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STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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July 2, 1991

Ms. C--- M. C---
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XXXX --- Avenue, Suite XXXX
---, Texas XXXXX-XXXX

Dear Ms. C---,

This is in reply to your May 13, 1991 letter addressed to Senior Tax Counsel John Abbott requesting our opinion on the application of California sales and use tax to certain hypothetical factual situations outlined in your letter. Your letter does not identify a client on whose behalf you request our opinion and, therefore, this opinion is not issued pursuant to Revenue and Taxation Code section 6596 and cannot be relied on as having binding effect.

Your factual situations involve a company ("the Company") which manufactures, sells, and sometimes installs, asphaltic concrete. The Company mines certain ingredients, and purchases others, for incorporation in the asphaltic concrete.

The Discussion portion of your letter points out that Sales and Use Tax Regulation 1521, Construction Contractors, specifically defines the paving of surfaces as a construction contract; such regulation also classifies construction contractors as consumers of "materials" which they furnish and install. You further point out that the chart appearing at State Board of Equalization Audit Manual section 1207.40 provides that a lump-sum construction contractor obtaining materials from its own realty for use in improving other realty incurs no sales or use tax liability.

You then discussed, at some length, Western Concrete Structures, Inc. v. State Board of Equalization, 66 Cal.App.3d 543, which you describe as concluding that Western Concrete Structures, Inc. (WCS) was a consumer, rather than a retailer, of materials even though WCS was not contractually obligated to perform the actual installation of the materials (steel tendons). To the extent Western Concrete Structures is relevant to the hypothesis below, we note that our interpretation of such court opinion is more limited than yours.

Western Concrete Structures is far from clear on a number of points. Firstly, did the court really hold that installation was not the contractual obligation of WCS, as you contend? In reaching its holding, the court states:

> "There was evidence that WCS was contractually responsible and directly provided all supervision and testing in the installation of the tendons and was required to make necessary corrections in the installed tendons, whenever there was a force failure…WCS's contractual services in connection with the installation of the tendons were pervasive. The totality of the picture evoked by the court's findings is that all employees of the general contractor – including supervising personnel – labored under the expert direction of WCS's representative on the job site." (Emphasis added.)

The court's opinion in Western Concrete Structures is surely open to the interpretation that WCS was "obligated" or "responsible" for the installation. Furthermore, as our underlining of "representative on the job site" in the above quote emphasizes, WCS always had an installation expert present at the job site supervising the general contractor's personnel, or the subcontractor's personnel, who performed the installation labor.

Lastly, we believe an indispensable part of the court's holding in Western Concrete Structures is expressed in its statement, on page 547, that:

> "Only WCS had the required expertise."

The lack of expertise on the part of those performing the installation labor, combined with WCS's responsibility "…through contract interpretation, custom and practice…to make corrections regardless of who is at fault …" are essential findings of the Western Concrete Structures opinion.

The lack of clarity in Western Concrete Structures, particularly as to the three points we just discussed, has made it a controversial case. A very similar factual situation, again involving post-tensioning tendons, is back before the superior court and has yet to come to trial in VSL Corporation v. State Board of Equalization, San Francisco Superior Court Case No. 910542 filed September 8, 1989. The final answer is not yet in as to Western Concrete Structures.

Nevertheless, our difference of opinion as to the interpretation of Western Concrete Structures does not prevent us from replying to your hypotheticals as to the asphalt concrete industry. We have been writing on asphalt contracts since at least 1953, e.g., see Business Taxes Law Guide Annotations 190.0040 (5/22/57) on asphalt on roads, and 190.0060 (9/1/53) on asphalt and similar products. My research on your hypotheticals brought to my attention that, unfortunately, a certain market place disequilibrium has occurred, particularly in Northern California, because of inconsistent application of sales and use tax to asphalt road contracts. This inconsistency, in our opinion, results from improper attempts, by contract draftsmanship with little connection to reality, to reclassify a retailer of "materials" as a consumer of those materials within Regulation 1521 in circumstances in which the retailer contracts with a prime contractor for the retailer to "furnish and install materials", with the retailer in turn subcontracting the work of installation back to the prime contractor. It is our position that, in such circumstances, or in any even more inventive variation of such circumstances, the retailer is making a taxable retail sale of materials to the prime contractor and is not the consumer of materials. Any agreement providing otherwise, whether by single contract or multiple contracts, will be disregarded for sales and use tax purposes.

