our client for resale by manufacturers because they are both physically incorporated into the products produced by the manufacturers.

"Product 1-Film with No Residue

"Product 1 is a plastic film with patterns and/or lettering imprinted upon it. The samples of Product 1 are a clear plastic film with dots and the word 'C---' imprinted upon it and a plastic container lid with bow patterns and the words 'S---' n 'W---' imprinted upon it. As you can see from the plastic lid, Product 1 is imprinted in its entirety on the lid. This includes the plastic film as well as the patterns and words. Under Regulation 1525(b), sales tax does not apply to the sales of tangible personal property to persons who purchase it for the purpose of incorporating it into manufactured articles to be sold. Therefore, if customers provide resale certificate, sales tax should not apply to sales of Product 1.

"Product 2-Film with Plastic Residue

"Product 2 is also a plastic film with patterns imprinted upon it. The samples of Product 2 are two plastic laminate plates. One plate has a role of Product 2 carrying a wood grain pattern taped to it. The second plate has the wood grain pattern imprinted upon its with the film residue taped in place. Normally, after imprinting, the film residue would be peeled off and thrown away. Through the hole cut in the plate, you can see and feel the texture of the pattern which is transferred. It has thickness and its own texture. Under Regulation 1525(b), sales tax does not apply to the sale of tangible personal property to persons who purchase its for the purposes of incorporating it into manufactured articles to be sold. However, Regulation 1525(a) states that tax applies to tangible personal property sold to persons who purchase it for the purpose of use in the manufacturing process.

"In this case, Product 2 is partially incorporated into the finished product for resale. That is, the pattern is incorporated into the product. However, the film backing of the pattern does not become incorporated...."

"In addition, we believe that it is important to note that no portion of Product 2 acts as a catalyst, processing agent or any other type of manufacturing aid. The sole purpose of the product is to incorporate the pattern into manufacturing products."

Regulation 1525(b) provides as follows:

"Tax does not apply to sales of tangible personal property to persons who purchase it for the purpose of incorporating it into the manufactured article to be

sold, as, for example, any raw material becoming an ingredient or component part of the manufactured article."

From the facts presented by you, it is our opinion that Product 1 will be incorporated into the finished product. It is a raw material which is purchased by your client's customers "for the purpose of incorporating it into the manufactured article to be sold...." and which entirely becomes "an ingredient or component part of the manufactured article." (Reg. 1525(b).) Your client may therefore sell the property extax by accepting timely and valid resale certificates.

Product 2 is not purchased to be entirely incorporated into the manufactured article. A substantial portion is left over after the manufacturing process as plastic residue. However, both the Sales and Use Tax Annotations, going back to the 1950's, and the California appellate cases have looked at the principal reason for the purchase of the property. (Annot. 440.0860, 440.1220, 440.1300, 440.1780.) This has evolved into the "primary purpose" test. (Kaiser Steel Corp. v. SBE (1979) 24 Cal 3d 188.) It is our opinion that the primary purpose for a manufacturer to purchase Product 2 from your client is to incorporate a portion of the product into the articles to be manufactured for resale. Your client may sell Product 2 to such a manufacturer extax for resale by accepting a timely and valid resale certificate.

If you have other questions, please contact me.

Sincerely yours,

Donald L. Fillman  
Staff Counsel

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