



STATE BOARD OF EQUALIZATION

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November 14, 1994

BURTON W. OLIVER
Executive Director

Mr. O--- K---
K--- C---, Inc.
XXXX --- Avenue
---, Ca XXXXX

Re: K--- C---, Inc.
SR -- XX-XXXXXX

Dear Mr. K---:

Your letter dated August 2, 1994 to the Board's Union City branch office has been referred to the Legal Division for response. You ask whether the measure of tax includes charges for fabrication labor, and whether it includes your markup.

You state that you recently received a time and material contract to maintain railroad and crane rails for the Port of ---. Pursuant to this contract, you fabricated and installed a switch cover for one of the railroad switches. The new switch cover was made in your --- facility and was then transported to the railroad switch site. You removed the old switch cover and installed the new cover. Your invoice to the Port of O--- itemized "sales tax" measured by your charges for the switch cover, including fabrication charges and markup on the materials. You state: "The Port of O--- has removed the fabrication tax from my invoice, is this the correct procedure? The Port also said that I should not tax my mark up on materials..." You separately stated installation charges, and did not include them in the measure of tax.

Sales and Use Tax Regulation 1521, which explains the application of sales and use tax to construction contracts, defines "construction contract" to include a contract to erect, construct, alter or repair any building or other structure, project, development, or other improvement to real property. You have not described the switch cover sufficiently for us to determine whether it constitutes an improvement to real property. However, we will assume for purposes of this letter that the switch cover is an improvement to real property.

Regulation 1521 defines the terms "materials," "fixtures," and "machinery and equipment" as those terms apply to construction contracts. Materials are items which, after being incorporated into real property, lose their identity to become an integral and inseparable part of that real property. (Reg. 1521(a)(4).) A list of typical items regarded as materials is set forth in Appendix A of Regulation 1521. "Fixtures" are defined 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).) A list of typical items regarded as fixtures is set forth in Appendix B of Regulation 1521.

Items which constitute machinery and equipment are not improvements to real property. Since we assume the switch covers are improvements to real property, we will not discuss the application of tax to machinery and equipment.

The application of tax depends on whether you are the retailer or the consumer with respect to your contract with the Port of O---. The general rule is that construction contractors are consumers of materials they furnish and install in the performance of lump sum construction contracts, and tax applies to the sale to, or use by, contractors of such materials. (Reg. 1521(b)(2)(A)1.) In your situation, this would mean that no tax would be due on your charges for your own fabrication or markup.

However, a construction contractor is the retailer of materials furnished and installed pursuant to a time and material contract when the contract provides that the transfer of title to the materials will take place prior to the time the materials are installed, and separately states the sale price of the materials, exclusive of the charge for installation. (Reg. 1521(b)(2)(A)2.) In the case of a time and material contract, if the contractor bills his or her customer an amount for "sales tax" computed upon the contractor's marked up billing for materials, it will be assumed, in the absence of convincing evidence to the contrary, that the contractor is the retailer of the materials. (*Id.*) Sales tax will apply measured by the retail sale price, including the cost of the materials prior to installation, the markup, and the fabrication charges, but not including installation charges.

Contractors are the retailers of fixtures which they furnish and install in the performance of construction contracts, and tax applies to their sales of those fixtures measured by the retail selling price. (Reg. 1521(b)(2)(B)2.) When the contract does not state the sales price, Regulation 1521 explains how the sales price shall be determined. However, since you separately state the sales price, tax will be measured by that price, which includes the cost before installation, the markup, and the fabrication charges. Tax does not apply to installation charges.

Therefore, under a time and material contract which includes a separate charge itemized as "sales tax," you are the retailer whether the switch covers constitute materials or fixtures, and

sales tax applies to the separately stated charge for the switch covers, including markup and fabrication charges.

You indicate that you have another contract to fabricate and install seismic restraints for office furniture and other items within buildings for C--- Real Estate Management Company. Since you state that this is a "similar ongoing project" to the Port of O--- contract, it appears that this contract is also a time and material contract with a separate charge itemized as "sales tax"; therefore, the same analysis as above applies.

If you have further questions, please feel free to write again.

Sincerely,

Kelly W. Ching
Staff Counsel

KWC:cl

cc: --- District Administrator