For each of your hypotheticals, we now state the hypothetical itself, the contention/conclusion you submitted, and our opinion:

Hypothetical 1

The Company, either independently as a prime contractor or by subcontracting with a prime contractor, enters into a lump sum contract to furnish and install asphaltic concrete. The installation is performed by the Company's employees.

Your Contention/Conclusion – Contract 1

The Company is a construction contractor furnishing and installing asphaltic concrete under a lump sum contract, and as such, is the consumer of all materials purchased and/or mined. As the consumer of materials, the Company must pay California sales/use tax on all materials purchased, but those materials mined will not be subject to tax.

Our Opinion

We agree that the company is the consumer of materials; sales tax reimbursement or use tax must be paid on all materials purchased but there will be no sales or use tax as to the materials mined by the Company.

Hypothetical 2

The Company, either independently as a prime contractor or by subcontracting with a prime contractor, enters into a lump sum contract to furnish, haul and install asphaltic concrete. The Company subcontracts the hauling and installation of the asphaltic concrete to an unrelated third party. The installation occurs under the direction of the Company and is performed by employees of the third party subcontractor.

Your Contention/Conclusion – Contract 2

The Company is a construction contractor and is contractually obligated to furnish, haul and install asphaltic concrete under a lump sum contract. The fact that the Company subcontracts the installation does not alter the underlying contractual relationship which involves the furnishing and installation of asphaltic concrete. The Company is the consumer of all materials purchased and/or mined. As the consumer of materials, the Company must pay California sales/use tax on all materials purchased, but those materials mined will not be subject to tax.

Our Opinion

We agree that the Company is the consumer of materials; sales tax reimbursement or use tax must be paid on all materials purchased, but there will be no sales or use tax as to the materials mined by Company. Our conclusion would be the same even if the installation was not under the direction of the Company.

Hypothetical 3

The Company enters into a lump sum contract with a prime subcontractor to furnish, haul and install asphaltic concrete. The Company subcontracts the hauling and installation of the asphaltic concrete to the prime contractor. The installation occurs under the direction and supervision of the Company and is performed by employees of the prime contractor.

Your Contention/Conclusion – Contract 3

The Company is a construction contractor and is contractually obligated to furnish, haul and install asphaltic concrete under a lump sum contract. The fact that the Company subcontracts the installation back to the prime contractor does not alter the underlying contractual relationship which involves the furnishing and installation of asphaltic concrete. The Company is the consumer of all materials purchased and/or mined. As the consumer of materials, the Company must pay California sales/use tax on all materials purchased, but those materials mined will not be subject to tax.

Our Opinion

Your analysis is incorrect. The Company is the retailer of the materials with sales tax applying to its gross receipts from the sale of the materials. The "two" contracts are treated as on integrated agreement for California sales and use tax purposes. The obligation of the Company to "furnish and install" is without substance for California sales and use tax purposes.

Hypothetical 4

The company enters into a lump sum contract with a prime contractor to furnish, haul and install asphaltic concrete. The Company subcontracts the hauling and installation of the asphaltic concrete to an affiliate of the prime contractor. The installation occurs under the direction and supervision of the Company and is performed by employees of the prime contractor's affiliate.

Your Contention/Conclusion – Contract 4

The Company is a construction contractor and is contractually obligated to furnish, haul and install asphaltic concrete under a lump sum contract. The fact that the Company subcontracts the installation back to an affiliate of the prime contractor does not alter the underlying contractual relationship which involves the furnishing and installation of asphaltic concrete. The Company is the consumer of all materials purchased and/or mined. As the consumer of materials, the Company must pay California sales/use tax on all materials purchased, but those materials mined will not be subject to tax.

