

Petitioner's Contentions

The petitioner states that it is directed to all of the items in the auditor's report, but primarily to the fabrication labor issue (Item F).

With respect to the Item F, it is contended that the labor performed was not fabrication labor and in any event since the labor was performed on Petitioner's own property no tax is applicable.

At the hearing Item E also was discussed. Petitioner contending that the 20% "mark up" in actuality was merely an exempt service and handling charge. No specific argument was presented with regard to the balance of the items identified on the audit report.

Summary of Petition

Petitioner is a corporation engaged in the repair, servicing and adapting motor vehicles for auto racing.

On September 1, 1966, Begin deleted text REDACTED TEXT End deleted text Parent of this Petitioner, entered into a contract with Begin deleted text REDACTED TEXT End deleted text for the basic purpose of adapting Begin deleted text REDACTED TEXT End deleted text stock cars for racing and the entering of the cars in such performance events.

The contract while entered into by Begin deleted text REDACTED TEXT End deleted text was performed in California by Begin deleted text REDACTED TEXT End deleted text its subsidiary, with the consent of Begin deleted text REDACTED TEXT End deleted text.

The performance under the contract engenders the tax consequences which are the primary subject to this petition.

Included in the audit on Item F are charges made by Petitioner to Begin deleted text REDACTED TEXT End deleted text for the adaptation of the stock cars to racing cars on the basis that such charges are for fabrication labor performed on cars owned by Begin deleted text REDACTED TEXT End deleted text.

Petitioner argues that the adaptation consists of repair and exempt installation labor and not fabrication labor. It is further contended that in any event the labor is performed on Petitioner's own property by virtue of the contract provision transferring title and possession of the vehicles to Petitioner by Begin deleted text REDACTED TEXT End deleted text.

Item E consists of a charge of 20% of the cost of parts purchased by Petitioner for use on the Begin deleted text REDACTED TEXT End deleted text cars. Tax on the cost price of the parts was included in the billing to Begin deleted text REDACTED TEXT End deleted text for reimbursement

of expenses, however, no tax was billed or paid on the 20% added to the cost of the parts by Petitioner. The audit has included 20% "mark up" as additional sales price of the parts to Begin deleted text REDACTED TEXT End deleted text.

Analysis and Conclusion

The primary issue to be resolved is whether the vehicles supplied by Begin deleted text REDACTED TEXT End deleted text and upon which modification and adaptation is performed are Petitioner's own property or remain the property of Begin deleted text REDACTED TEXT End deleted text.

Pursuant to the agreement entered into between Begin deleted text REDACTED TEXT End deleted text and Begin deleted text REDACTED TEXT End deleted text, the parties have agreed that "in consideration of mutual covenants herein,"

1. Begin deleted text REDACTED TEXT End deleted text during the period of this agreement and in accordance with its terms and conditions, shall:

A. Receive possession and title to certain Begin deleted text REDACTED TEXT End deleted text Division automobiles and related components to be supplied by Begin deleted text REDACTED TEXT End deleted text.

2. Services to be performed by Begin deleted text REDACTED TEXT End deleted text

A. Transfer to Begin deleted text REDACTED TEXT End deleted text possession of and title to as many Begin deleted text REDACTED TEXT End deleted text Division automobile and components thereof as are necessary for the performance of this agreement.

The above provisions expressly provide that possession and title to the automobile are transferred to Petitioner. We were informed that no formal documentation of title were executed. However, we were further informed that the parties operation under the terms of the agreement, without dispute during the entire history of the transaction. In this regard, a letter statement of Begin deleted text REDACTED TEXT End deleted text was submitted for our consideration. The statement provides that Mr. Begin deleted text REDACTED TEXT End deleted text was an employee of Begin deleted text REDACTED TEXT End deleted text at the time the contract was entered into and until November 1970 that Mr. Begin deleted text REDACTED TEXT End deleted text was charged with the responsibility in connection with the administration of the contract. The affidavit further provides that, consistent with the terms and provisions of the contract, title and ownership of the vehicles provided by Begin deleted text REDACTED TEXT End deleted text under the terms of that contract during the years it was in effect passed to Begin deleted text REDACTED TEXT End deleted text and that said vehicles were not owned by Begin deleted text REDACTED TEXT End deleted text.

It is the purpose of the statement to reaffirm Petitioner's contention that the intent of the parties to transfer title consistent with the terms of the contract was in fact a mutual intent which controlled the status of the vehicles.

Pursuant to the terms and provisions of the agreement however, Begin deleted text REDACTED TEXT End deleted text retained a complete control over the vehicles. The title transferred was, therefore, less than an absolute property in the vehicles. Begin deleted text REDACTED TEXT End deleted text retained the right of approval with respect to the performance events in which the vehicles were to be entered (Item 1C(1)); the appointments of the racing teams to be utilized in competing in the performance events (1D(2)) conditions under which Begin deleted text REDACTED TEXT End deleted text may transfer title to one or more of the cars to the racing teams (2B(2)); and the performance of repairs to the vehicles (2B(2)). Under the agreement the replacement and disposition of the vehicles and components are provided for by the following terms:

"4. Replacement of Cars and Associated Components.

A. In the event that, in Begin deleted text REDACTED TEXT End deleted text opinion, any car or component

(1) Is damaged or worn to the extent that it cannot be raced further, or

(2) Should be withdrawn from racing for any other reason, Begin deleted text REDACTED TEXT End deleted text should replace such automobile or component and Begin deleted text REDACTED TEXT End deleted text shall therefore perform its obligations hereunder with respect to Begin deleted text REDACTED TEXT End deleted text such replacement.

