



STATE BOARD OF EQUALIZATION

LEGAL DIVISION (MIC:82)
450 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 324-2642

MEMBER
First District

BRAD SHERMAN
Second District, Los Angeles

ERNEST J. DRONENBURG, JR.
Third District, San Diego

MATTHEW K. FONG
Fourth District, Los Angeles

GRAY DAVIS
Controller, Sacramento

August 29, 1994

BURTON W. OLIVER
Executive Director

Mr. C--- S---
P. O. Box XXXXXX
---, CA XXXXX

Re: C. W. W---
SR -- XX-XXXXXX

Dear Mr. S---:

This is in response to your letter dated May 18, 1994. You ask about computing tax on charges for labor on cabinets, windows, and tables.

Attached is a photocopy of the scenarios that you sent to us and we have indicated the correct method of computing tax on that information for your convenience. We also enclose our discussion of the problems you presented.

In your letter, you describe types of work that W--- does in each of seven "scenarios," you set forth one or two methods of computing tax on charges for each type of work, ask which method is correct, and ask the reason therefor. We will generally try to direct an answer to your inquiry about computation of tax in the manner in which the questions were asked. Since W--- registered with the Board as a construction contractor making retail sales, we will provide a general overview of the law concerning retail sales as well as construction contractors, so that we do not have to repeat sections of the law for each answer to your inquiry. We will divide our overview and discussion by first covering retail sales and construction contracts and, thereafter, repairs or fabrication.

RETAIL SALES AND CONSTRUCTION CONTRACTS

Regarding retail sales, a sales tax is imposed on all retailers measured by their gross receipts from retail sales of tangible personal property in this state. (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.) Sale means and includes producing, fabricating, and processing of tangible personal property. (Rev. & Tax. Code § 6006(b).) Gross receipts means the total amount of the sale price of the retail sale of retailers valued in money without any deduction for the cost of property sold, the cost of materials used, labor or service costs, interest paid, losses or any other expense. Gross receipts do not include the price received for labor or services used in installing or applying property sold. (Rev. & Tax. Code §§ 6012(a)(1), (2), and (c)(3).)

Regulation 1521 specifically concerns construction contractors, and at subdivision (b)(2)(A)1 it provides:

“In General. Construction contractors are consumers of materials which they furnish and install in the performance of construction contracts. Either sales tax or use tax applies with respect to the sale of the materials to or the use of the materials by the construction contractor.”

A construction contractor may sell and install materials sold. A construction contractor is a retailer of materials if his contract explicitly provides for transfer of title to materials prior to installation and if the price of the materials is separately stated. (Reg. 1521(b)(2)(A)(2).) Regulation 1521(b)(6)(B) provides a sales tax exemption for construction contractors for out-of-state use of property used to complete performance under a construction contract, as follows:

“Sales tax does not apply to sales of tangible personal property to a construction contractor who holds a valid California seller’s permit when the property is used by the contractor outside this state in his performance of a contract to improve real property and as a result of such use the property is incorporated into and becomes a part of real property located outside of this state. This exemption is available only if at the time of the purchase the contractor certifies in writing to the seller that he holds a valid California seller’s permit (giving the number of that permit and identifying the property purchased) and states that the property will be used in the manner stated above. The certificate must be signed by the contractor or an authorized employee. Such a certification may appear in the body of a purchase order which bears the signature of the purchaser. Any certificate given subsequent to the time of purchase will not be recognized.

“If the property purchased under a certificate is used by the contractor in any other manner or for any other purpose than stated in the certificate, the contractor shall be liable for sales tax as if he were a retailer making a retail sale of the property at the time of such use, and the sale price of the property to him shall be deemed the gross receipts from the sale.”

A construction contract includes a contract on a lump sum or other basis to erect, construct, alter, or repair any building or other structure, project, development, or other improvement on or to real property.

