

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

190.2332

APPEALS SECTION

In the Matter of the Petition)
for Redetermination Under the) DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)
)
A--- D--- P--- INC.) No. S- -- XX-XXXXXXX-010
)
)
Petitioner)

The Appeals conference in the above-referenced matter was held by Senior Staff Counsel Elizabeth Abreu on February 8, 1995 in Sacramento, California.

Appearing for Petitioner:

R--- R. R---
Attorney

Appearing for the Sales
and Use Tax Department:

Randy Pace
Supervising Tax Auditor

Type of Business:

Construction Contractor
for Sports Equipment

Protested Item

The protested tax liability for the period July 1, 1986 through December 31, 1992 is measured by:

<u>Item</u>	<u>State, Local and County</u>
Unreported taxable sales on an actual basis	\$1,074,481

A ten percent failure to file penalty for the period July 1, 1986 through December 31, 1989 was assessed.

Petitioner's Contentions

The sports equipment in issue should be classified as materials. Petitioner is entitled to a credit under section 6406, or to a tax-paid purchases resold deduction, for sales tax paid to Utah on the cost of materials used in the sports equipment. Failure to give petitioner a credit or deduction for tax paid to Utah is unconstitutional.

Summary

Petitioner is a Utah corporation which manufactures and sells sports equipment. Over half of the equipment in issue in this case is basketball equipment (hoops, backboards, supports etc.), most of which were installed indoors but a few of which were installed outdoors on large poles. Diagrams of some of the basketball equipment sold by petitioner are attached as Exhibit A. In addition to basketball equipment, petitioner sold movable walls for gymnasiums, wall mats, scoreboards, and indoor volleyball and badminton equipment. It appears from the audit work papers that petitioner manufactures the basketball equipment but purchases the other sports equipment in a completed condition. A large number of petitioner's customers are C--- L--- D--- S--- ("LDS").

The transactions in issue involve sports equipment which petitioner furnished and installed in California under lump-sum construction contracts. Petitioner shipped the equipment via common carrier directly to the customer. Notations on the available contracts show that petitioner's employees installed the equipment. Petitioner's contracts did not contain title clauses, but the bid sheets were FOB job site.

The work papers do not explain how the basketball equipment was installed. The bills of lading show that this equipment was shipped to the job site in pieces. (See Exhibit B, showing freight charges for six types of component parts.) In a memorandum dated April 24, 1995, a District Principal Auditor explained how he believed the basketball equipment is assembled at LDS. (Exhibit C.) First pipe rails are installed to the roof rafters. Then the hanging support structure, which is a welded unit, is bolted to the pipe rails by hinged clamps. A back bar is then bolted to the pipe rails and connected to the support structure. Next, the backboard, along with the hoop, is attached to the support structure. Last, the motor and the lifting belt/chain is attached to the support structures.

Under Utah law, petitioner was regarded as the consumer of the raw materials it purchased for sports equipment which it furnished and installed, regardless of where the equipment was installed. According to petitioner, it was audited by Utah and had to pay Utah sales tax measured by its purchase price of the raw materials which were used in construction contracts in California.^{1/} Petitioner, however, was not required to pay Utah tax on those transactions in which it shipped the equipment to California but did not install because Utah

1/ Utah's position regarding these types of transactions is set forth in two Utah court cases in the Petition File, pp. 17-28.

regarded such transactions as exempt interstate shipment sales.

The Sales and Use Tax Department (Department) contends that all of the equipment in issue is fixtures and that petitioner was the retailer of this equipment. The Department asserts that title passed in California; therefore, these were sales tax transactions. The Department further contends that petitioner is not entitled to a credit for out-of-state taxes under section 6406 because this section only applies to consumers. Petitioner is also not entitled to a tax-paid purchases resold deduction because, under section 6012, such deduction may only be taken with respect to California taxes.

Petitioner obtained a seller's permit on January 1, 1990. For the period after petitioner obtained the permit, the auditor included in the measure of tax the sales for the furnish and install contracts and the sales for the furnish only contracts. For the period before the permit, the auditor included only the sales from the furnish and install contracts.