B. Begin deleted text REDACTED TEXT End deleted text shall remove or cause the removal from racing service of any car or component for which a replacement has been made by Begin deleted text REDACTED TEXT End deleted text , in which event, Begin deleted text REDACTED TEXT End deleted text at its own discretion may employ one or more of the following procedures in disposing of any item so replaced:

(1) Begin deleted text REDACTED TEXT End deleted text will take title to and possession of such car or Begin deleted text REDACTED TEXT End deleted text component.

(2) Begin deleted text REDACTED TEXT End deleted text will take title to such car or component and shall Begin deleted text REDACTED TEXT End deleted text request that Begin deleted text REDACTED TEXT End deleted text attempt to sell those items on Begin deleted text REDACTED TEXT End deleted text behalf. In consideration therefore, Begin deleted text REDACTED TEXT End deleted text agrees to pay Begin deleted text REDACTED TEXT End deleted text a commission equal to twenty percent

(20%) of the proceeds resulting from such sale.

(3) Begin deleted text REDACTED TEXT End deleted text will take title and offer to sell such items to Begin deleted text REDACTED TEXT End deleted text at a price to be determined by Begin deleted text REDACTED TEXT End deleted text. All Begin deleted text REDACTED TEXT End deleted text items so purchased by Begin deleted text REDACTED TEXT End deleted text will become the property of Begin deleted text REDACTED TEXT End deleted text.

In view of the above terms and provisions of the agreement Petitioner could deal with the property only as directed by Begin deleted text REDACTED TEXT End deleted text. No ownership passed to Petitioner until such time as it elected to purchase the property in accordance with the provisions dealing with the withdrawal and disposition of the property.

We find the complete control over the property and the retention of incidents of ownership by Begin deleted text REDACTED TEXT End deleted text inconsistent with ownership of the property in Petitioner. A title clause standing alone is not conclusive of ownership for tax purposes when it appears that the taxpayer retains the essential indicia of ownership. (General Dynamics Corp. v. County of Los Angeles, 51 Cal 2d 59.) Ownership of property is not a single indivisible concept but a collection or bundle of rights with respect to that property. All of the rights inherent in the property were retained by Begin deleted text REDACTED TEXT End deleted text. It is concluded that for sales and use tax purposes, ownership of the vehicles upon which Petitioner performed the modification rested in Begin deleted text REDACTED TEXT End deleted text and not in Petitioner.

Section 6006(b) of the Revenue and Taxation Code provides that “sale” means and includes 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 imprinting.

Regulation 1526, which implements the above statutory provision provides,

“Tax applies to charges for 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.

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. The terms do not include operations which do not result in the creation or production of tangible personal property or which do not result in the creation or production of tangible personal property or which do not constitute a step in a process

or series of operations resulting in the creation or production of tangible personal property, but which constitutes merely the repair or reconditioning of tangible personal property to refit it for the use for which it was originally produced.”

It is contended that the labor of adapting the stock cars for racing purposes is not labor involving “fabricating” within the meaning of Section 6006(b) of the Revenue and Taxation Code. While it is true that “fabricating” is not defined in the statute the board has interpreted the term to mean that labor involved 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.

The vehicles here involved were regular new stock cars taken directly from assembly line. At this point the vehicles were entirely unsuitable for racing purposes.

According to Petitioner the labor required to adapt these cars for racing consisted of two types.

1. Blueprinting the engine.

This procedure is described by Petitioner as, Blueprinting engines involves primarily disassembly and subsequent reassembly of the engine to the precise specifications of the manufacturer. This procedure is further described in the following manner. The first step is a teardown of the engine. Each part is inspected, magnafluxed or zyglold. Begin deleted text REDACTED TEXT End deleted text use a Magnaflux Ultrasonic testing machine to measure cylinder wall thickness on the engine blocks used in their race cars. These parts with even the most minor flaws are discarded. Next all dimensions of the crankshaft journals, rod and main bearings are measured and fitted using the high precision Sheffield air measuring system. The sizes and resulting clearances are noted on that engine’s papers.

Begin deleted text REDACTED TEXT End deleted text works with a tolerance of .0001 inch. Following this we balance all moving elements. Various parts are grouped in matching sets, identical in weight and size. Tolerance is within ¼ gram. The last is cleaning. We employ sonic cleaning machine for this job. The parts are immersed in the tank while sound waves vibrate the tiniest dirt and metal particles away. With these clean parts we reassemble the engine. The completed engine assembly then goes to the mass balancer where the engine is balanced under its own power. The final step is break in and power run on the dynamometer.

2. Other labor.

Petitioner states that the major portion of this labor is expended to reduce the weight of the production vehicles and to remove flammable material for driver safety. Some of the labor is expended in replacing standard parts with competition components for example, cutting and fitting is

required for hoods, wheel wells, and oil pans. Also, it may be necessary to change radius rods, perhaps change transmissions and enlarge fender wells for larger tires, etc.

The production stock cars as delivered from the manufacturers assembly line were complete production units which were suitable for inclusion in dealers inventories for sale to the public, the purpose of which they were produced. No further modification or adaptation was required for that purpose.

The units as produced however, were incomplete for racing purposes. The additional work required to modify and adapt the vehicles for competition events constituted a step or series of steps in the production of a racing model and is regarded for sales and use tax purposes as fabrication labor the charges for which are subject to the tax.

Recommendation

That the determination be redetermined without adjustment.

Signature of Joseph Manarolla, Hearing Officer

Joseph Manarolla, Hearing Officer

12/11/73

Date

Reviewed for Audit:

No signature

Principal Tax Auditor

No date

Date