STATE OF CALIFORNIA

325.0170

STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 324-3828

December 20, 1991

Dear Ms. ---:

This is in response to your two letters, each dated October 28, 1991, in which you ask for a ruling with regard to the application of sales and use tax to engine repairs performed by your clients, companies A and B. Initially, I note that the Board staff does not issue rulings. The Board may relieve a person of tax liability for taxes properly due only when that person relies to his or her detriment on an opinion coming within the provisions of Revenue and Taxation Code section 6596. Under that section, the Board has discretion to relieve a person of liability if that person relied on incorrect written advice from the Board in response to a written request for advice that includes all the facts of the transactions, including the identity of the taxpayers. Since your clients are not identified, this opinion does not come within the provisions of section 6596.

Company A is primarily engaged in the repair and overhaul of turbine engines for commercial airlines. Company B is engaged in the same business primarily for charter and private business aircraft, but not commercial airlines. Company A's repair facilities are located outside of California. Company B's repair facilities are located both inside and outside California. An engine to be repaired is removed from the aircraft at its regular maintenance location and is secured for shipment to company A's or company B's repair facilities. When the repairs are completed, the engine is shipped F.O.B. the shipping point to company A's customer in California or to company B's customer in California or in other states. Charges for various portions of the repairs are stated separately as noted below. Your first question is quoted below followed by our response.

> "Does California law provide a sales and use tax exemption for repairs of general aviation and business aircraft [or for commercial

airlines]? If yes, are there any special requirements or conditions for qualifying for the exemption?"

Revenue and Taxation Code section 6366 provides an exemption for sales of aircraft to persons using such aircraft as common carriers, or sold to any foreign government for use by such government outside of this state, or sold to persons who are not residents of this state and who will not use such aircraft in this state except to remove it from California. Revenue and Taxation Code section 6366.1 provides an exemption from tax for sales to persons who will lease the property for the same uses covered by section 6366. These exemptions are explained in Regulation 1593, a copy of which is enclosed. I note, however, that these exemptions are for aircraft and not for aircraft parts, except as provided in subdivision (b) of section 6366.1, which is not relevant here.

If the parts are sold in California or for delivery into California as parts, the exemptions provided by section 6366 and 6366.1 do not apply. On the other hand, if the parts are installed onto the aircraft outside California and do not enter California until the parts are actually part of the aircraft, they are regarded as aircraft and the exemption would apply if the other conditions are met. (See Flying Tiger Line, Inc. v. State Board of Equalization (1958) 157 Cal.App.2d 85.) Company A installs parts onto engines and ships those engines back into California. The engine does not qualify as "aircraft" under sections 6366 and 6366.1. Thus, none of the parts sold by Company A would be entitled to the exemption since all those parts enter California as parts and not as aircraft. Similarly, all parts sent by company B to its California customers would not be entitled to the exemption because they are not sold as aircraft.

Specific Charges

You ask the proper application of sales or use tax to several specific charges. Before addressing them, I will discuss the general rules for application of tax to repairs and to shipments outside California. The application of tax to repairs is explained in Regulation 1546, a copy of which is enclosed. If the repairer does not make a separate charge for the parts and materials furnished in connection with repair work and if the retail value of those parts and materials is 10 percent or less of the total charge, then the repairer would be regarded as the consumer of all such parts and materials. Since company A and company B separately state the charges for the parts and materials they furnish in connection with the repair work, they are regarded as the retailer of those parts.

Sales tax applies to a retail sale of tangible personal property in California unless specifically exempt by statute. (Rev. & Tax. Code § 6051.) Thus, when company B sells tangible personal property in California (e.g., from its California facilities), that sale is subject to sales tax unless specifically exempt. The most likely exemption is provided by Revenue and Taxation Code section 6396. Section 6396 provides an exemption from sales tax when, pursuant to the contact of sale, tangible personal property is required to be shipped, and is shipped, to a point outside this state by the retailer by means of facilities operated by the retailer or by delivery by the retailer to a carrier for shipment to such out-of-state point.

When sales tax does not apply, use tax applies to the use of property purchased for use in California. (Rev. & Tax. Code §§ 6201, 6401.) Thus, when company A or company B sells property outside California for use in California (e.g., sales from their out-of-state facilities to customers in California), use tax applies to those sales, unless specifically exempt by statute. The most likely exemptions are those provided by sections 6366 and 6366.1.

