

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

**190.1086**

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition )  
for Redetermination Under the ) DECISION AND RECOMMENDATION  
Sales and Use Tax Law of: )  
)  
J--- P--- P--- ) No.: SR -- XX-XXXXXX-010  
)  
)  
Petitioner )

The Appeals conference in the above-referenced matter was held by Staff Counsel Donald L. Fillman on December 28, 1994 in Sacramento, California.

Appearing for Petitioner: W. E. H---, CPA

Appearing for the  
Sales and Use Tax Department: Leon J. Adams  
District Principal

Cynthia Burba-Jeruss  
Senior Tax Auditor

Protested Items

The protested tax liability for the period January 1, 199X through March 31, 199X is measured by:

<u>Item</u>	<u>State, Local and County</u>
A. Disallowed sales claimed as exempt resales, labor, and interstate commerce, actual basis	\$ XXX,XXX
C. Unexplained difference between sales on 199X income tax return and sales reported on sales tax returns, actual basis	X,XXX

Contentions of Petitioner

1. A large portion of the disallowed sales in Item A were sales for resale.
2. Petitioner was not licensed as a construction contractor, so should not be classified as one for sales and use tax purposes.
3. A sale to a prime contractor for use on a construction contract at M--- Air Force Base should be an exempt sale to the United States.
4. When the only work performed for a customer is simple work upon materials provided by the customer, such as the cutting of wood into smaller pieces, the work should be classified as a service, and not as a taxable fabrication.
5. The cost to create cabinets used for display in a booth at a home show, where the cabinets were returned to petitioner at the end of the show, should not be classified as a taxable sale or use.
6. There is no tax due on unreported sales for 1990. All reportable sales for 199X were properly reported.

Summary

Petitioner is a sole proprietorship which manufactures and sells store fixtures and tenant improvements at retail. Petitioner also makes some installations of these items.

During the audit period, petitioner reported several types of transactions as exempt sales (Item A). These included sales reported as sales for resale, and sales reported as made in interstate commerce (but for which petitioner could not provide documentary support), sales treated as non-taxable labor, a sale to a United States construction contractor, and fixtures returned to petitioner after their use at a home show.

Of the sales reported as sales for resale, there were no resale certificates for sales totaling \$XXX,XXX. An additional total of \$XX,XXX represented sales in which petitioner acted also as the installer of fixtures.

Specific invoices were argued to represent exempt transactions, including the following numbered invoices:

**(a) Furnish and Install**

1936 – F---

2285 – F---

2308 – F---

In these contracts, petitioner both furnished and installed the tangible personal property.

**(b) Working on Purchaser Supplied Materials**

2183 – S--- Woodworks  
2186 – B--- A---  
2791 – E--- W---  
2795 – S--- V---

In these contracts, petitioner only did simple work on materials that had been supplied by the purchaser. Other persons completed the projects.

**(c) Fixtures Displayed and Returned**

2349 – M--- (NARI show)

In this contract, petitioner provided cabinets to a supplier of appliances, to be used to create a model kitchen for a display booth at a home show. Upon the conclusion of the home show, petitioner received back the items it had supplied.

**(d) Sale to U. S. Construction Contractor**

2731 – J--- B

In this contract, petitioner made sales to a prime contractor that had contracted with the United States to perform a project at M--- Air Force Base. Petitioner believes that this sale should be treated as an exempt sale to the United States Government or one of its agencies.

Under the second protested category, Item C, petitioner reported a larger total sales figure on its 199X income tax return, than it reported on its quarterly sales tax returns for the same period. Petitioner's representative indicated that the reason for the difference is that in 1990 petitioner changed from an accrual method of accounting to a cash method for income tax purposes. No documentation was provided in support of this explanation.

Analysis and Conclusions

The California Sales and Use Tax Law, in Revenue and Taxation Code section 6091, presumes that all gross receipts are subject to tax until the contrary is established. This section also provides:

"The burden of proving that a sale of tangible personal property is not a sale at retail is upon the person who makes the sale unless he takes from

the purchaser a certificate to the effect that the property is purchased for resale."

In the absence of a resale certificate, which is timely taken in good faith, the seller may be relieved of liability for the tax only if the seller presents satisfactory evidence that he is not liable for the tax. This means proof that the specific property sold was either resold by the purchaser (or is still being held for resale by the purchaser) without an intervening taxable use, or proof that the purchaser has paid the use tax directly to the State. See Regulation 1668(c).

In most of the disputed sales, petitioner has failed to receive and retain resale certificates. Although petitioner was provided with XYZ letters to assist in securing other satisfactory evidence of sales for resale, no responses have been provided. I have no basis upon which to recommend that any of these sales are exempt as sales for resale.

Each of the specific invoice categories listed above will be discussed separately:

Furnish and Install. Regulation 1521 defines and discusses "construction contractors", as well as related terms such as "construction contract", "materials", "fixtures", and "machinery and equipment".

"`Construction contractor' means any person who...agrees to perform and does perform a construction contract. `Construction contractor' includes subcontractors and specialty contractors...." (Reg. 1521(a)(2).)

"`Construction contract' means and includes a contract to:

1. Erect, construct, alter, or repair any building or other structure, project, development, or other improvement on or to real property...." (Reg. 1521(a)(1)(A)1.)

"Construction contractors are retailers of fixtures which they furnish and install in the performance of construction contracts and tax applies to their sales of fixtures." (Reg. 1521(b)(2)(B)1.)

