

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

In the Matter of the petition)
for Redetermination Under the) DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)
)
)
Petitioner _____)

This matter was heard on Monday, August 9, 1976 at 1:30 p.m. in San Francisco, California by Hearing Officer Donald J. Hennessy.

Appearing for Petitioner: REDACTED TEXT

Appearing for the Board: Stan J. Rose, Field Audit Supervisor

Protested Item
(Audit Period 1/1/72 to 9/30/74)

Pursuant to a Notice of Determination dated April 22, 1976, for tax and interest in the total amount of \$139,192.26, Petitioner protests the imposition of tax on:

Self-Consumed Understated

Ex-tax purchases of materials consumed)
on government contracts not reported.) \$2,031,522

Contentions of Petitioner

The items in question qualified as machinery and equipment under Regulation 1615, U.S. Government Contractors.

Summary of Petition

Petitioner is a California corporation engaged in business as an electrical contractor, with a minor amount of repair work and over-the-counter sales. A prior audit covered through December 31, 1971.

Of the total measure of tax of \$2,031,522, Petitioner protests the amount of \$1,711,924. This protested amount is comprised of the \$1,629,778 cost of transformers, switchgear, wiring, and conduit installed by Petitioner at the Alameda Naval Air Station and the \$82,146 cost of

switchgear installed at Fort Ord, California. All such items were purchased by Petitioner for resale or from out-of-state vendors without the payment of tax or tax reimbursement on the theory that such items constituted machinery or equipment resold to the United States Government. The audit imposes use tax on the cost of the items on the theory that Petitioner consumed the items in performing contracts with the United States for the construction of improvements on or to real property in California.

The work performed at the Alameda Naval Air Station (NAS) involved the conversion of the station from a functional naval air field to a facility primarily manufacturing and overhauling aircraft and providing support for naval vessels in San Francisco Bay. The electrical portion of the facility conversion project was to upgrade the electrical distribution system at the station. Basic power was 5KV', which had to be upgraded to 15KV', as 5KV' power was inadequate for the Naval Aviation Rework Facility (NARF) and the pierside hotelling of naval vessels.

Specifications for the work were prepared by the Naval Facilities Engineering Command and required that certain equipment be portable and usable in other locations if use at the location where installed ceased. Petitioner describes the new distribution system as one giant power loop installed primarily for manufacturing, rework, and pierside hotelling functions, with less than 5 percent of the power usage of certain equipment being required for housekeeping functions. All equipment supplied was to accommodate higher voltage and no changes were made to any lighting or other end uses. Petitioner has paid, or concedes, tax on the cost of duct work, cable, and other material, including building and structural matters not satisfying the tests set forth in Regulation 1615 (Title 18, California Administrative Code; all regulation references hereinafter are to such code).

The switchgear installed at Ford Ord was an auxiliary and backup unit for existing equipment. It was intended to increase the capacity of the electrical distribution system. Such increase was necessary because of the change in function of Fort Ord from a "boot camp" to an operational installation with the transfer of the Seventh Infantry Division to Fort Ord.

The hearing included a mention of, and Mr. REDACTED TEXT has submitted a memorandum discussing, the cases or *King v. State Board of Equalization* (1972), 22 Cal. App. 3d 1006;

C. R. Fedrick, Inc. v. State Board of Equalization (1974), 38 Cal. App. 3d 385, hearing by California Supreme Court denied; *A. S. Schulman Electric Co. v. State Board of Equalization* (1974), 49 Cal. App. 3d 180; and *Chula Vista Electric Co. v. State Board of Equalization* (1975), 53 Cal. App. 3d 445, hearing by California Supreme Court denied (January 28, 1976); dismissed as an appeal and denied as a petition by United States Supreme Court, 49 L.ed. 2d 383.

Analysis and Conclusion

Section 6381 of the Revenue and Taxation Code (all section references hereinafter are to such code) provides an exemption from sales tax for sales of tangible personal property to the United States Government. Petitioner argues that this exemption applies to the sale of the items in question by Petitioner to the United States Government as the items are machinery and

equipment within the provisions of Regulation 1615 (repealed February 4, 1976, effective April 1, 1976. Incorporated in Regulation 1521).

Sections 6007.5 and 6384 provide that, notwithstanding any other provision of the Sales and Use Tax Law, tax applies to the sale of tangible personal property to a contractor or subcontractor for use in the performance of contracts with the United States for the construction of improvements on or to real property in California. The gross receipts from such sale or the sales price of property so sold is subject to tax. The audit considers the use tax to apply to the cost of the items in question pursuant to Sections 6007.5 and 6384.

The issue here is whether Petitioner, in installing the transformers, switchgear, conduit, cable, etc., was performing contracts with the United States for the construction of improvements to real property or was selling machinery and equipment to the United States. After a careful study of the above cited cases and the Board's recent decision on the petition of REDACTED TEXT, we conclude that Petitioner was improving real property for the United States and that the audit properly imposes the tax.

The items installed by Petitioner were components of an electrical transmission and distribution system. Section 6016.5 provides that electrical transmission and distribution lines, and the poles, towers, or conduit by which they are supported or in which they are contained, are not tangible personal property. The above cited case law has interpreted Section 6016.5 to mean that such lines constitute "structures on land" within Regulation 1521 (see *King* case, supra, page 1014).

Chula Vista, supra, held that electrical cable installed at an air station was an improvement to real property and that tax applied pursuant to Sections 6007.5 and 6384.

C. R. Fedrick, supra, involved the installation of electrical systems for the U. S. Corp of Engineers at military facilities, one of which was the same NAS involved here. Footnote 5, page 389, of the court's opinion states at length the variety of electrical equipment installed by C. R. Fedrick. All of the items here in question were also involved in the case before the court, including an alternate power system for use in case of a power failure. The court held the items were personal property used for improvements to real property and taxable within Section 6384.

The Board heard the petition of REDACTED TEXT. On REDACTED TEXT, the Board decided that the electrical wiring, switchgear, and transformers installed to furnish temporary power to submarines were improvements to realty under Sections 6007.5 and 6384. Certain of the items installed by Petitioner were for a like purpose and the REDACTED TEXT decision of the Board rules here.

The gist of the Board position may be summarized as follows. All equipment constituting part of an electrical transmission or distribution system, including the electrical transmission and distribution lines, the poles, towers, or conduit by which they are supported or in which they are contained, and transformers, switchgear, and substations, are improvements to real property within the meaning of Section 6384.

Consistent with the position taken by the Board in *Chula Vista*, supra, the transmission or distribution system on a naval base or similar government installation includes transformers,

switchgear, substations, and other equipment up to the power panels in buildings. The system includes transformers, switchgear, and substations leading to pumps or other machinery and equipment or to ships at a pier. However, transformers or other equipment installed only on a temporary basis, for example, transformers on skids that are used temporarily for emergency purposes, are not part of the system and on that account improvements to real property.

The Board is logically compelled to the above conclusions by Section 6016.5 and the above cited case law. Any contrary positions taken earlier under the tests set out in Regulation 1615 must yield to the case laws evolving interpretations of the relevant statutes.

Recommendation

Redetermine without adjustment.

Donald J. Hennessy, Hearing Officer

9-17-76
Date