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May 22, 1997

Mr. J--- W---
J--- W--- & Associates
XXXX W. --- Avenue
---, CA XXXXX

**Re: P--- E--- E--- Services
SR -- XX-XXXXXX**

Dear Mr. W---:

Assistant Chief Counsel Gary J. Jugum has requested that I respond to your inquiry, received by our legal division on March 17, 1997, concerning P--- E--- E--- S--- (P---).

You write that P--- is a new entity which is the primary contractor for the sales, service, and repair of heating, ventilation and air conditioning, appliances, and seismic apparatuses. You state that the work will be done by licensed contractors for each particular field.

You state that P--- will receive the payments for the work performed "which will include the parts or new sales, the sales tax, and the labor. The subcontractor will receive a predetermine distribution. The applicable tax will be retained and paid by P---...." You further state that, "Repairs on machinery will include major home appliances and repairs to real property as listed under regulations 1521." (Quoted as written.)

You ask us to review "the enclosed sales activities which would generate sales tax and advise on the procedures necessary for proper collection and payment." You describe the activities as follows:

- (1) "Subcontractor buys part from wholesaler and pays no sales tax."
- (2) "Subcontractor pays sales tax when purchases for parts are made."
- (3) "Contractor makes flatrate bid on real property repair."

Bid: Parts (sales tax paid at cost)
 Supplies (sales tax paid)
 Cost of labor
 Margin for profit

 Total flatrate bid
 1. No mark-up on parts
 2. No sales tax due."

You have not described the facts sufficiently for us to understand clearly what work will be performed. For your assistance, we will respond with general information concerning your inquiry. However, please be aware that if the actual facts differ from what we understand you to be describing, our response might also differ.

Discussion

A retailer who makes sales of tangible personal property at retail in California must pay sales tax for the privilege of selling that property at retail in this state. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax applies to a purchaser's use of property purchased from a retailer for use in California. (Rev. & Tax. Code §§ 6201, 6401.)

It appears that you are describing contracts for improvements to real property, and seeking information concerning how tax applies. (If, in fact, the contracts are not for improvements to real property, this opinion letter is not applicable.) The application of tax to contracts to improve real property is governed by Regulation 1521.

Regulation 1521 (a)(1)(A)1 defines a contract to furnish and install property which becomes an improvement to real property as a construction contract. A person who performs a construction contract or subcontract is a construction contractor. (Reg. 1521(a)(2).)

However, a construction contract does not include a contract for the sale or for the sale and installation of tangible personal property such as machinery and equipment, or the furnishing of tangible personal property under what is otherwise a construction contract *if the person furnishing the property is not responsible for the final affixation or installation of the property furnished.* (Reg. 1521(a)(1)(B); emphasis added.) Our understanding from your letter is that in each instance a subcontractor, not P---, will furnish and install the tangible personal property

which becomes an improvement to real property. Thus, it is the subcontractor who is *the* construction contractor referred to in Regulation 1521, and not P---.

Regulation 1521 also defines the terms "materials" and "fixtures" as those terms apply to construction contractors. Materials are construction materials and components, and other tangible personal property incorporated into, attached or affixed to real property, such as a building, by a construction contractor, which when combined with other tangible personal property lose their identity to become an integral and inseparable part of the real property. (Reg. 1521(a)(4).) A construction contractor is generally the consumer of materials which the contractor furnishes and installs in the performance of a construction contract. Tax applies to the sale to, or use by, the contractor of those materials. (Reg. 1521(b)(2)(A)1.)

"Fixtures" are defined by Regulation 1521 as items which are accessory to a building or other structure and do not lose their identity as accessories when installed. (Reg. 1521(a)(5).) In general, a construction contractor is the retailer of fixtures which the contractor furnishes and installs in the performance of a construction contract, and tax applies to its sale of the fixtures. (Reg. 1521(b)(2)(B)1.)

Thus, in those instances in which the subcontractor both furnishes and installs materials, the subcontractor is the consumer of those materials which it furnishes and installs in the performance of the construction contract, and tax applies to either the sale of the materials to the subcontractor or to its use of the materials. In those instances where the subcontractor furnishes and installs fixtures, the subcontractor is generally the retailer of the fixtures. As the retailer, the subcontractor must remit tax to the state on its sale of the fixtures. As the prime contractor, P--- is neither the retailer nor the consumer of the materials or fixtures, and may not properly collect sales tax reimbursement or pay the sales tax. P--- has no tax liability in either of these situations.

Regulation 1521 also discusses repair contracts to repair a fixture in place or a fixture the contractor is required by the contract to reattach to the realty. (Reg. 1521(c)(5).) Such contracts are construction contracts under Regulation 1521. If any of P---'s contracts are repair contracts under Regulation 1521(c)(5), the following discussion applies.

In general, in such a contract the construction contractor, i.e., P---'s subcontractor, is the retailer of the parts furnished in the performance of the contract to repair the fixture when the sale price of the parts is billed separately from the repair labor. The construction contractor, i.e., P---'s subcontractor, is the consumer of the parts furnished in the performance of a lump sum contract to repair a fixture. (Reg. 1521(c)(5)(B).) Thus, if the subcontractor bills the parts separately from labor, the subcontractor is the retailer of the parts and tax applies to the subcontractor's sale of the parts. If the subcontractor bills lump sum, the subcontractor is the consumer of the parts and tax applies to the sale of those parts to the subcontractor.

I hope this information is of assistance. If you have further questions, please write again and provide us with copies of relevant contracts and other more detailed information so that we may better understand and respond to your inquiry.

Sincerely,

Sharon Jarvis
Senior Tax Counsel

SJ:cl

cc: Norwalk District Administrator (AA)