

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

190.6805

BUSINESS TAXES APPEALS REVIEW SECTION

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

The Appeals conference in the above-referenced matter was held by Senior Staff Counsel W. E. Burkett on March 24, 19XX in San Bernardino, California.

Appearing for Petitioner: Mr. Patrick J. Leone
Certified Public Accountant

Appearing for the Sales and Use Tax Department: Mr. Carl Herth
District Principal Auditor

Mr. Michael B. Edwards
Senior Tax Auditor

Protested Items

The protested tax liability for the period July 1, 1988 through September 30, 1991 is measured by:

<u>Item</u>	<u>State, Local and County</u>
A. Transit Tax Increases (0.50%) considered not applicable to fixed price contracts.	\$9,250,710
B. State Temporary Tax Increase (1.25%) considered not applicable to fixed price contracts.	\$ 63,066

C. Earthquake Relief Fund (0.25%)
considered not applicable to fixed
price contracts. \$ 283,900

Contentions of Petitioner

A. The exclusion is applicable to purchases made under fixed price contracts entered into prior to the operative date of the change in the tax rate.

B. An exclusion is applicable because the property was "obligated" for use on engineering construction contracts or building contracts.

C. Same as stated for item B above.

Summary

The petitioner is engaged in business as a construction contractor specializing in steel products. A prior audit of petitioner was completed through September 30, 1987.

Protested item A consists of purchases of materials consumed on construction contracts performed in various transit districts after the effective dates of increases in the particular transit tax rate. Claimed exemptions for these amounts were denied by the field auditor.

It is petitioner's contention that an exclusion was applicable if it was obligated to make the purchases from vendors at the time of the rate change, or alternatively, if it was obligated to use property already purchased for use on a construction contract at the time of the rate change. These contentions are summarized in a letter prepared by Patrick L. Leone, CPA dated April 26, 1993, as follows:

"Under Section 7261 (f) (sic), if the purchaser is obligated to purchase the property for a fixed price pursuant to a contract entered into prior to the operative date of the ordinance it is exempt from the transit tax increase. If the contractor had a fixed price contract with its supplier, the material should be exempt. Also, to borrow the definition of 'obligated' from the State Board of Equalization notice to construction contractors dated August 12, 1991 (dealing with the 1.25% increase in the sales tax rate) the term means that the materials or fixtures are necessary for the completion of a construction contract."

The Sales and Use Tax Department (Department) contends that the exclusion is limited to purchases made under taxable purchase contracts entered into prior to the effective date of the tax increase. Since the petitioner made all purchases for resale, it is reasoned that no exemption is applicable in any event. It appears from the record that the petitioner consistently made

purchases for resale even though a large percentage of its purchases were used on construction contracts.

At the conclusion of the discussion on protested item A, the petitioner's representative advised that petitioner no longer objected to the application of the tax to protested items B and C.

Analysis & Conclusions

The petitioner relies primarily on the provisions of Transactions and Use Tax Section 7262(f) which reads as follows:

"A provision that the storage, use, or other consumption in the district of tangible personal property is exempt from the tax if the purchaser is obligate to purchase the property for a fixed price pursuant to a contract entered into prior to the operative date of the ordinance. The possession of, or the exercise of any right or power over, tangible personal property under a lease which is a continuing purchase of the property is exempt from tax for any period of time for which the lessee is obligated to lease the property for an amount fixed by a lease entered into prior to the operative date of the ordinance. For purposes of this subdivision, the storage, use or other consumption of, or possession of, or exercise of any right or power over, tangible personal property shall be deemed not to be obligated pursuant to a contract or lease for any period of time for which any party to the contract or lease has the unconditional right to terminate the contract or lease upon notice, whether or not the right is exercised."

By its terms this provision requires that the tax ordinance (including any amended ordinance increasing the rate of tax) provides for an exclusion from the increased tax rate "if the purchaser is obligated to purchase the property for a fixed price pursuant to a contract entered into prior to the operative date of the ordinance". A comparable provision is included as Revenue and Taxation Code Section 7261(g) to provide the seller with an exclusion from the transactions (sales) tax increase on the same terms and conditions. These exclusion provisions constitute partial exemptions from the tax. Statutes granting exemption from taxation must be reasonably, but nevertheless strictly, construed against the taxpayer. (See Santa Fe Transportation Co. v. State Board of Equalization, 51 Cal.2d 531, 539.)

Under the terms of Revenue and Taxation Code Section 7262(f), the exclusion from the tax increase is granted only for purchases made under fixed price contracts which were executory on the operative date of the ordinance and whose transit use tax burden thus could not be increased by reason of the fixed price. Absent the exclusion, the actual purchase would have resulted in an immediate taxable storage or use of the property and the application of the higher tax rate. There is no indication that the Legislature intended this limited exclusion to apply to other taxable events not arising by reason of the sale or purchase of the property under the fixed

price contracts.

In the present petitioned matter, the property was purchased without any tax obligation by tendering a resale certificate. The property was then held in resale inventory until such time as it was withdrawn for use on a particular construction contract. Contrary to the claim of petitioner, there was no taxable storage of the property or other taxable event prior to the time it was withdrawn from the resale inventory. (See particularly Revenue and Taxation Code Section 6008; Sales and Use Tax Regulation 1668(a)(2).)

The petitioner's purchases do not qualify for exclusion from the tax increase under Section 7262(f) because the taxable event did not arise by reason of a sale or purchase under a pre-ordinance date fixed price contract, but rather from the subsequent withdrawal from the resale inventory. It follows that the petitioner is not entitled to an exclusion for the property used in this manner.

It is also our conclusion that the ordinance did not incorporate the exclusion for materials and fixtures obligated pursuant to an engineering construction contract or a building contract as provided by Revenue and Taxation Code Section 6376.1. This section of the law provides for a limited exclusion from the increase in the rate of state tax. The incorporation and substitution of the transactions and use tax rate is prohibited by the provisions of Revenue and Taxation Code Section 7261(b) and 7262(b) which prohibits any amendment which operates so as to affect the rate of tax imposed by the district's board.

Recommendation

It is recommended that the petition be denied.

W. E. BURKETT, SENIOR STAFF COUNSEL

DATE