

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

190.2515

In the Matter of the Petition )  
for Redetermination Under the ) DECISION AND RECOMMENDATION  
Sales and Use Tax Law of: )  
)  
S--- S---, INC. ) No. SY -- XX-XXXXXXX-010  
)  
)  
Petitioner )

This petition was heard on Tuesday, July 11, 1978, at 9:00 a.m. in Hollywood, California, by Hearing Officer Donald J. Hennessy.

Appearing for Petitioner:

L--- E. T---, Attorney at Law

A--- M---, Secretary - Treasurer

Appearing for the Board:

Irving D. Jenkins, Supervising Auditor

Peter C. Chan, Field Audit Supervisor

Protested Item  
(Audit Period 4/1/74 to 12/31/76)

Petitioner protests a Notice of Determination dated July XX, 1977, for tax and interest in the total amount of \$XXX,XXX.XX. Specific protest is to Items A and D of the Report of Field Audit dated June XX, 1977, which read as follows:

- |    |  |           |
|----|--|-----------|
| A. | Taxable fixtures and material cost on incompleted contracts                        | \$141,564 |
| D. | Disallowed amount of fixtures and material installed under time and material jobs. | \$19,169  |

### Contentions of Petitioner

A. The "completed contract" method of reporting tax for income tax purposes should also be accepted for sales and use tax purposes. Such method has been accepted by prior Board audits for sales and use tax purposes throughout Petitioner's 20 year history. Additionally, a "sale" cannot be deemed to have occurred until such time as the installation has been completed and accepted by the customer.

D. These transactions were either exempt sales to the U. S. Government or were sales for resale to customers who submitted purchase orders stating the sale was for resale.

### Summary of Petition

Petitioner is a corporation engaged in the business of designing, manufacturing, installing, selling and renting theatrical scenery, drapery, stage sets and stage equipment. There was a prior sales and use tax audit through June 30, 1973.

Item A raises the question of what is the proper period for which Petitioner must report its sales of fixtures and consumption of materials for transactions constituting "construction contracts" within Sales and Use Tax Regulation 1521. (Title 18, Calif. Administrative Code.) Petitioner's contracts take a period of time to perform and often run through one calendar quarter or fiscal year to another. Progress billings, which may or may not coincide with installation, are issued to cover costs and insure payment. Petitioner uses the "completed contract" method of reporting such transactions for federal and state income tax purposes. Prior Board audits did not disturb such reporting for sales and use tax purposes.

Item A includes the fixtures and materials from the work in progress as of December 31, 1976, the end of the audit period. Petitioner does not quarrel with the amount of tax, but only with when the tax must be reported. Petitioner believes the sales and use tax reporting should coincide with income tax reporting. Furthermore, Petitioner believes that the definition of "sale" in Revenue and Taxation Code Section 6006(a) is not satisfied until installation has been completed and accepted by the customer and that, therefore, the tax is not due until the contract is completed. Petitioner states that title clauses in certain of its contract lead to the same result.

Item D involves time and material contracts which Petitioner performed for H--- A--- Company (H---) and the J--- --- (J---) of the --- --- of --- in P---. H--- and J--- submitted purchase orders (see attachments to audit memo schedule R8-2B) stating that the curtains and draperies to be installed by Petitioner were for resale and that the purchase orders related to U.S. Government work. Petitioner therefore believes that the sales of the fixtures installed pursuant to such purchase orders were exempt sales to the U.S. Government or nontaxable sales for resale to H--- or J---.

### Analysis and Conclusions

Item A. Our research reveals that the Board has never accepted the “completed contract” method of reporting tax as permissible within the context of the Sales and Use Tax Law. The Board’s longstanding position is that the accrual method is the only permissible method of reporting sales and use taxes. The question often arises in the context of sales on credit and in this regard Sales and Use Tax Regulation 1641(c), in defining the due date of the tax, states that “the total amount of the tax on the entire sales price in credit transactions is due and payable on the due date of the return to be filed after the close of the reporting period in which the sale is made.” This is basically a statement of the accrual method of tax reporting; its application is not limited to “credit” transactions; it applies to all transactions to which the sales and use tax apply.

No different rule applies to construction contracts within Regulation 1521. The Board’s application of the accrual method to construction contracts was restated in the Board order on the petition for redetermination of J--- C---, Inc. (SZ --- XX XXXXXX), which was the subject of a public hearing in San Diego, California, on May 19, 1976, and in which J--- C---, Inc. presented substantially the same arguments as Petitioner does here. The Board concluded “...that tax is due on materials for the reporting period in which they are allocated to a contract and for installed fixtures no later than the reporting period during which they are installed....” This is the rule applicable to Petitioner’s furnish and install contracts.

