

STATE OF CALIFORNIA
 BOARD OF EQUALIZATION
 BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the petition)	
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
)	
<u>Petitioner</u>)	

The Appeals conference in the above-referenced matter was held by Staff Counsel Carl J. Bessent on January 25, 1995 in Sacramento, California.

Appearing for Petitioner:

Appearing for the Sales and Use Tax Department:	Mr. Jack Warner Out-of-State District Principal Auditor
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Protested Item

The protested tax liability for the period January 1, 1989 through December 31, 1991 is measured by:

<u>Item</u>	<u>State, Local and County</u>
A. Ex-tax purchases of materials and supplies used on U.S. Government construction contracts (Contract _____)	\$41,100

Petitioner's Contention

The Board improperly levied use tax on materials owned by the U.S. Government which qualified for exemption from taxation.

Summary

Petitioner is a Delaware corporation headquartered in Illinois. Petitioner is a wholly-owned subsidiary of the _____ a second tier holding company under the control of _____. Petitioner's principal business activity is the custom design, engineering, fabrication and erection of large welded-plate storage and processing tanks, petroleum and chemical storage tanks, waste water treatment facilities, and other specially manufactured structures for research facilities and industrial processes. A prior audit was conducted for the period through December 31, 1988.

In June 1990, petitioner entered into a lump-sum contract with the National Aeronautics and Space Administration (NASA) for the manufacture, supply and erection of a certified and code-stamped pressure vessel wind tunnel at _____, California. The manufacture of the component parts of the wind tunnel occurred at petitioner's fabrication facility in _____. Specially ordered steel plate was purchased from vendors in Indiana, Utah and California, with the majority of the steel coming from _____. The steel plate was fabricated into the component wind tunnel parts and shipped to the jobsite in California via flatbed truck or rail. A large amount of the needed steel plate was stored at the _____ facility for several months prior to the actual fabrication of the wind tunnel components. At the jobsite, petitioner did the installation.

According to petitioner, a special invoicing and payment process was created in accordance with the terms of the contract. Pursuant to Part II, Section I, of the contract clauses for construction, paragraph 52.252-2 incorporates by reference various Federal Acquisition Regulations (FAR). FAR 52.232-27(a)(1)(i)(A) required NASA to remit payment to petitioner within 14 days after invoice approval. According to petitioner, invoices were generated by petitioner within two weeks of every month end, and were pre-approved by NASA at the _____ jobsite. The result of this process was to reimburse petitioner for all material purchases within 60 days from the date of purchase (FAR 52.232-5(b)). Pursuant to FAR 52.232-5(f), upon petitioner's receipt of payment, title to all materials and work covered by the payment passed to NASA. Thus, title to the majority of the steel plate purchases passed to NASA prior to the actual fabrication of the component parts. Petitioner states that title to the fabricated component parts passed prior to the materials entering the State of California and their arrival at the jobsite.

Petitioner stated at the conference that construction of the wind tunnel started in 1991, the hull was completed in 1993, and the wind tunnel will be available for use for testing in 1995.

At the conference, petitioner went step by step through Exhibits 4 through 8 which are located in the petition file at pages 5 through 9. Exhibit 4 indicated that petitioner received steel plate on July 10, 1991. Each shipment was specifically marked and identified. Next, in Exhibit 8, invoice date August 16, 1991, NASA had 14 days to pay from the approval date. Next, Exhibit 5 showed an internal cash funding report dated September 3, 1991 showing a receipt of approximately \$1.9 million from NASA. Petitioner states that this is when title passed to NASA. Next, Exhibit 6 showed the date the metal entered into the fabrication facility. This is more than five months after NASA paid for the material. Next, Exhibit 7 revealed a change in the name of the product because the metal was fabricated and became a support ring assembly. The fabricated metal left the shop on June 4, 1992.

Petitioner states that the levy of additional use tax was erroneous as title to the material passed to NASA prior to petitioner's use or storage of the materials in the State of California. Petitioner also relies on Aerospace Corp. v. State Board of Equalization (1990) 218 Cal.App.3d 1300 and Lockheed Aircraft Corporation v. State Board of Equalization (1978) 81 Cal.App.3d 257.

Prior to the conference, the Sales and Use Tax Department's (Department) position was that title to the materials used in the government contract passes as payment is made by the government (i.e., progress payments). Progress payments cover materials and labor to date, less a hold-back amount. The materials would already be in place in most instances prior to any payments. The amounts included as allowable in the audit is as allowed under Sales and Use Tax Regulation 1521(a)(6)(C).

At the conference, the Department reviewed the documents supplied by petitioner and stated that it appeared title to the materials passed to NASA outside California.

Petitioner stated that the reaudit report dated January 18, 1994, does not reflect the payment made on February 24, 1993. (See Exhibit 1.) Subsequent to the conference, an Appeals Section auditor did a computer check of the records (see Exhibit 2) which reflects petitioner's February 24, 1993 payment.

Analysis and Conclusion

FAR 52.232-5(f) states in pertinent part that, "All material and work covered by progress payments made shall, at the time of payment, become the sole property of the Government." We conclude that petitioner obtained title to the goods outside California and transferred title to NASA before the goods entered California. Therefore, any subsequent use in California would be on behalf of the U.S. Government and beyond the reach of California tax law. This is because Revenue and Taxation Code Section 6202 is interpreted to mean that the person liable for the tax is the person who purchases the property and who uses the property while owning it in California. In order for use tax to apply, there must be some use in California which is incident to the ownership of the property in question. (Rev. & Tax. Code § 6009.) Since title to the goods sold vested in the U.S. Government prior to entry into California, no taxable use is made in California. Petitioner was merely installing or otherwise using government-furnished goods. Petitioner would not then be responsible to collect use tax.

Neither the Aerospace case nor the Lockheed case involved U.S. Government construction contracts, which are distinguishable from U.S. Government supply contracts. The California Legislature has statutorily provided for different classifications for U.S. Government construction contractors. (Rev. & Tax. Code §§ 6007.5 and 6384.)

Recommendation

Grant the petition.

Carl Bessent, Staff Counsel

2/24/95
Date

Attachment: Exhibits 1 and 2