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STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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Executive Director

December 18, 1992

Ms. W--- C---
Sales Tax Supervisor
[Name 1]
--- --- ---
--- ---, MN XXXXX

Dear Ms. C---:

This is in response to your letter dated November 18, 1992 regarding the application of tax to your charges for repairs to vehicles owned by, or leased to, [Name 2]. [Name 2] refuses to pay tax or tax reimbursement to you based on the case of *Aerospace Corporation v. State Board of Equalization* (1990) 218 Cal.App.3d 1300. [Name 2] characterizes that case as having held that contractors are exempt from sales and use taxes added to the cost of materials and supplies purchased for overhead accounts which are then allocated to federal government contracts containing title provisions. As a result of this decision, it states:

> "[Name 2] S--- & D--- has become exempt from California sales and use tax for purchases except the following:
>
> (1) Purchase of capital assets and improvements to real property,
>
> (2) Lease/rentals of tangible personal property."

[Name 2]'s has a basic misunderstanding of the *Aerospace* case. That case provided no exemption whatsoever for sales of property to persons such as [Name 2] who consume that property in the performance of contracts with the United States. Rather, that case relates to whether certain sales to persons performing contracts for the United States are sales for consumption by the contractor (i.e., retail sales) or instead are sales to the contractor for resale to the United States.

When a person purchases tangible personal property that the purchaser will consume in the performance of its contract with the United States, that sale of property to the contractor is subject to sales or use tax. (See, e.g., Rev. & Tax. Code § 6384.) On the other hand, only retail sales are subject to sales or use tax. (Rev. & Tax. Code §§ 6051, 6201.) Thus, if [Name 2] were reselling property to the United States prior to any use by [Name 2], the sale to [Name 2] would not be subject to tax because it would not be a retail sale. (Rev. & Tax. Code § 6007 (retail sale is a sale for any purpose other than resale in the regular course of business), Reg. 1668.) If this were the case, [Name 2]'s sale to the United States would, of course, be exempt from sales or use tax. (Rev. & Tax. Code § 6381.)

The *Aerospace* case examined the Board's Regulation 1618. The regulation provided that, regardless of the provisions of a person's contract with the United States, certain overhead materials would not be regarded as resold to the United States for purposes of sales and use tax. The challenged portion of Regulation 1618 stated:

> "If 'overhead materials' are charged to an expense account which is then allocated to various locations, cost centers or contracts, some of which are not exclusively engaged in cost reimbursement contracts and/or fixed-price contracts with a progress payments clause, it will be considered that title did not pass to the United States prior to use of the property, and tax will apply with respect to the purchase or use of all the property charged to the overhead expense account, unless the overhead item is specifically accounted for as being charged to a specific contract, pursuant to the terms of which title passes to the United States prior to the use of the item, through some type of requisition, work order or similar accounting device."

In effect, what this provision stated was that if a contractor charged the cost of a light bulb in such a way that part of the cost was allocated to a contract with the United States which passed title prior to any use by the contractor and part of the cost was not allocated to such a contract, we would generally not have regarded the contractor as reselling part of the light bulb to the United States prior to any use by the contractor.

Even before the *Aerospace* decision, however, Regulation 1618 regarded property as resold to the United States prior to any use by the contractor when the cost of that property was entirely allocated to a qualifying contract or contracts. For example, if all of a contractor's business was pursuant to contracts with the United States which included the relevant title passage provisions, and all of that contractor's overhead expenses were allocated to such contracts, the *Aerospace* decision would have had no effect on that contractor's business since Regulation 1618 already provided that such property was purchased for resale to the United States. *If the cost of a particular item or items was* allocated to a specific contract under which title passed to the United States prior to any use by the contractor, that contractor was regarded as purchasing the property for resale.

The court in *Aerospace* concluded that the portion of Regulation 1618 quoted above was invalid when it conflicts with the terms of a person's contract with the United States. The contract that Aerospace had with the Air Force provided that title to the subject property passed to the United States prior to any use of that property by Aerospace. The court held that the Board's regulation could not disregard this title provision clause and that the property was therefore regarded as sold to Aerospace for resale to the United States. In effect, the court concluded that if the contractor's contract with the United States provided that the United States would purchase only one-half of each light bulb the contractor used to illuminate its work area, then the United States did in fact purchase one-half of each light bulb. The sale to Aerospace, which the Board had regarded as a taxable retail sale, was therefore not subject to sales or use tax since it was a sale for resale. Aerospace's sale to the United States was, of course, exempt from sales tax.

The *Aerospace* case did not alter the only basis upon which a person may purchase property for resale, that is, that it will resell the property prior to any use. In order to come within the *Aerospace* case with respect to the purchase of any property, the purchaser must show that it resells such property to the United States prior to any use.

If a vehicle you repair for [Name 2] is registered to the United States, then property you install on that vehicle would usually be the property of the United States unless the government's contract with [Name 2] provides that [Name 2] is entitled to remove that property at the end of [Name 2]'s contract with the United States. Therefore, property installed onto a vehicle registered to the United States would normally be regarded as purchased by [Name 2] for resale to the United States. If any if the transactions were of this type and if [Name 2] issued you a timely and valid resale certificate when purchasing such property, we would regard you as having accepted that certificate in good faith, and you would be relieved of liability for sales or use tax. However, my understanding is that none of the transactions were of this type.

