STATE BOARD OF EQUALIZATION
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(916) 445-5550

January 30, 1990

Mr. [W]
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XXX --- ---
--- ---, -- XXXXX

Re: [V]

Dear Mr. [W]:

This is in response to your letter dated December 27, 1989 regarding the application of sales and use tax to the activities of your client, Retailers Engaged in Business in this State. . You state that [V] has no place of business in California and is not registered in California as a seller.

[V] will enter into contracts with owners of aircraft for modification of those aircraft. The aircraft owner may be a person using the aircraft as a common carrier in interstate commerce or may be a person using the aircraft for private purposes.

Some of the modification work will be performed in California by [T], a subcontractor of [V], or some other subcontractor located in California. Engines for the modification will be manufactured and delivered to [V] outside California. Nacelles and struts will be manufactured in California. In some cases these will be delivered to [V] outside California and in other cases the nacelles and struts will be shipped directly from the supplier in California to the subcontractor in California. The items that are delivered to [V] outside California will be delivered by [V] to the subcontractor in California.

The aircraft will be flown by the owner to the subcontractor's facility in California. The subcontractor will then install the engines, nacelles, and struts on the aircraft and, upon completion of that installation, the aircraft will be delivered to [V] at the subcontractor's facility in California. [V] will then fly the aircraft to a location outside California and deliver the aircraft to the owner outside California. If the owner is a common carrier, the aircraft may thereafter be used on interstate routes which include California.

Each of your assertions is quoted below followed by our response.

"1. The engines, nacelles, and struts are all purchased by [V] for resale. Therefore, they are not purchased from a retailer for consumption in California, as would be required by §6201 for use tax to apply."

When [V] modifies a new aircraft, that modification constitutes fabrication. (See Business Taxes Law Guide Annot. 435.0180 et seq.) Since that fabrication would be for a consumer (the aircraft owner), that fabrication is a sale. (Rev. & Tax. Code § 6006(b).) When [V]'s modification is a sale, [V] may purchase the engines, nacelles, and struts ex tax for resale to its customers provided [V] makes no use of those items in California prior to the sale to its customers.

Modifications to a used item usually constitute a repair. However, if the modification results in an item suited for a new and different use, the modification is a fabrication. (See Business Taxes Law Guide Annot. 435.0260 (4/9/57).) We have previously concluded that the conversion of a piston type aircraft to a jet aircraft is not such an extensive change as to be regarded as the fabrication of a new aircraft. Rather, we regard such conversion as a repair. (Business Taxes Law Guide Annot. 435.0160 (9/21/65).) It is most likely that we would also regard any modifications [V] performs upon used aircraft as a repair.

Regulation 1546 sets forth the application of tax to repairs. If the retail value of the parts and materials furnished in connection with the repair is more than 10 percent of the total repair charge, or if the repairer makes a separate charge for that property, the repairer sells the property and, if the sale is at retail, tax applies to the fair retail selling price of the property. (Reg. 1546(b)(1).) If the retail value of the parts and materials furnished in connection with the repair work is 10 percent or less of the total charge, and if no separate charge is made for the property, the repairer is the consumer of the property and sales tax applies to the sale of the property to the repairer or use tax applies to the repairer's use of that property in the performance of the repair. (Reg. 1546(b)(2).)

Thus, if the retail value of the parts and materials furnished in connection with the repair is more than 10 percent of the total charge, or if [V] makes a separate charge for that property, [V] will be regarded as selling the property to the customer and the same rules discussed above with respect to a fabrication sale applies. That is, [V] may purchase the property for resale provided it makes no use of the property in California prior to the resale of the property to the customer. The remaining questions would then be whether [V]'s sale of the property to the customer is subject to tax or whether [V] is required to collect use tax from the purchaser.

