



STATE BOARD OF EQUALIZATION

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January 7, 1993

BURTON W. OLIVER
Executive Director

J--- M. L---, Esq.
P--- & M---
XXX --- Street
--- ---, CA XXXXX

Dear Mr. L---:

This is in response to your letter requesting our opinion with regard to whether the structure and operation of a proposed joint venture (JV), for the performance of construction contracts, will have the intended sales and use tax results. We apologize for the delay in responding.

Your letter provided as follows:

"FACTS

"Two California corporations (the 'Venturers') intend to form a joint venture (the 'Joint Venture') for the fabrication and erection of structural steel as improvements to realty located within the State of California. The Venturers are unrelated and each Venturer currently is engaged, within and without California, in active business involving the fabrication and erection of structural steel. The Joint Venture will be established pursuant to a joint venture agreement to be entered into by the Venturers. (The joint venture agreement has not yet been prepared.) Each of the Venturers currently holds a California sales and use tax permit.

"It is intended that the Joint Venture (rather than either of the Venturers) regularly will bid for and enter into contracts with property owners or general contractors for the fabrication and erection of structural steel. Furthermore, the Venturers intend that all materials necessary for the performance of such contracts will be purchased by the Joint Venture with funds contributed to the Joint Venture by the Venturers. The Joint Venture, in its separate capacity, will hold a contractor's license. Fabrication and erection activities, however, will be performed by employees of each of the Venturers in satisfaction of the Joint Venture's contractual obligation to provide the improvements to the realty. The fabrication and erection activities of each Venturer will be treated as capital contributions to the Joint Venture, with such services valued at

an agreed upon cost. The Joint Venture itself will not have any employees performing fabrication or erection activities. Insurance coverage will be provided under the policy of the Venturer whose employees are performing service, with the Joint Venture named as an additional insured. Distributions by the Joint Venture of revenues with respect to a project will be made in proportion to the contributions made by the Venturers with respect to such project.

"The activities of the employees of each Venturer will vary from project to project. With respect to certain projects, each Venturer's employees may perform a portion of both fabrication and erection activities. On other projects, one Venturer's employees may perform all necessary fabrication activities while the other Venturer's employees perform the necessary erection activities. On certain projects it may be possible that one Venturer's employees will perform both the fabrication and erection activities required under the contract. The determination with respect to these matters will be made by the Venturers based on the size and location of the project, the availability of each Venturer's employees to undertake the project and other business-related factors. In all events, however, the contractual relationship will be between the Joint Venture and either the property owner or general contractor.

"OPINIONS REQUESTED

"Based on the Facts described above, we hereby request that you render the following opinions in connection with contracts which the Joint Venture may enter into to fabricate and erect structural steel:

"(1) The Joint Venture, rather than the Venturers, will be characterized as a 'construction contractor' with respect to the contracts in question.

"(2) Assuming the contracts entered into by the Joint Venture to make improvements to realty are 'lump sum contracts,' as such term is defined by Sales & Use Tax Regulation 1521(a)(8), the Joint Venture, rather than the Venturers, will be characterized as the consumer of materials utilized in the performance of such contracts.

"(3) The measure of Sales and Use Taxes in connection with the materials provided pursuant to the construction contracts entered into by the Joint Venture will be the purchase price of raw materials paid to third party suppliers by the Joint Venture. The value of the labor provided by the Venturers in connection with fabrication and erection activities related to such contracts will not be included in the measure of tax."

Discussion and Opinions

A joint venture is a "person" as defined in Revenue and Taxation Code section 6005, and is a separate entity for sales and use tax purposes. From your stated facts, your proposed JV will be a valid separate entity from either of the two corporate joint venturers. It also appears that the JV will be a

"construction contractor" as defined in Regulation 1521(a)(2). The key requirement is that an entity be contractually obligated to both furnish and install improvements to real property. This obligation may be fulfilled "in conjunction with, or by or through others," such as the joint venturers or subcontractors.

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by the "gross receipts" from the retail sale of tangible personal property. A "retail sale" means a sale for any purpose other than resale in the regular course of business. (Rev. & Tax. Code § 6007.) A "sale" includes any transfer of title or possession of tangible personal property, and the fabricating or processing of tangible personal property, for a consideration.

"Gross receipts" means the total amount of the sale price, valued in money, whether received in money or otherwise, without any deduction for the cost of materials or labor, including fabrication and assembly labor. (Rev. & Tax. Code § 6012(a).) Gross receipts, however, do not include the price received for labor or services used in installing the property sold. (Rev. & Tax. Code § 6012(c)(3).) If a retailer makes a taxable retail sale of tangible personal property, he must include in the measure of tax the retailer's charges for fabrication, whether such charges are separately stated or included in the total sales price.

Regulation 1526 (copy enclosed) provides as follows:

"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."

