



STATE BOARD OF EQUALIZATION

450 N STREET, SACRAMENTO, CALIFORNIA  
(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)  
TELEPHONE: (916) 324-2634  
FAX : (916) 323-3387

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March 24, 1997

E. L. SORENSEN, JR.  
Executive Director

Mr. and Mrs. B--- and L--- D---  
D--- E--- E--- P---  
XXXX --- ---  
---, CA XXXXX

Re: Account No. SR --- XX-XXXXXX

Dear Mr. and Mrs. D---:

This letter responds to your inquiry dated January 6, 1997 to our Legal Division concerning the above account. You have questions concerning who is responsible for "sales tax and material tax" in your business.

You state:

"It has been my understanding that we were to pay tax on materials only, which we have done thus far.

"We are considered a sub-contractor for our salesman. The salesman gets our customers from home shows and referrals. He demonstrates and sells the product from his leads. He makes up the contracts which are accepted and signed by the actual customers. These contracts include the size and color of each window to be installed as well as the price charged for the job. The contracts are sent to us (D--- E--- E--- P---). We then fabricate and install the insulating windows. We supply all materials for the job. When the job is complete, the customer either writes a check, is billed through a finance company, or is charged to a major credit card. The full amount billed to the customer goes to the salesman (S--- P---). We then bill the salesman for our services. Ours is one flat rate per square foot of the windows installed, 1/2 of which is material cost, and 2/3 of material cost charged we do not pay sales tax on. I have been paying the material tax on the 2/3 of the materials. The salesman has no flat rate. His charge varies according to the complexity of the job.

“So, if the salesman receives all money from the customers and we are sub-contracted and paid by him to complete the jobs, who is responsible for these taxes?” (Quoted as written.)

You enclosed copies of several contracts between M--- I--- I--- W--- S--- P--- (S---) and various customers to “install/deliver” the insulating window “systems”. You also included copies of the corresponding invoices from D--- E--- E--- P--- (D---) to S---. The invoices from D--- to S--- show a charge per square foot for the windows, a charge for sales tax reimbursement based upon the window amount, and a separate charge for “labor”. (Two of the invoices also show an additional charge after labor, in one instance for “2 sliders” and, in the other instance, for “12’ slider”. We assume that these are charges for additional labor required for sliding glass doors/windows.) Since no written contract between D--- and S---, other than the invoices, was submitted, we assume for purposes of this opinion letter that the invoices from D--- to S--- memorialize the agreement/contract between the two parties. (If, in fact, another written contract between them exists, the views expressed in this opinion letter may be subject to change.) We also assume from the statements in your letter and the documents provided that S--- is the prime contractor who contracts with the customer to furnish and install the insulating windows, and that S--- then subcontracts the work to D---. Since all of the provided contracts are with California customers, we further assume for purposes of this opinion letter that D--- purchases the items which it needs to make the insulating windows, and makes and installs the insulating windows in this state.

## **Discussion**

A sales tax is imposed on retailers measured by their gross receipts from retail sales of tangible personal property in California, unless the sale is specifically exempted or excluded by statute. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax applies to a purchaser's use of property purchased from a retailer for use in California. (Rev. & Tax. Code §§ 6201, 6401.)

The application of sales tax to construction contracts and construction contractors is explained in Regulation 1521. (Copy enclosed.) Subdivision (a)(1)(A)1 of that regulation defines a construction contract to include contracts to erect, construct, alter, or repair any building or other structure or improvement on or to real property. A person who performs a construction contract *or subcontract* is a construction contractor. (Reg. 1521(a)(2).) Thus, D---'s subcontracts to furnish and install insulating windows are construction contracts because they are contracts for improvements to real property, i.e., buildings, and the application of tax to D---'s subcontracts with S--- to furnish and install the windows is governed by Regulation 1521.

Regulation 1521 also defines "materials" and "fixtures" as those terms apply to construction contracts. "Materials" are construction materials and components, and other tangible personal property incorporated into, attached or affixed to real property, such as a building, by a construction contractor, which when combined with other tangible personal property lose their identity to become an integral and inseparable part of the real property. (Reg. 1521(a)(4).) "Fixtures" are items which are accessory to a building or other structure and do not lose their identity as accessories when installed. (Reg. 1521(a)(5).)

Appendix A to Regulation 1521 lists typical items regarded as materials, including windows, window screens, and some of the items of tangible personal property commonly used in making standard windows and window screens, such as glass, lumber, paint, screen, and weather stripping. The insulating windows and the tangible personal property which D--- purchases and uses to make the windows are materials as defined by Regulation 1521. (Cf. Business Taxes Law Guide Annotation 190.1860 (5/26/64).)

A construction contractor is generally the consumer (as opposed to a retailer) of materials which the contractor furnishes and installs in the performance of a construction contract; and tax applies to the sale *to*, or use *by*, the contractor of those materials. (Reg. 1521(b)(2)(A)1.) In your case, if you were the consumer, you would pay tax or tax reimbursement on your purchase price of the materials and you would make no charge to S--- for "tax".

However, in the instance of "time and material contracts", if the contractor bills its customer an amount for "sales tax" computed upon its marked up billing for materials, it will be assumed, in the absence of convincing evidence to the contrary, that it is the retailer of the materials. (Reg. 1521(b)(2)(A)2.) In your case, if you are the retailer, you would purchase the materials for resale and you would pay to the Board sales tax on your selling price of tangible personal property. You would be entitled to collect reimbursement for your sales tax liability from S--- if your contract of sale so provided. (Civ. Code § 1656.1.)

A "time and material contract" is defined as a contract under which the contractor agrees to furnish and install materials or fixtures, or both, and which sets forth a charge for the materials or fixtures and a charge for their installation or fabrication. (Reg. 1521(a)(7).) The agreement between S--- and D--- is for separate charges for materials and for labor. Thus, their contracts are time and material contracts. Since D--- bills S--- for "tax" computed upon D---'s charge for materials in their time and material contracts, D--- is presumed to be the *retailer* of the materials which it bills to S---. As such, sales tax applies to D---'s gross receipts from the sale of the materials to S---, and D--- is responsible to remit that sales tax to the Board. (Reg. 1521(b)(2)(A)2.) In other words, when D--- computes tax as it is doing on the invoices submitted to us (sample attached), it is responsible to report and remit that tax to the Board.

Mr. & Mrs. B--- and L--- D---

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March 24, 1997  
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I hope this information is of assistance. Please write to us again if we may answer any further questions.

Sincerely,

Sharon Jarvis  
Senior Tax Counsel

SJ:rz

Enclosure: Regulation 1521  
Attachment: Copy of Invoice

cc: --- District Administrator - (--) (with attachment and copy of incoming)