Although petitioner agrees that title passed in California, it contends that under the case of Chicago Bridge & Iron Co. v. Johnson (1941) 19 Cal.2d 162 it is the consumer of the basketball equipment. Therefore, it is entitled to a credit under section 6406. In addition, petitioner's attorney has been informed by former Board auditors that when faced with these types of transactions, the auditors would only assert tax on the ex-tax amount of the price. (The Department's auditor stated that he was unaware of any audits where this occurred.)

Petitioner further contends that, if the Board does not allow a credit or tax-paid purchases resold deduction, the imposition of the tax is unconstitutional because the tax discriminated against interstate commerce and subjects petitioner to multiple taxation. Petitioner believes that without the credit it will be difficult to compete in California.

At the Appeals conference, petitioner indicated that, for purposes of our review, nexus was not in issue but that it reserved the right to argue lack of nexus before the Board.

Analysis and Conclusion

The first issue which must be addressed is whether the sports equipment was materials or fixtures as those terms are defined in Regulation 1521(a)(4) and (5). If the sports equipment were fixtures, petitioner would be the retailer of the equipment which it furnished and installed in California. (Reg. 1521(b)(2)(B)1.) Since title passed in California, the applicable tax would either be sales or use tax, depending upon whether there was local participation in the sale. (Reg. 1620(a)(2). Neither party at the Appeals' conference knew whether there was local participation, though petitioner's sales force was involved in some sales during and after 1990.) If sales tax applies, the tax would be imposed upon petitioner. (Rev. & Tax. Code §6051.) If use tax applies, it is imposed upon the purchaser, but petitioner would be required to collect the use tax from the purchaser and pay it to the state. (Rev. & Tax. Code §§ 6201, 6203, and 6204.)

If the sports equipment were materials, petitioner would be the consumer of all basketball items it furnished and installed since the contracts were lump-sum contracts, and the applicable tax would be use tax imposed directly upon petitioner. (Reg. 1521(b)(2)(A)1.) However, if petitioner was required to furnish, but not install the sports equipment, petitioner would be the retailer for all of those retail sales.

Movable walls and wall mats are materials. (See Annotation 190.1980.) Therefore, petitioner was the consumer of such items. The sleeves for the poles for the volley ball and badminton equipment, which were set in the floors of the gymnasiums, should also be regarded as materials. The poles, nets, and other component parts of the volleyball and badminton equipment are neither materials nor fixtures since they are readily removed from the gymnasium floor and are not intended to be permanently affixed to the building. Petitioner is the retailer of such items.

The scoreboards, which are pictured in one of its brochures (see Exhibit D), appear to be the type of scoreboards which are fully manufactured prior to installation. Therefore, they are fixtures. (See Annotation 190.2115.)

The more difficult issue is to determine how the basketball equipment should be classified. With respect to the outdoor basketball equipment, we conclude that the poles should be classified as materials. (See Annotation 190.1360 (clothesline poles are materials).) However, different component parts of an item or a system may be classified differently. For example, Annotation 190.1430 holds that conveyor units are fixtures but that legs or other supports for the conveyor units are materials. In addition, the manner in which an item is affixed may determine its classification.

In a memorandum dated November 20, 1989, the Principal Tax Auditor^{2/} concluded that attaching a 31-foot sign as one unit to concrete with anchor bolts makes the sign a fixture. However, the memorandum states that the sign would appear to qualify as materials if it is built piece by piece on the job site from the ground up. Yet this does not entirely answer the question because, if one of the pieces is a completed fixture immediately prior to installation, that piece will be regarded as a fixture. For example, if a pole for a sign is embedded into realty and the sign is attached in a completed condition to the pole, the sign is regarded as a fixture and the pole as materials.

In the present case, we conclude that the pipe rails, hanging support, and back bar are materials. These components parts are not a completed fixture and therefore should be regarded as materials. The backboard and hoop and the motor and lifting belts, however, are each a completed fixture and should be so taxed.

^{2/} Memorandum to Jack Infanca, Van Nuys District Principal Auditor.

