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STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
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January 27, 1994

Dear _____,

This is in response to your letter dated October 2, 1992. You ask:

> "DND, Canada [Department of National Defense, Canada], is purchasing spare parts from a California supplier to be stored in California for possible use in equipment either in California or in Canada. Are the Canadians subject to California use tax? If the supplier is a U.S. Department of Defense contractor and exempt from sales tax as a result of the ruling in Aerospace Corporation v. State Board of Equalization, would Canada be exempt from the tax?"

Your question indicates that you misunderstand the impact of the *Aerospace* decision. (*Aerospace Corporation* v. *State Board of Equalization* (1990) 218 Cal.App.3d 1300.) However, prior to explaining the meaning of that case, your question also indicates that it is necessary to review the general rules regarding when sales tax applies to a transaction and, alternatively, when use tax may apply.

A retailer owes sales tax on its retail sales of tangible personal property in California. (Rev. & Tax. Code § 6051.) A retail sale is a sale for any purpose other than resale in the regular course of business. (Rev. & Tax. Code § 6007.) Thus, when a retailer makes a sale of tangible personal property in California and the purchaser will not resell the property prior to any use, and the sale is not specifically exempt by statute, the retailer owes sales tax. Although the sales tax is imposed on the retailer, the retailer may collect reimbursement for its sales tax liability from the purchaser if their contract of sale so provides. (Civ. Code § 1656.1.)

Use tax is imposed on a person's use of tangible personal property in California if the property is purchased from a retailer for use in California. (Rev. & Tax. Code § 6201.) If, however, the sale of the property is subject to the sales tax, then the use of the property is exempt from use tax. (Rev. & Tax. Code § 6401.) That is, either sales tax or use tax applies to a transaction, but both would not apply to a single retail transaction. The use tax most commonly applies when property is purchased outside California for use in California. That is, since the sale occurs outside California sales tax does not apply, but since the property is purchased for use in California the purchaser owes use tax.

Your question relates to a sale of tangible personal property by a California seller. You state that the property will thereafter be stored in California. I assume, therefore, that the seller transfers possession of the property to the purchaser in California. Thus, unless that sale is a sale for resale or is specifically exempt by statute, the sale is subject to *sales* tax, not use tax. Generally, in transactions such as these, the only exemption relevant is the exemption for sales to the United States provided by Revenue and Taxation Code section 6381. This exemption is not relevant to the transaction you describe since the supplier is not making a sale to the United States.

There is **no** exemption from sales or use tax for sales of property to persons who consume that property in the performance of contracts with the United States (such persons are commonly referred to as United States contractors). When a seller sells tangible personal property in California to a person who will consume that property in the performance of the contract with the United States, that sale is subject to sales tax. (See, e.g., Rev. & Tax. Code §§ 6007.5, 6384.) On the other hand, a person's sales of tangible personal property to the United States are exempt from sales tax. (Rev. & Tax. Code § 6381.)

If a seller sells tangible personal property to a contractor who will resell the property prior to use, the contractor my purchase the property extax by issuing the seller a resale certificate as described in Regulation 1668. If the contractor thereafter resells the property in California in a transaction not exempt from sales tax, the contractor would owe sales tax on its sale. If, however, the contractor resells the property to the United States, that sale would be exempt from sales tax. Nevertheless, as indicated above, if the contractor will consume the property in the performance of its contract with the United States rather then reselling the property to the United States prior to any use, then the sale to the contractor in California is subject to sales tax, and the contractor should not issue, and the seller should not accept, a resale certificate with respect to that sale.

The *Aerospace* case related to our Regulation 1618 which had specified that, regardless of the provisions of a person's contract with the United States, certain overhead materials would not be regarded as resold to the United States for purposes of application of sales and use tax. This meant that sales or use tax was always due with respect to those overhead materials. (The materials in question were only those overhead materials which were charged to expense accounts which were not allocated exclusively to contracts with the United States which contained the necessary title provisions.) The *Aerospace* case held that this portion of Regulation 1618 was invalid when it conflicted with the terms of a person's contract with the United States. The contract that Aerospace had with the Air force provided that title to the subject property passed to the United States prior to any use of that property by Aerospace. The court held that the Board's regulation could not disregard this title provision clause and that the property was therefore regarded as sold to Aerospace for resale to the United States. The sale to Aerospace was therefore a sale for resale and was not subject to tax on this basis. (Aerospace's sale to the United States was, of course, exempt from sales tax.)

My understanding of the transaction about which you inquire is that the supplier, who happens to be a United States contractor, is selling tangible personal property in California to DND. For purposes of application of sales and use tax, a person is a “United States contractor” only with respect to its performance of contracts for the United States. That is, its status as a United States contractor is only relevant with respect to its contracts with the United States. Since the United States is not a party to the contracts at issue, whether the seller is a United States contractor is irrelevant. We are not aware of any exemption for sales to the Canadian government. Thus, based upon the facts in your letter, we conclude that the sale in California of tangible personal property to DND is subject to sales tax.

You also state:

> "As a secondary issue, _____ is exempt from sales and use tax as a DOD contractor. Your local office referenced a cover letter available to contractors for distribution to vendors explaining the exemption. Please forward any such document that we can use for this purpose at your earliest convenience."

As discussed above, _____ is **not** exempt from tax because it is a United States contractor. Sales or use tax applies to the sale of tangible personal property to _____ that it uses in the performance of contracts with the United States. If, however, the contract between the United States and has an explicit provision that passes title to certain property to the United States prior to any use of that property by then _____ may purchase that property extax for resale by issuing its vendors timely and valid resale certificates.

I am not aware of the cover letter to which you refer. You may, of course, provide a copy of this letter to your vendors. Otherwise, I suggest that you contact the local district office that advised of the availability of the letter and ask that office to forward a copy to you. If that office does not have a copy, I suggest you ask them which Board division distributed the letter, and then contact that division.

If you have further questions, feel free to write again.

Sincerely,

David H. Levine
Senior Tax Counsel

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