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STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

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Executive Director

February 23, 1995

Ms. REDACTED TEXT
REDACTED TEXT, Inc.

Re: REDACTED TEXT, Inc.

Dear Ms. REDACTED TEXT:

This is in response to your letter dated November 30, 1994 regarding the application of tax to certain costs you incur and later pass on to the purchasers of fire trucks you sell.

You state that you are often required to obtain a performance bond as a condition of the sale of a new fire truck. You further state that you list the bond as a separate item on the contract, and that the bond price is not included in the price of the truck. The bond is issued in REDACTED TEXT's name, and the cost of the bond is passed on to the customer as a separate line item on the invoice.

It is our understanding that the bonds you describe are used as a form of insurance. It appears that the purchasers of your trucks require you to obtain the performance bonds in order to insure that the trucks perform as required in the provisions of the performance bonds.

Retail sales of tangible personal property in California are subject to sales tax, measured by gross receipts, unless specifically exempt by statute. (Rev. & Tax. Code § 6051.) Charges for mandatory warranties are part of a retailer's gross receipts and are subject to sales tax whether or not they are separately stated. (Reg. 1655(c)(2).) On the other hand, charges for warranties or insurance which are optional are not part of a retailer's gross receipts, and are not taxable. (Reg. 1655(c)(3), Business Taxes Law Guide Annotations 490.0580 (12/13/63), 490.0700 (5/10/60).)

Sales and Use Tax Regulation 1655(c)(1) explains the distinction between mandatory and optional warranties:

"A warranty is mandatory within the meaning of this regulation when the buyer, as a condition of the sale, is required to purchase the warranty or guaranty contract from the seller A warranty is optional within the meaning of this regulation when the buyer is not required to purchase the warranty or guaranty contract from the seller, i.e., he is free to contract with anyone he chooses."

Our understanding of your situation, based on the facts you provide, is that you do not require the buyer to purchase the performance bond; you would be willing to sell a fire truck without also obtaining a performance bond and passing on the cost to your purchaser. Since the bond is not seller-required but is rather purchaser-required, we consider the bond to be similar to an optional warranty rather than to a mandatory warranty. Therefore, the performance bond charges you "pass on" to your purchasers are not subject to tax.

If you have further questions, please feel free to write again.

Sincerely,

Kelly W. Ching
Staff Counsel

KWC:cl

cc: REDACTED TEXT District Administrator