M e m o r a n d u m

435.1364

To: Mr. Dennis Fox, Supervisor
Audit Evaluation and Planning Section (MIC:40)

Date: July 28, 1995

From: Pat Hart Jorgensen
Senior Staff Counsel

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Subject: X----------

This is in response to your memorandum dated April 14, 1995, in which you requested guidance from the Legal Division on the characterization of labor expended in “rekeying” locks and door handles to conform with a customer's existing house keys.

As I understand the situation, Senior Tax Auditor David Theiss responded to an inquiry regarding the application of sales tax for operations to “rekey” locks to fit a customer's existing house keys. Mr. Theiss concluded that because the locks were rekeyed on the day following their purchase, the locks were considered “used” property and the keying operation constituted nontaxable repair pursuant to Regulation 1546.
Mr. Theiss noted that if the locks had been rekeyed at the time of purchase, the operation would have been considered taxable fabrication labor under Regulation 1526.

Mr. Jack Warner, Out-of-State District Principal Auditor, disagreed with Mr. Theiss's conclusion, citing Business Taxes Law Guide Annotations 435.0780 and 435.0800. These Annotations state that certain property must be used by the consumer for a considerable length of time before the property can be considered “used” for determining if the labor expended constitutes fabrication or repair.

We believe that Mr. Warner's interpretation is correct and that this issue represents a classic example of the application of Regulation 1526. Specifically, this regulation provides that tax applies to charges for producing, fabricating or processing tangible personal property furnished by the consumer. Here we have a customer who has furnished property, which had not been installed or previously used for the purposes intended, to a retailer/fabricator for customization. The property, as purchased, was independently functional and operational for the use for which it was originally designed. However, the customer decided to have this newly purchased property fabricated to conform to the customer's specifications. As such, the rekeying operations constituted "a step in a process or series of operations resulting in the creation or production of tangible personal property", which, pursuant to Regulation 1526 constitutes taxable fabrication labor.

The language in these annotations apparently led Mr. Theiss to conclude that the passage of time alone is a significant factor in determining whether the doors and locks constituted "used" property. A review of the relevant annotations (435.0000-435.1760) indicates that actual "use" or presumed "use" of the property, not the passage of time, is essential in determining if the labor expended is fabrication labor or repair labor. Accordingly, if the doors and locks had been purchased three years prior to the time they were rekeyed, **but had never been installed**, the rekeying operations would still be considered taxable fabrication labor.

You have suggested that Annotations 435.0780 and 435.0800 be either be deleted or updated. We believe that these annotations remain valid. We note that passage of time, alone, is never a valid reason for deletion. However, we will consider adding a clarification to these annotations incorporating the discussion in the previous paragraph.
We also have comments with respect to the last portion of Mr. Theiss's letter, regarding the Board's authority to prevent a retailer from collecting excess reimbursement. Mr. Theiss states that the Board has no authority to prevent a retailer from collecting excess reimbursement. We believe that this conclusion is incorrect.

The California Supreme Court has recognized that this Board has a vital interest in the integrity of the Sales and Use Tax Law. (Javor v. State Board of Equalization (1974) 12 Cal.3d 790, 798; Decorative Carpets, Inc. v. State Board of Equalization (1962) 58 Cal.2d 252, 255.) In fact, the Supreme Court has specifically stated that “the integrity of the sales tax requires not only that the retailers not be unjustly enriched [citation omitted], but also that the state not be similarly unjustly enriched.” (Javor v. State Board of Equalization, supra, 12 Cal.3d 802.) These decisions clearly state that is the Board's duty and obligation to ensure that it collects all sales and use taxes that are due to California: no more and no less. Accordingly, this agency **does** have the authority to prevent a retailer from collecting excess tax reimbursement. Normally, we would first advise the retailer to cease collecting the sales tax reimbursement. If the retailer refused to comply our next recourse would be to revoke the retailer's seller's permit.

I hope that letter addresses your concerns. Please feel free to contact me if you wish further discussion regarding this issue.

PHJ:cl

Cc: Mr. David H. Levine