

M e m o r a n d u m**190.0445**

To: Sacramento – Auditing (CNW)

Date: June 4, 1976

From: Tax Counsel (JDP) - Headquarters

Subject: --- and ---

S- -- XX XXXXXX

I have discussed your memorandum of May 11, 1976, with Mr. John Murray. Our conclusions regarding the proper application of the Sales and Use Tax Law to the various factual situations presented are as follows:

Based upon the information furnished the taxpayer agrees to design, furnish and install a signal system and automatic speed control detectors for the cars on the 33,000-foot underground double track for the San Francisco Municipal Railway. The scope of work includes segregating the track into blocks, providing code generators for power controlling switches, signals and lighting and destination signs at each loading platform. For each car the taxpayer provides pickup coils and equipment to identify codes transmitted through the rails, the combination of which control the speed at which the cars may travel.

Engineering and programming work was performed at Sacramento and many of the components were preassembled into equipment racks for delivery to the jobsite. Jobsite work includes the installation of these subassemblies, completion of the final assembly, interconnecting wiring and conduit and related electrical work to complete a total operating system. This is all performed pursuant to a lump-sum contract. Taxpayer has paid tax on the cost of all purchased items. However, no tax has been reported on the preassembly or pretesting of the control units and computers performed by the taxpayer.

You submitted a change order which you state is typical of how the taxpayer invoices the city for the work performed. A copy of the change order as submitted is attached hereto. You state that the change order was prepared by the superintendent of the job. The controller, Mr. Cliff Wiggins, maintains that assembly is very limited and that testing represents the major portion of the charges.

In addition to what is shown on the change order, there is some peripheral equipment involved which is free-standing, and is merely plugged in to the master units. Also, the taxpayer installs certain pickup coils and equipment on the railroad cars.

You propose to audit as follows:

1. Sensing cables are materials.
2. Train-carried equipment and free-standing peripheral equipment are “tangible personal property”.
3. All control units and computer equipment are fixtures. The measure of tax includes the cost of purchased items plus costs for preassembly and pretesting prior to actual installation.

It is our opinion that sensing cables are materials. In so stating, we are assuming that they are wire or wiring, as contemplated by Regulation 1521, and are installed in such a manner that they become an improvement to realty.

We also believe that the train-carried equipment and peripheral free-standing equipment which is attached merely by plug-ins are tangible personal property. As to the train-carried equipment, if the cars have previously been used prior to the installation of these items, then the costs related to installation are exempt as installation labor. However, if these items are installed on new unused units, such installation would be part of the fabrication labor related to creating the finished product for the customer and tax would apply to such charges.

As to such tangible personal property, tax would necessarily include the cost of all purchased items and the charges for shop assembly and testing.

We agree that control units and computer equipment are fixtures under Regulation 1521. This is predicated on the assumption that they are firmly attached to the structures or other improvements, and that they are accessory thereto. Attachment is an essential part of concluding that such items are fixtures. The measure of tax would include the cost of purchased items and the charge of preassembly and testing prior to actual installation.

As to the Contra Costa County contract, you state that the units being tested by the taxpayer for installation are as follows:

1. Seven color graphic Cathode Ray Tubes and Keyboards:
 - 3 in color
 - 4 are black and white

These units have electronic memory capability as well as logic capability. They are connected to the main computers; however, they do some of their own work, thereby releasing the main units.

The three color units are used for plant operations.

The four black and white units are used throughout the plant, i.e.:

A. Standard data processing functions such as (1) chemical analysis from computer base as to amount of chlorine in the water, thus determining the amount of chloring to be added; (2) personnel office, normal accounting functions; and (3) procurement office, normal accounting functions.

2. Matrix Printer:

This takes a snap shot of the face of the color tube thereby allowing later recovery. Also allows the operator to peruse the data at a later date. Used to order spare parts, etc.

3. Teletype unit:

Methodology of the computer programmer. Talks to the computer at different skill levels.

4. Computer itself:

2 major ones		Approximately 3 ft. wide
21 remote slaves	=	and 5 ft. high

5. Card recorder:

Device key punched on IBM cards. Different programs; such as, (1) add instruments (2) PH measurement, etc. Read in with cards. Permanent record as opposed to tape.

6. Magnetic tape unit:

Storage media not really secure with tape, as tape deteriorates.

7. Paper tape punch:

Also another media – all different types of media are needed as retention periods vary.

8. Line printer:

High speed tool used rather than wait for the slow printer.

You state that all the above mentioned units were connected by means of a plug-in system and one outlet to the power supply. All units are mobile, in that they are on rollers or are on a desk-type holder. Mr. H---, Engineering Computer Supervisor, stated that the units need not be secured to the real property.

You state that the taxpayer has paid tax on the cost of equipment (it is assumed that cost means the taxpayer's purchase price). Testing of these items has been going on for approximately six months or more at a cost of probably \$250,000 or more.

It is our position that the items enumerated are all tangible personal property, and that the measure of tax would include the taxpayer's purchase price of the items, plus any shop assembly and testing prior to actual installation. If units like those enumerated for installation for Contra Costa County are installed for the Federal Government, they would be exempt from tax. If units like those installed for San Francisco Municipal Railway are installed for the Federal Government, the ones designated as tangible personal property would be exempt from tax. The tax measure for "materials" and "fixtures" would be the taxpayer's purchase price, which would not include any testing or assembly performed by the taxpayer.

I trust the information contained herein is sufficient for your purposes. If you have further questions, please feel free to inquire.

JDP/vs

cc: Mr. Robert Nunes
Mr. John H. Murray, w/attachments