Regarding Petitioner’s argument that such rule does not satisfy the definition of “sale” in Section 6006(a), it must first be noted that Petitioner is the consumer of, not the retailer of, “materials” used in performing its contracts within Regulation 1521. The applicable definition is not that of “sale” in Section 6006(a), but that of “use” in Section 6009. “Use” takes place when materials purchased ex-tax are removed from resale inventory and allocated for use in performing a contract.

As to fixtures, the “sale” of the fixture takes place on installation, at which time the fixture loses its status as tangible personal property and become a part of the real property. (General Electric Co. v. State Board of Equalization, 111 Cal. App. 2d 180; Honeywell, Inc. v. State Board of Equalization, 48 Cal. App. 3d 897.) Title passes on installation to the owner of the real property and any reservation of title is limited to the reservation of a security interest (Cal. U.C.C. Section 2401(2).) There is also a transfer of possession of the fixture which is defined in Section 6006(a) as a sale when it is in lieu of a transfer of title, which is the case when the transfer of title is subject only to the condition of payment. The condition of acceptance by the owner or architect does not negate a prior “sale” as Section 2404(4) of Cal. U.C.C. provides that rejection or revocation of acceptance reverts title to the goods in the seller. Such provision assumes a prior passage of title. We have found no title clauses in any of Petitioner’s contracts which require further comment on the Board rule.

Therefore, the accrual method applies to Petitioner's contracts. The acceptance by inaction of the completed contract method in Petitioner's prior audits was in error and provides that no basis for continuance of the error. (Market St. Ry. Co. v. State Board of Equalization, 137 Cal. App. 2d 87.)

Regarding Petitioner's comment that the application of the accrual method in this audit may result in a credit or refund, if any materials were allocated or fixtures installed prior to April 1, 1974 (start of audit period), Petitioner should specify the relevant contracts for the audit staff and an adjustment should be made if the tax is included in the determination here in question. This seems highly unlikely since, under the "completed contract" method, Petitioner would have reported the tax for the quarter in which the job was completed. If this was the case, no refund or credit is possible, as a voluntary payment of an amount of tax due is not refundable simply because the amount would have been barred at the time a determination actually issues. (Owens-Corning Fiberglass Corp. v. State Board of Equalization, 38 Cal. App. 3d 532.)

Item D. We have researched three preliminary matters which arose at the hearing with the following results. The audit staff is correct in pointing out that, while the Board position that household drapes are tangible personal property (not fixtures) was upheld in L.W.J., Inc. v. State Board of Equalization, 38 Cal. App. 3d 549, the Board position is that theatrical or classroom drapes or curtains such as are installed by Petitioner are "fixtures" within Regulation 1521. (See Business Taxes Law Guide (BTLG), Annotation 190.1440, dated June 3, 1965.)

Secondly, the case of Western Concrete Structures, Inc. v. State Board of Equalization, 66 Cal. App. 3d 543, has no relevance here as the court therein merely held that the plaintiff was the consumer of certain "materials" and not the seller thereof. Here, no on quarrels with Petitioner being the consumer of "materials", the only questions arise as to Petitioner's sales of "fixtures". Fixtures were not involved in the Western Concrete case, supra.

Thirdly, present Regulation 1521 did not change the application of tax to United States construction contractors. They are still the consumers of both materials and fixtures which they furnish and install in the performance of contracts with the U.S. Government. (See Sections 6007.5 and 6384; General Electric v. State Board of Equalization, 111 Cal. App. 3d 180; C.R. Federick, Inc. v. State Board of Equalization, 38 Cal. App. 3d 385, cert. denied 42 1. Ed. 2d 620.)

In our opinion, Petitioner is a United States construction contractor within Regulation 1521, since the definition of construction contractor includes subcontractors. Therefore, the contractor who furnishes and installs fixtures under a United States construction contract is "the construction contractor" within Regulation 1521.

Petitioner is therefore the United States construction contractor as to the fixtures and is the consumer of them, not the retailer of them as concluded in the audit. Petitioner therefore owes use tax on the cost of the materials from which the drapes or curtains were made. Petitioner could not sell the drapes or curtains to H--- or J--- for resale, nor were the drapes or curtains sold by Petitioner to the United States Government. Petitioner was the consumer of the drapes or curtains within Sections 6007.5 and 6384.

Recommendation

(1) Delete Item D from the audit and replace it with the cost of materials from which the drapes or curtains were made.

(2) Redetermine as adjusted

District to reaudit.

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Donald J. Hennessy, Hearing Officer

8-11-78

\_\_\_\_\_  
Date

\_\_\_\_\_  
Principal Tax Auditor

August 22, 1978

\_\_\_\_\_  
Date