This brings us to the measure of tax and to the issue of credits. The auditor regarded all sports equipment as fixtures and used the amounts shown as cost and markup on the bid sheets as the measure of tax. Because we have concluded that some of the items were materials, a reaudit needs to be performed. For those items which should be regarded as materials, the measure is limited to petitioner's costs of the materials. For those items which are fixtures and were purchased in a completed condition, such as the scoreboards, the measure of tax is also petitioner's cost of the fixture. (Reg. 1521(b)(2)(B)2.b.) Since we have determined that part of the basketball equipment is materials and part fixtures, the audit staff should use the last method set forth in Regulation 1521(b)(2)(B)2.b., which is based upon a breakdown of material costs, direct labor, etc., to determine the measure of tax for the component parts of the basketball equipment which are fixtures.

Revenue and Taxation Code section 6406 provides in pertinent part:

“A credit shall be allowed against, but shall not exceed, the [use tax]...imposed on any person...by reason of the storage, use, or other consumption of tangible personal property in this state to the extent that the person has paid a retail sales or use tax, or reimbursement therefore, imposed with respect to that property by any other state, political subdivision thereof...prior to the storage, use, or other consumption of that property in this state....”

Under this section, petitioner is entitled to a credit on its use tax liability for materials, which it purchased in Utah and used in its construction contracts in California. During the reaudit, petitioner will need to establish how much sales or use tax it paid to Utah on the materials.

The section 6406 credit only applies to use tax imposed upon a person who stores, uses, or otherwise consumes tangible personal property in California. Accordingly, if petitioner's sales of fixtures were sales tax transactions, this section would not apply. If petitioner's sales of fixtures were use tax transactions imposed upon its California customers, petitioner still would not obtain the benefit of this section because the use tax is imposed upon the purchaser (customer), not upon petitioner. Only the person upon whom the use tax is imposed may obtain the benefit of the credit. Therefore, this credit does not apply no matter which tax applies to the sales of fixtures.

The tax-paid purchases resold deduction arises from Revenue and Taxation Code section 6012. Among its requirements: the retailer must have reimbursed his or her vendor for tax, which “the vendor is required to pay to the state or has paid the use tax with respect to the property.” The words “to the state” imply that the tax paid by the vendor (for which the retailer paid tax reimbursement) must be California sales tax. The words “the use tax” also implies the California use tax. Since petitioner paid Utah sales or use tax, petitioner is not entitled to a deduction under this section.

The case of Chicago Bridge & Iron Co., supra, has no bearing on this case, other than it establishes that California may constitutionally impose the use tax on out-of-state construction contractors who furnish and install materials in California. The case did not involve an issue of classification.

An administrative agency cannot declare a statute unenforceable on the basis of its being unconstitutional unless an appellate court has made a determination that such statute is unconstitutional. (Cal. Const., Art. III, sec. 3.5.) We are unaware of any appellate court case holding that the sales and use tax statutes are unconstitutional as applied to facts like those in this case.

Tax should be applied uniformly to all taxpayers. However, we cannot recommend relief from tax on the basis that some former auditors may have given a credit that was not allowable under the law.

Although not directly raised during the Appeals conference, we believe that the facts do not support the imposition of tax on petitioner's sales of fixtures for furnish and install contracts prior to the time petitioner had a sales force in California. According to the audit work papers, before January 1, 1990, petitioner did not have a sales force in California and its only connection with California were employees who installed the sports equipment. Only retailers engaged in business in California are required to collect use tax from purchasers. (Rev. & Tax. Code § 6203.) Prior to January 1, 1993, a retailer whose only contact with California was employees performing installation labor was not a retailer engaged in business in California.

Petitioner has filed the required statement under Revenue and Taxation Code section 6592. Based upon this statement and the Department's concurrence at the Appeals conference, we recommend that the failure to file penalty be deleted.

Recommendation

Reaudit by classifying movable walls, wall mats, basketball poles, and sleeves for volley ball and badminton poles as materials. Determine the manner in which basketball equipment was affixed and reclassify pipe rails, support structures, and back bars as materials if such equipment was installed in the manner set forth in Exhibit C. Allow a credit under section 6406 for all materials. Redetermine the measure of tax for scoreboards and the component parts of the basketball equipment which should be classified as fixtures in the manner explained in this Decision and Recommendation. Delete sales of all fixtures prior to January 1, 1990. Delete the failure-to-file penalty.

Elizabeth Abreu, Senior Staff Attorney

August 8, 1995
Date

Exhibits A to D.