Each of your explanations of the relevant charges is quoted below from your letter regarding company B, followed by our analysis. For purposes of the discussion below, I assume that any sales of tangible personal property do not qualify for the exemptions discussed above. Of course, if the transactions are regarded as sales but those sales qualify for one of the exemptions, sales tax would not apply. If a transaction qualified for exemption under either section 6366 or section 6366.1, use tax would not apply to the use of the aircraft.

> "Special Process – A flat rate charge for labor, materials, and overhead used in the performance of special process functions such as x-rays for internal engine cracks or plasma spray. The billings for special process activities are lump-sum."

For purposes of this opinion, I assume that the materials used in the performance of this special process are actually consumed by the repairer during the special process and are not furnished and installed onto the engine. Based on this assumption, no tax applies to the charge for the labor, and the repairer is regarded as consuming the property used in performing this special process.

> "Customer Furnished Parts and Supplies Fee – A handling fee charged to the customer when the customer provides parts for [Company A or] Company B to use in a repair service. The handling fee is above and beyond the charge for labor."

Subdivision (b) of section 6006 defines "sale" to include the fabrication of tangible personal property for consumers who furnish the materials used in that fabrication. Thus, if the customer provided raw materials which company A or company B fabricated into a finished part, the charge for that fabrication labor would be subject to tax when the sale occurs in California or the property is sold for use in California. However, for purposes of this opinion, I assume that neither company A nor company B performs any fabrication upon the parts furnished by customers but rather merely installs the finished parts onto the engine. Under such circumstances, the handling fee would not be subject to tax.

> "Trade-In Service Charge (Rotable Fee) – A fee paid by customers who use parts from [Company A's or] Company B's rotable inventory, which is an inventory of reconditioned parts. The fee is calculated as a percentage of the part's list price and is done to expedite customer work."

When the property is sold in California, of purchases for use in California, tax applies to this fee. (Reg. 1546(b)(4).)

> "Trade-In Allowance (Exchange) – A credit allowed by [Company A or] Company B for used parts taken in trade when a customer purchases new parts."

Revenue and Taxation Code sections 6011 and 6012 define the measure of tax when property is subject to sales or use tax. The taxable measure includes the total amount for which the property is sold, whether paid in money or otherwise, including any credit given to the purchaser by the seller. When a customer trades in a used part to purchase a new part, the sales price for the new part includes both the cash and the used part. The value of that used part, measured in money, must be included in the measure of tax. That value is the amount of the credit allowed by the seller.

> "Fuel and Oil Used in Testing Engines – A charged passed through to the customer for fuel and oil used in testing customer engines. All fuel is consumed at the repair facility or removed from the engine prior to shipment to the customer. The charge is for cost plus a mark-up by product line of approximately 5-25%."

The repairer is the consumer of this fuel and oil and the sale of this fuel and oil to the repairer is the retail transaction. With respect to fuel and oil consumed at the California facilities, sales tax applies to the sale of the fuel and oil to the repairer or use tax applies to the repairer's use of the fuel and oil in California measured by the purchase price. I assume that any fuel and oil used at the repair facilities outside California are not sold to the repairer in California or are sold in a manner qualifying for exemption under Section 6396. Under such circumstances, either the sale of the fuel did not occur in California or that sale was one in interstate commerce exempt from sales tax. California use tax does not apply since the fuel and oil would be purchased for use, and used outside California.

> "Test Cell Fee – A fee for the use of [Company A's or] Company B's test cell. A test cell is a special facility used to test engines against the original manufacturer's standards for power, vibration, and heat. [The test cell is located and used outside California for Company A and inside California for Company B.]"

When company A or company B repairs an engine and then charges a separate fee for testing that repaired engine, no sales or use tax applies to the charge for the testing, regardless of whether the testing is conducted inside or outside of California. Of course, as the consumer of the test equipment in California, the sale of the equipment to company B is subject to sales tax or use tax applies to company B's use in California.

If you have further questions, please do not hesitate to write again.

Sincerely,

David H. Levine
Senior Tax Counsel

DHL:cl
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Enclosures (1546, 1593)

bc: Torrance District Administrator