We might reach a different conclusion when you perform repairs on a vehicle registered to [Name 2]. If the vehicle is owned by [Name 2] at the time of the repairs and will be owned by [Name 2] at the end of its contract with the United States, it does not appear that [Name 2] would be purchasing the parts which become part of that vehicle for resale to the United States. Rather, it appears that [Name 2] would merely be consuming those parts in the performance of its contract with the United States. A general title provision in the contract with the United States would not necessarily pass title to such parts to the United States. On the other hand, if [Name 2]'s contract with the United States clearly and specifically provides for passage of title to such parts to the United State prior to any use by [Name 2] notwithstanding [Name 2]'s ownership of the vehicles, under the logic of the *Aerospace* case that title passage provision would be controlling and we would regard [Name 2] as having purchased such parts for resale.

A similar analysis is applicable to your repairs of vehicles that you lease to [Name 2]. I assume that you are either collecting use tax measured by rentals payable from such leases or made a timely election to report and pay sales tax reimbursement or use tax measured by the cost of such vehicles. When you perform repairs on vehicles that you lease to [Name 2], it does not appear that [Name 2] would be passing title to the parts installed during the repairs to the United States under a general title passage provision.

As noted above, the relevance of the *Aerospace* case is that it held that the terms of a contract with the United States are controlling. As relates to your inquiry, the critical question is whether the applicable contract between [Name 2] and the United States passes title to the property in question to the United States prior to any use of the property by the contractor. When a contractor's contract with the United States passes title to property prior to any use of the property by the contractor, even if that passage of title makes no practical sense (e.g., one-half a light bulb or parts on a vehicle owned by [Name 2]), that title passage provision is controlling and the contractor is regarded as having purchased the property for resale.

As you know, all your sales are presumed to be taxable retail sales until you establish otherwise. (Rev. & Tax. Code §§ 6091, 6241.) In order to avoid liability for sales tax or for collection of use tax with respect to your sales of tangible personal property in California or for use in California you must prove that the property was actually resold prior to use unless you take a timely and valid resale certificate in good faith. If you accept a timely and valid resale certificate from [Name 2] with respect to the sales in question, and you accept that certificate in good faith, you will be relieved of liability for sales tax or for collecting use tax. If there were any tax applicable to such transactions, we would look to [Name 2]. (Reg. 1668.)

You did not include a seller's permit number in your letter. Please telephone and provide us with the applicable account number so that we can place this correspondence in the correct file. (If neither my secretary nor I answer, please simply give the account number to the person who answers and ask him or her to give me the message.) If you have further questions, feel free to write again.

Sincerely,

David H. Levine
Senior Tax Counsel

DHL:es

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GRAY DAVIS
Controller, Sacramento

BURTON W. OLIVER
Executive Director

January 20, 1994

Ms. W--- C---
Sales Tax Supervisor
[Name 1]
--- --- ---
--- ---, MN XXXXX

Dear Ms. C---r:

In a letter dated December 18, 1992, I responded to your inquiry regarding the application of tax to certain repairs of vehicles. We have reexamined one of the conclusions in that letter and believe that clarification is necessary.

In the December 18, 1992 letter, I analyzed the basis for a United States supply contractor to purchase items extax. As I explained, there is no exemption for property consumed by such a contractor on a federal contract, but the contractor may be entitled to purchase property extax for resale to the United States (the sale by the contractor to the United States would be the exempt sale). I also explained that the case of Aerospace Corporation v. State Board of Equalization (1990) 218 Cal.App.3d 1300 did not change this analysis, but did make clear that the terms of a contract with the United States are controlling.

In my previous letter, I considered vehicle repair contracts involving the sale of parts, under circumstances where the United States might not own the vehicles being repaired. I had concluded that a general title passage provision between [Name 2] (the person purchasing the parts) and the United States would not necessarily pass title to the United States to parts installed on vehicles not owned by the United States and that a clear and specific title passage provision covering such parts might be necessary to regard [Name 2] as having purchased the parts for resale to the United States.

Although this analysis is correct, it has been pointed out to me that my statement that a general title passage provision "would not necessarily pass title to such parts to the United States" can be read as saying that such a general title passage provision "would not pass title." As noted in my previous letter, the terms of a contract with the United States regarding title passage are controlling "even if that passage of title makes no practical sense." Thus, when [Name 2] and the United States have a contract containing a general accelerated title passage provision, if [Name 2] and the United States understand that provision as applying to parts purchased by [Name 2] and installed onto vehicles not owned by the United States, we will recognize those parts as having been purchased by [Name 2] for resale to the United States. As explained in my previous letter, if you take a timely resale certificate in good faith from [Name 2], then you will be relieved of liability for tax on your sale of parts and, if any tax were applicable, we would look to [Name 2]. Under such circumstances, assuming [Name 2] purchased such parts for resale under a contract with a general accelerated title provision, it could establish that it and the United States understood the general provision as covering such parts by establishing that it and the United States accounted for the parts in that manner.

I hope this clarification is helpful. If you have any questions, feel free to contact me.

Sincerely,

David H. Levine
Senior Staff Counsel

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