This means that tax is applicable to the charges for the fabricating process itself, when performed for a consumer that provides the materials. These are precisely the facts in your case. Tax will apply to the charges for fabrication on behalf of the JV, unless the transaction does not constitute a sale for sales and use tax purposes.

Special rules apply to construction contracts: the erection or construction of an improvement to real property. (Reg. 1521, copy enclosed.)

If a construction contractor is obligated to both furnish and install property under a construction contract, the contractor is the consumer of all materials which it uses in the construction. This means that either sales or use tax will apply to the sale of materials to, or the use of the materials by, the construction contractor. Tax does not apply to any of the construction contractor's charges to furnish and install the materials, including charges for fabrication.

If a contractor, subcontractor, or supplier of materials for a construction project does not also have the duty to install those materials, the sales or use tax will be applicable to the entire gross receipts or sales price (including fabrication) of the materials when they are transferred from such person. (See Reg. 1521 (a)(1)(B)2., (b)(2)(A)(2).) Charges for installation are never taxable. (Rev. &

Tax. Code §§ 6011(c)(3), 6012(C)(3).)

The same rule applies when a subcontractor is obligated to both furnish and install materials. (for purposes of this analysis, the terms "fabrication" and "materials" are treated substantially the same. One could change the phrase to read "furnish and install fabrication".) No tax applies to the furnishing of materials or fabrication work by the subcontractor, if he or she must also install, because the subcontractor is the consumer of the fabrication and materials. No retail sale takes place when the property is transferred to (installed on the property of) the owner. The key is whether the person that supplies the materials or fabrication also has the contractual duty to install the materials or fabrication, even if the actual installation work is performed by another person. ¹

It is our opinion that under the facts submitted by you, the JV is a construction contractor with the duty to both furnish and install the steel. It is our opinion that the JV is the consumer of the materials which it furnishes, even though the installation is done by an individual venturer or others.

An individual venturer may also be a construction contractor, and therefore a consumer, depending upon the facts of a particular job. For example, if a venturer was hired by the JV to do fabrication work using materials supplied by the JV, but the installation was not done by that individual venturer, the fabrication work would be a sale which is subject to tax when transferred to the consumer, that is, the JV. Only if the fabricating venturer also performs the installation (furnish and install) will it not be subject to tax.

Your letter suggests that the fabrication may be a nontaxable contribution to capital. Tax does not apply to transfers qualifying as capital contributions in only two situations. One is when property is transferred "to a commencing corporation or commencing partnership [joint venture] in exchange solely for first issue stock of the commencing corporation or an interest in the commencing partnership". (Reg. 1595(b)(4).) In your case, the "contribution" of fabrication work is a contribution over a long period of time, and could not be considered a contribution to a "commencing" entity.

The other type of capital contribution which has been treated as nontaxable is one which is made:

"by a shareholder of the corporation, if the corporation merely credits a 'donated capital' or similar equity account. The transfer is regarded as a contribution of capital. It is immaterial that the value of the shares held by the person contributing the tangible personal property may be enhanced as a result of the contribution." (Annot. 495.0090.)

The Board applied these rules to a recent case. The Joint Venture Agreement in that case required an individual joint venturer to provide a specified quantity of tangible personal property over the life of the contract, as its contribution to capital. To avoid the contribution being spread out

¹ There are transactions that are disregarded for sales and use tax purposes, such as when a prime contractor subcontracts a construction contract to a supplier who subcontracts the installation portion back to the prime contractor. This fact situation is not present in your case.

beyond the commencement of the venture, the individual venturer made a commencing contribution to capital in the form of cash in an amount which was approximately equal to the value of the tangible personal property to be contributed as commencing capital. When it was time to contribute the tangible personal property, the property was exchanged for a like amount of the cash previously contributed. The transaction was recorded as first a credit, and then a debit in the same amount, to that individual venturer's capital account.

The Board held that the transfers of tangible personal property were nontaxable contributions to capital, but only up to the amount of the original cash contribution to capital from that venturer. When the individual venturer had used up all of the cash which that venturer had contributed as a commencing contribution to capital, all subsequent transfers of tangible personal property were held to be sales subject to tax, without regard to how the transaction was shown on the books and without regard to the fact that such transfers were provided for in the original joint venture agreement.

It is our opinion that your proposed method of "contributing" fabrication does not meet the requirements of nontaxable contributions to capital, explained in the two rules noted above, or as applied by the Board. Thus, when an individual venturer performs only fabrication for the JV, the venturer is making a taxable sale to a consumer. On the other hand, when a venturer contracts to both fabricate and install, the venturer is the consumer of any fabrication that it installs, and tax does not apply.

If you have further questions, please contact me.

Sincerely yours,

Donald L. Fillman
Staff Counsel

DLF:wk

Enclosures: Regs. 1521, 1526