Our Opinion

In our opinion, the Company will be regarded as a construction contractor provided the "affiliate" is a legal entity separate and apart from the prime (and not just a division) and the affiliate is actually independently engaged in the business of hauling and installing asphaltic concrete. That is, the affiliate must have employees, equipment and be actively engaged in the business. If the affiliate is without independent business substance, we would regard the Company as a retailer of materials.

Hypothetical 5

The Company enters into a lump sum contract with a prime contractor to furnish, haul and install asphaltic concrete. The Company subcontracts the hauling and installation of the asphaltic concrete to an affiliate of the prime contractor. The affiliate then subcontracts the installation of the asphaltic concrete to the prime contractor. The installation occurs under the direction and supervision of the Company and is performed by employees of the prime contractor.

Your Contention/Conclusion – Contract 5

The Company is a construction contractor and is contractually obligated to furnish, haul and install asphaltic concrete under a lump sum contract. The fact that the Company subcontracts the installation back to an affiliate of the prime contractor and the affiliate's contractual relationship with the prime contractor does not alter the underlying contractual relationship which involves the furnishing and installation of asphaltic concrete. The Company is the consumer of all materials purchased and/or mined. As the consumer of materials, the Company must pay California sales/use tax on all materials purchased, but those materials mined will not be subject to tax.

Our Opinion

We disagree. The Company is the retailer of the materials with sales tax applying to its gross receipts from the sale of the materials. See our comments in opinion on hypothetical 3.

Hypothetical 6

The Company enters into a lump sum contract with a prime contractor to furnish, haul and install asphaltic concrete. The Company contracts with the prime contractor or its affiliate for the hauling and installation of the asphaltic concrete. The installation occurs under the direction and supervision of the prime contractor and is performed by employees of the prime contractor or its affiliate.

Your Contention/Conclusion – Contract 6

The Company is a construction contractor and is contractually obligated to furnish, haul and install asphaltic concrete under a lump sum contract. The underlying contractual obligation of the Company remains constant with regard to the obligation for the quantity and quality of installed asphaltic concrete. The Company is the consumer of all materials purchased and/or mined. As the consumer of materials, the Company must pay California sales/use tax on all materials purchased, but those materials mined will not be subject to tax.

Our Opinion

We disagree. The Company is the retailer of the materials with sales tax applying to its gross receipts from the sale of the materials. See our comments in opinion on hypotheticals 3 and 4.

Hypothetical 7

The Company enters into a lump sum contract in which it will be required to furnish asphaltic concrete for use in the construction project. Although the Company will not be contractually obligated to install the asphaltic concrete, the Company will be obligated to supervise the installation of the asphaltic concrete and provide knowledge and expertise with regard to the quality, characteristics, amount and place of delivery.

Your Contention/Conclusion – Contract 7

The Company is contractually obligated to furnish asphaltic concrete and to provide supervision of the installation of the asphaltic concrete. The factual situation is similar to Western Concrete Structures, Inc. v. State Board of Equalization in that the distinction between this contractual situation and those previously discussed is superficial. The Company is a consumer or materials purchased and/or mined, not a retailer of the asphaltic concrete furnished. Tax must be paid by the Company on materials purchased, but materials mined will not be subject to tax.

Our Opinion

We disagree. The Company is the retailer of the materials with sales tax applying to its gross receipts from the sale of the materials. Your contention here is an application of your reading of the Western Concrete Structures case without giving us any of the facts necessary to decide if that case applies within our above analysis. From the hypothetical, we cannot tell who does the installation, whether or not there is on the job continuing supervision by a Company expert, or whether the installing contractor or property owner have the installation expertise which was lacking in Western Concrete Structures. In the absence of more facts, we conclude the Company is the retailer, not the consumer of the materials.

If you have further questions, feel free to write.

Very truly yours,

Gary J. Jugum
Assistant Chief Counsel

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7/15/91 – cc: Mr. Charles L Cordell
Sfg Mr. Glenn A. Bystrom
Mr. P. Martin Fiorino