If the retail value of the parts is 10 percent or less of the total charge and if [V] makes no separate charge for the property, [V] will be regarded as the consumer of that property. [V] would use that property in the performance of the repair operations. Since that repair will be performed in California by [V]'s subcontractor, [V] will be regarded as purchasing the property for use in California. Sales tax will apply to the sale of nacelles and struts that are shipped form a California seller to [V] (i.e., to [V]'s subcontractor) in California. [V] will owe use tax measured by purchase price on property delivered to [V] outside California that will be used in repair operations in California.

> "2. The subcontractor's charges to [V] are mainly charges for installation labor and therefore excludable from 'gross receipts' under §6012(c)(3). To the extent they may constitute charges for fabrication labor, and be within the definition of 'sale' under §6006(b), or charges for transfer of materials, they are sales to [V] for resale. (Ruling 475.0040.)"

Initially, we must analyze this aspect of the transaction in the same manner as that discussed above. That is, we must ascertain whether the subcontractor is performing fabrication or repair. If fabrication and if the subcontractor furnishes no tangible personal property when performing that fabrication, the subcontractor has not made a sale. The reason for this is that fabrication is defined as a sale under the Sales and Use Tax Law only when performed for the consumer. The subcontractor would be performing the fabrication for the retailer [V] and not for the consumer ([V]'s customer) and therefore no sale occurs. Since no sale occurs, the subcontractor does not need to take a resale certificate to establish that sales tax does not apply. The reasoning for the Annotation you cite is that, although a resale certificate may not be required, it may be advisable since the fabricator then has some documentation showing that the fabrication was no performed for a consumer (i.e., the fabrication is equivalent to a sale for resale even though not technically a sale).

If the work is performed on a used aircraft, then the subcontractor's work would likely be regarded as a repair, as discussed above. Since [V] will be supplying the most costly parts, it appears likely that the retail value of the parts and materials the subcontractor furnishes in connection with its repair work will be 10 percent of less of its total charge to [V]. If so, and if the subcontractor does not separately state its charges for those parts and materials incorporated into the aircraft, the subcontractor will be regarded as the consumer of that property. Sales tax would apply to the sale of that property to the subcontractor or use tax would apply to the subcontractor's use of the property in the repair operations. If, on the other hand, the retail value of that property is over 10 percent of the subcontractor's charge to [V], or if the subcontractor separately states the charge for that property, the subcontractor will be regarded as the seller. Since [V] will accept delivery in California, the subcontractor will not be making a sale in interstate commerce exempt from sales tax. If, however, [V] makes no use of the property prior to its resale to the customer, [V] may purchase that property ex tax for resale by issuing the subcontractor a resale certificate.

> "3. [V]'s charges to the owner are for a sale which occurs outside California and therefore are not subject to sales tax."

> "4. The installation of the engines, nacelles, and struts is not a taxable use of those properties in California by the owner…."

As mentioned above, if the subcontractor or [V] is regarded as the consumer of any parts and materials used to repair the aircraft in California, and if sales tax reimbursement had not been paid with respect to those parts and materials, then the subcontractor of [V], as appropriate, would owe use tax for that use measured by the purchase price of the parts and materials. With respect to parts and materials that are regarded as sold to the customer, we assume that [V]'s contract with the customer requires delivery outside California and title to the parts and materials does not pass to the customer until the time of delivery outside California. Based on this assumption, the customer makes no use of those parts and materials in California since the customer does not own the parts

and materials prior to delivery outside this state. Thus, the customer does not owe use tax with respect to the parts and materials prior to the delivery to the customer. Sales tax does not apply since the sale occurs outside California.

> "5. The return of the modified aircraft to California by a carrier owner in the course of interstate flights which include California landings and takeoffs will not subject the owner to a use tax. There will be no taxable moment in California when the property is used other than in interstate transportation…."

We agree provided title to the property passes to the carrier outside California and provided the requirements of subdivision (b)(2)(B) of Regulation 1620 are satisfied. That is, provided the first time the aircraft enters into California after title to the property passes to the carrier is in the course of interstate or foreign commerce and provided the aircraft is not thereafter used exclusively in California.