Appendix B of Regulation 1521 provides a list of typical items which are included under the definition of "fixture". Included are "[c]abinets, counters, and lockers (prefabricated)".

Petitioner excluded from the measure of tax the sales price of fixtures which were both furnished and installed by petitioner. Petitioner argues that since it is not licensed as a construction contractor, it cannot be defined as one for the purposes of sales and use taxes. I disagree.

The Sales and Use Tax Law does not distinguish between entities which are licensed and those which are not. It only looks at the transaction between the parties. In this case, petitioner acted as a construction contractor when it furnished and installed the fixtures.

If the prime contractor, such as F--- in these cases, had already self-assessed and paid the tax on these transactions, the Board's policy has been to recognize this payment as an offset against the petitioner's liability. In an attempt to assist petitioner in this case, the Board provided petitioner with confirmation letters (referred to as ABC letters), to see if any of the prime contractors had self-assessed and paid the tax. None of the ABC letters were returned.

Working on Purchaser Supplied Materials. A few of the contracts which petitioner performed required only that petitioner do simple work on materials supplied by the prime contractor. As an example, under the S--- W--- contract petitioner only took the purchaser's wood and cut it into the correct sizes and shapes. The prime contractor then used the precut wood to finish its project. Petitioner believes that its work was in the nature of a service, and not subject to tax.

Revenue and Taxation Code, section 6006, provides as follows:  
``Sale' means and includes:

(a) ....

(b) The producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, or imprinting."

Regulation 1526 distinguishes between fabricating and repairing. It provides:

"Producing, fabricating, and processing include any operation which results in the creation or production of tangible personal property or which is a step in a process or series of operations resulting in the creation or production of tangible personal property." (Reg. 1526(b).)

The cutting of the wood was one step in the creation of the end product, which fits clearly within the definition of "fabrication" in the California Sales and Use Tax Law. These transactions are subject to the sales tax.

Fixtures Displayed and Returned. The transaction with M--- (concerning the NARI home show) has not been sufficiently documented to support petitioner's position. The accounting records lend support to the audit conclusion that the transaction was a taxable sale. It

appears that the purchaser, an appliance supplier, purchased cabinets from petitioner for use by the appliance supplier to create a display booth at a home show. The total charge was \$X,XXX, of which \$XXX was for installation.

It is uncertain how these dollar figures were determined, since petitioner indicated that there was no receipt of money from M---. Petitioner's accounting records initially indicated that this was a barter for advertising, but the records were changed prior to the audit. No new information has been provided.

Petitioner's representative at the appeals conference provided an oral explanation to the effect that the display booth was a joint project of the two parties. Each party contributed tangible personal property for the purpose of showing off their products for advertising purposes. In support of this characterization, it is emphasized that petitioner received the property back after the show was over.

Although not cited by petitioner, it sounds like petitioner is arguing that the transaction was one in which the property was used "solely for demonstration or display while holding it for sale in the regular course of business", as discussed in Regulation 1669(a).

Nothing was presented, however, to indicate what role, if any, petitioner had with regard to the home show. For example, it was not shown whether petitioner had someone at the booth to answer questions, or whether petitioner's sales literature was distributed along with that of M---', or whether petitioner's product was even being promoted.

I am not persuaded by petitioner's brief description of the transaction. If this were truly a joint advertising venture, it is unlikely that there would have ever been a title transfer of tangible personal property from petitioner to M---. Each party would probably have contributed his or her respective property to the project and retained title.

If petitioner's characterization of the transaction is accepted, another question is raised. What happened to the property after it was returned to petitioner? If it was used by petitioner for some other purpose, given away, or scrapped, it was self-consumed and still subject to use tax. No information was provided as to the condition of the property, or whether it was even saleable, after its removal from the display booth and after the appliances had been removed.

Sale to U. S. Construction Contractor. Revenue and Taxation Code section 6384 provides that tax applies to the gross receipts from the sale of tangible personal property to United States construction contractors, if the property is purchased for use in the performance of construction contracts with the United States. Regulation 1521(b) provides that United States construction contractors are the consumers of materials and fixtures which they furnish and install in the performance of contracts with the United States Government. As the consumers,

their purchases are subject to tax.

In these cases, the incidence of tax falls on the contractor, not on the United States. (See Chula Vista Electric Co. v. State Board of Equalization (1975) 53 Cal App 3d 445.) A sale must be directly to an agency of the United States Government, with no intervening use by the contractor, before it is immune from state tax under the U. S. Constitution, or is exempt under section 6381 of the Revenue and Taxation Code.

Petitioner's sale to --- B", a United States construction contractor working at M--- Air Force Base, was one of materials and fixtures for use in the performance of a construction contract with the United States. As such, it was subject to the sales tax.

Item C. The last item, Item C, should be a simple factual question. If the differences between the sales shown on the income tax return and those shown on the sales tax returns for the same periods of time were merely the result of a change, for income tax purposes, from an accrual to a cash method of accounting, no additional tax would be due. However, nothing was provided to substantiate either the alleged change in accounting method for income tax purposes, or its impact on petitioner's 199X tax liability. A bare assertion is not adequate evidence.

Petitioner was given a period of ten (10) days, following the appeals review conference, to provide additional documentary support for its allegations. To date I have received nothing. Without documentation of both the alleged accounting method change, for income tax purposes, and a mathematical determination of its impact on petitioner's 199X sales and use tax liability, I have no choice but to recommend that Item C be redetermined without change.

Recommendation

It is recommended that the tax be redetermined without adjustment.

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Donald L. Fillman  
Staff Counsel

Dated: March 2, 1995