State of California Board of Equalization

M e m o r a n d u m

190.1924

To: Mr. Ed Moore – EAA (Laguna Hills) January 25, 1990
Tax Auditor

From: Stella Levy
Tax Counsel

Subject: K--- C--- Enterprises/Taxpayer Inquiry/SR -- XX-XXXXXX

This memorandum is in response to your November 2, 1989 request for advice regarding the application of sales and use tax to the sale of "mezzanine storage" by the above referenced taxpayer, K--- C--- Enterprises (C--- hereafter).

The facts, as I understand them, are as follows: C--- purchases mezzanine storage systems directly from the manufacturer. These systems, according to the manufacturer's brochure, are "engineered for quick and easy assembly to provide the answer to your specific storage need." Judging from the illustrated brochure, the system consists of multiple metal shelves, posts, racks, decking, as well as stairs and can be substantial in size. The storage units are shipped unassembled from the manufacturer directly to the jobsite. C---'s subcontractor assembles and installs the unit. The majority of labor consists of assembly. Installation of the mezzanine consists of bolting the unit's support posts to the floor.

C--- has requested a ruling with respect to a specific contract. A copy of the bidsheet is enclosed with your memorandum. As you have noted, the contract would be a lump sum contract to furnish and install a mezzanine storage unit. (Reg. 1521(a)(8).) Optional features include windows, floor tiles, doors and extra shelving. The selling price includes all materials, labor and delivery, drawings and installation.

Applicable Law

For sales and use tax purposes, C--- is considered to be a construction contractor under the circumstances you describe. Regulation 1521(a)(2) defines a construction contractor as "any person who for himself, in conjunction with, or by or through others, agrees to perform and does perform a construction contact. 'Construction contractor' includes subcontractors and specialty contractors…." A construction contract is defined as "a contract, whether on a lump sum, time and material, cost plus, or other basis to…erect, construct, alter, or repair any building or other

structure, or project, development, or ther improvement on or to real property…'construction contract' does not include …the furnishing of tangible personal property under what is otherwise a construction contract if the person furnishing the property is not responsible under the construction contract for the final affixation or installation of the property furnished." (Reg. 1521(a)(1).)

The tax treatment of a construction contract depends in a large part upon whether the contract is one to provide materials or to provide fixtures. Regulation 1521(l)(4) defines materials as "tangible personal property incorporated into, attached to, or affixed to, real property…which, when combined with other tangible personal property, loses its identity to become an integral or inseparable part of the real properyt…" Fixtures, on the other hand, are defined in Regulation 1521(a)(5) as "items which are accessory to a building or other structure and do not lose their identity as accessories when installed."

In general, construction contractors are consumers of materials which they furnish and install. Either sales or use tax applies to the sale or use of the materials. (Reg. 1521(b)(2)(A).) The contractor pays sales tax reimbursement on materials at the time of purchase or must report and pay use tax on any materials purchased ex-tax. On the other hand, construction contractors are retailers of fixtures which they furnish and install. Generally, tax applies to their sales of the fixtures. (Reg. 1521(b)(2)(B)1.) The measure of tax is the sale price (including fabrication and assembly labor) if so stated in the contract. If the sale price is not stated in the contract, the measure of tax is the cost price. The method of determining the cost price is described in detail in Regulation 1525(b)(2)(B)2. Installation labor is not taxable as it is excluded from the definitions of "gross receipts" (Rev. & Tax. Code § 6012(c)(3)) and "sales price" (Rev. & Tax. Code § 6011(c)(3)).

On a lump sum contract, the measure of tax is the sale price. If the sale price is not stated in the contract, it will be considered to be the cost of the fixture to the contractor. The method of determining the sale price is described in detail in Regulation 1521 at subsection (b)(2)(B)2.b.

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It appears, from the facts that you have provided, that the construction contract in question contains both a "materials" component and a "fixtures" component. In similar situations, the Board has segregated out and taxed the components according to law, regardless of whether such segregation was manifest in the contract. For instance, in Honeywell, Inc. v. State Board of Equalization (1975) 48 Cal.App.3d 897, the manufacturer maintained that the temperature-controlled devices it sold were materials. These precision instruments were fabricated by Honeywellin its factory and sold ready to install. They attached by bolts or screws to special panels and could be removed without damage to the building. Honeywell entered into lump sum contracts to install systems into buildings.

The Court upheld the Board, which had segregated out and taxed as materials only those parts of the system such as electric wiring, which were "so permanently affixed to the structures as real property so as to become an integral permanent part thereof." (Ibid p. 903. The main portion of the system was designated as fixtures.

Recently a taxpayer inquired about the applicability of sales and use tax under a contract to design and install customized closet interiors. Tax counsel advised that a non-removable wood backing, board feet and dowels cut on site, and mirrored sliding closed doors were materials. As to these items, therefore, the taxpayer was required to pay sales tax reimbursement or use tax only on their cost. However, other items such as drawers, cabinets, wall safes, qualified as fixtures. These items wer prefabricated by the taxpayer or purchased prefabricated by the taxpayer. Therefore, the contractor was the retailer of these items under Regulation 1521.

We would classify the mezzanine module as "materials" and the storage shelving as "fixtures." The Board staff has consistently treated mezzanines as parts of a building. Included in the "materials" classification would be windows, doors, and flooring, (see Appendix A of Regulation 1521) as well as handrails, stairs, and catwalks. See BTLG Annos. 190.1330 and 190.1430.

Please note that as to the mezzanine, although the actual work (assembly and installation) is subcontracted out, it is C--- and not the subcontractor which is responsible for payment of any sales tax reimbursement or use tax which is due. This is because the subcontractor does not furnish any of the property used in improving realty but only performs labor for C---. BTLG Annotation 190.0980. Since the subcontractor provided labor only (assembly and installation), its charge is not subject to tax.

The storage shelving should be classified as fixtures. As I understand it, the shelving consists of pre-fabricated, pre-assembled racks which are installed by affixation to the mezzanine. As such, the shelves fall within the definition of fixtures as "items which are accessory to a building or other structure and do not lose their identity as accessories when installed." (Reg. 1521(a)(5).) C--- is the retailer of the shelving and obligated to pay tax on the sale price if stated in the contract. On the bidsheet only the sale price of extra shelves is stated. Therefore, the measure of tax on the non-optional shelving would be the cost price of the shelving to C---. Jobsite fabrication labor, which "includes assembly labor performed prior to attachment of a …fixture to a structure…" must be included in the sale price of the fixture. (Reg. 1521(b)(2)(B)2.) Thus, C--- must include the amount it pays for assembly labor on the shelves in the measure of tax.

I noticed that the bidsheet contained a quote for office partitioning which includes sales tax. The tax treatment of partitions depends upon whether they are affixed to realty. Partitions which are attached to realty are treated as materials whereas freestanding partitions are treated as tangible personal property. I assume that, since sales tax reimbursement is included in the quote, the partitions in question are freestanding.

I hope the above analysis and our phone consultations are useful to you in advising this taxpayer. Please feel free to call again if you have further questions.

SL:cl

cc: Santa Ana District Administrator