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August 27, 1993

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Executive Director

Mr. N--- L. G---, CPA
Assistant Controller
S--- F--- Company
XXXXXX --- ---, Suite XXX
---, VA XXXXX

Account No. SV -- XX-XXXXXX

Dear Mr. G---:

This is in response to your letter of July 27, 1993, and in confirmation of our advice to you by telephone on August 27.

We understand that S--- F--- Company is a specialty contractor involved in the design, fabrication, installation, and testing associated with the construction of: (1) Earth Retention Systems (sheeting, jacked piles, underpinning, soil nailing, tiedback walls and bridge abutments); (2) Temporary Soil or Rock Tieback Anchors; and 3) Permanent Soil or Rock Tieback Anchors (tiedowns for structures such as dams and towers, and tiebacks for landslide stabilization and waterfront walls). This agency has issued to your company the consumer use tax account number referenced above.

You have been advised by your California sales office that several transactions will be occurring in the near future involving Hawaii construction projects which might result in the imposition of California sales tax.

Basically, you describe three factual circumstances. First, it is contemplated that you may purchase items of tangible personal property from a California vendor for shipment to a temporary storage site in California. These properties would ultimately be shipped to Hawaii for physical incorporation, use, or consumption by your own Hawaiian jobsites. These properties fall into two categories: building materials to be physically incorporated into the projects, and supplies or materials to be used or consumed on the projects.

As we advised you by telephone, California sales tax would apply to the sale of materials to be physically incorporated into the projects, and to the sale of the other supplies or materials. California sales tax applies because the California tax is imposed upon the vendor (although the cost of the tax is passed on to the purchaser) and the properties are delivered to the purchaser in this state. It is immaterial that the properties will subsequently be removed from California for use outside this state.

There is an exemption in California Revenue and Taxation Code section 6386 for sales of construction materials to contractors if the materials are to be incorporated into real property located outside of this state. This exemption is only available to persons who hold a valid California seller's permit issued under Revenue and Taxation Code section 6067.

Second, you inquire with respect to application of the tax under the same factual circumstances described above, except that the property is fabricated to job specifications in California at the temporary storage sites. The contracts with the vendors for sale of the materials are fully taxable as described above. Tax would also apply to charges made by independent contractors to the company for fabrication work performed in California. Again, tax applies to these transactions because the fabricating company is not shipping the work to you outside this state, but is performing work in this state on property which will be returned to you in this state.

Tax, of course, does not apply if the fabrication work is performed by your employees. Wages and salaries are not taxable under California Sales Tax Law.

Third, you further inquire as to how the tax applies on leases of construction equipment from California lessors for shipment to California temporary storage sites, with ultimate shipment to Hawaii for use on Hawaiian jobsites.

Under California law, leases of tangible personal property are basically subject to California sales or use tax if the lessor has not paid sales or use tax at the time of acquisition of the property. If the property is California tax-paid in the hands of the lessor, then the rental receipts are nontaxable without regard to the location of the equipment during the rental period. If the lessor has acquired the equipment tax-free (that is "for resale" under the California law), then generally tax applies to the rental charges.

(There is a special rule for leases of mobile transportation equipment such as railcars, trucks, aircraft, and ships, which would not be applicable here.) The basic tax is a use tax imposed upon the lessee. There is an exclusion, however, from the definition of "use," to be found in Revenue and Taxation Code section 6009.1. Under that section "use" does not include the keeping, retaining, or exercising of any right or power of tangible personal property for the purpose of subsequently transporting it outside the state for use thereafter solely outside the state. Thus, any lease of equipment to you, whether tax-paid or tax-free in the hands of the lessor, would not be subject to tax under the California law, because of the section 6009.1 exclusion. That is, you would be making a functional use of the equipment in Hawaii, and you

would be holding the equipment in California only for the purpose of transporting it to Hawaii for use in Hawaii.

Enclosed please find copies of our Regulations 1521(b)(6)(B) and 1600, which are applicable to your inquiry.

Sincerely,

Gary J. Jugum
Assistant Chief Counsel

GJJ:sr

Encs.

cc: Ms. Elizabeth Abreu
Staff Counsel

Sent by facsimile transmission on 8/27/93 to (703) 742-3319; Original letter to follow by mail.