> "6. In the case of a corporate owner, use tax will not apply at any level because of the exclusion stated in §6009.1 and Regulation 1620(b)(5). If, however, the modified aircraft does come back into California, the 90-day and six-month tests of Regulation 1620(b)(3) would be applicable to determine whether use tax is due."

Revenue and Taxation Code Section 6009.1 and subdivision (b)(5) of Regulation 1620 do not apply to this transaction with respect to use tax liability of the aircraft owner. Section 6009.1 excludes certain use from the definition of "use" under the Sales and Use Tax Law. It applies only when use tax would be otherwise applicable, but does not exclude from taxation a transaction subject to sales tax. Based upon the facts you present and the assumptions made herein, [V]'s sale to the corporate owner does not occur in California and sales tax therefore does not apply. Since the corporate owner makes no use of the property prior to its sale to the corporate owner outside California, there is no need to refer to Section 6009.1 to exclude from the definition of use a use by the owner in California that does not exist. We agree that if the aircraft does come back in California, the tests set forth in subdivision (b)(3) of Regulation 1620 would be applicable to determine whether use tax is due. We note also that Section 6009.1 excludes [V]'s transporting the property sold outside California from the definition of a taxable use (for which [V] would otherwise owe use tax for its use of the property in California to fly the aircraft outside California), provided no other use of the property is made in California by [V] (e.g., by carrying passengers or cargo in the aircraft on its flight from California), since [V] will be transporting the aircraft outside California and will not thereafter use the property in California. (See Stockton Kenworth, Inc. v. State Board of Equalization, (1984) 157 Cal.App.3d 334.)

> "7. If a use tax should be due from either a carrier owner or a corporate owner, [V] would have no obligation to collect it. [V] will not be a 'retailer engaged in business in this state' as defined in §6203; but even if it were, it will be delivering the modified aircraft to the buyer outside California and would not be liable for use tax collection unless it were to have actual notice that the owner intended to make the first functional use of the modified aircraft in California."

We do not have sufficient information to reach a conclusion as to whether [V] would be a retailer engaged in business in this state. A retailer engaged in business in this state includes any retailer maintaining, directly or indirectly, or through an agent, a warehouse or storage place or other place of business. (Rev. & Tax. Code § 6203(a).) [V] will be sending property owned by it to its subcontractor in California for installation into the aircraft of [V]'s customers. It is possible that this involves storage which would make [V] a retailer engaged in business in this state (for example, if the subcontractor had a dedicated storage area for property owned by [V] which would be stored until needed). We also note that a retailer engaged in business in this state includes a retailer having any representative operating in this state for the purpose of taking orders. (Rev. & Tax. Code § 6203(b).) If the contracts among the parties provided that the customer could give orders for modification to the subcontractor in California, [V] might be regarded as a retailer engaged in business in this state, depending on the actual contractual provisions.

If [V] is regarded as a retailer engaged in business in this state, we agree that [V] will be liable for use tax collection if it has actual notice that its customer intends to make first functional use of the aircraft in California. However, this is not the only circumstance for which [V] will be liable for use tax collection. Revenue and Taxation Code Section 6247 sets forth the presumption that tangible personal property delivered outside this state to a purchase known by the retailer to be a resident of this state was purchased from the retailer for storage, use, or other consumption in this state. This presumption may be controverted by a statement in writing, signed by the purchaser, and retained by the vendor, that the property was purchased for use at a designated point or points outside this state. This presumption may also be controverted by other evidence satisfactory to the Board that the property was not purchased for storage, use, or other consumption in this state. Thus, if [V] delivers the property outside California to a known California resident, there is a presumption that the property was purchased for use in California and, if a retailer engaged in business in this state, [V] is liable for use tax collection unless it takes the specified statement in writing or otherwise establishes that the property was not purchased for use in California.

When California sales or use tax is applicable, the measure of that tax would be [V]'s total charge when [V] performs fabrication. When [V] performs repairs, the measure of tax is the fair retail selling price of the parts and materials sold to the customer.

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

Sincerely,

David H. Levine
Tax Counsel

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