Regulation 1521(a)(8) explains a lump sum contract:

“A contract under which the contractor for a stated lump sum agrees to furnish and install materials or fixtures, or both. A lump sum contract does not become a time and material contract when the amounts attributable to materials, fixtures, labor, or tax are separately stated.”

Regulation 1521(a)(7) explains a time and materials contract:

“Time and material contract” means a contract under which the contractor agrees to furnish and install materials or fixtures, or both, and which sets forth separately a charge for the materials or fixtures and a charge for their installation or fabrication.”

A construction contract does not include a contract for the sale or for the sale and installation of tangible personal property such as machinery and equipment, or 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. A construction contractor means any person who for himself, in conjunction with, or by or through others agrees to perform and does perform a construction contract. (Reg. 1521(a)(1) and (2).)

Application of tax to construction contracts depends on the type of property furnished in performance of the contract. Reg. 1521 contains appendices which list typical items considered materials, fixtures, or machinery and equipment. Regulation 1521, as relevant here, defines materials and fixtures as those terms apply to construction contractors, as follows:

“Materials” means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property. A list of typical items regarded as materials is set forth in Appendix A.” (Reg. 1521(a)(4).)

“Fixtures” means and includes items which are accessory to a building or other structure and do not lose their identity as accessories when installed. A list of typical items regarded as fixtures is set forth in Appendix B.” (Reg. 1521(A)(5).

A construction contractor is the retailer of fixtures which the contractor furnishes and installs pursuant to the construction contract, and tax applies to the contractor’s retail sale of fixtures. (Reg. 1521(b)(2)(B)1.) Contractors holding valid seller’s permits may purchase fixtures for resale by issuing resale certificates to their suppliers. They may not purchase materials for resale unless they are also in the business of selling materials. (Reg. 1521(b)(6)(A).)

There are specific rules which apply to cabinets. For sales and use tax purposes, when cabinets are furnished and installed pursuant to a contract, they are sometimes considered materials and sometimes fixtures. The status of the cabinets as materials or fixtures determines the application of tax. Regulation 1521(c)(2) states the rule for determining whether a cabinet is materials or fixtures for sales and use tax purposes, and it provides that:

“A cabinet will be considered to be ‘prefabricated’ and a ‘fixture’ when 90 percent of the total direct cost of labor and material in fabricating and installing the cabinet is incurred prior to affixation to the realty. In determining this 90 percent, the total direct cost of all labor and materials in fabricating the cabinet to the point of installation will be compared to the total direct cost of all labor and materials in completely fabricating and installing the cabinet. If more than one cabinet is fabricated and installed under the contract, each cabinet will be considered separately in determining whether the cabinet is prefabricated.”

This means that if the contractor first constructs a cabinet, whether it does so at the job site or elsewhere, and then affixes the cabinet to the building and ninety percent of the total direct cost for labor and materials to make and install the cabinet is incurred before the actual attachment of the cabinet to the building, the cabinet is a fixture. In that case, the contractor is the retailer of the fixture, and tax is due on the contractor’s sale of the cabinet to its customer. On the other hand, if less than ninety percent of the total direct cost of labor and materials to make and install the cabinet is incurred before the contractor attaches the cabinet to the building, the cabinet is considered materials. Since the contractor is the consumer of materials which it furnishes and installs, tax is only due on the sale of the materials to the contractor, or if tax is not paid at that time, on the contractor’s use of the materials.

If the contract states the sale price at which a fixture is sold, tax applies to that price. If not stated, the sale price shall be deemed to be the cost price of the fixture to the contractor. (Reg. 1521(b)(2)(B)1 and 2(a).) The excess tax reimbursement provisions of Regulation 1700 apply to construction contractors. (Reg.1521(c)(11).) Regulation 1700(b)(1) and (2) provide:

“When an amount represented by a person to a customer as constituting reimbursement for sales tax is computed upon an amount that is not taxable or is in excess of the taxable amount and is actually paid by the customer to the person, the amount so paid is excess tax reimbursement. Excess tax reimbursement is charged when reimbursement is computed on a transaction which is not subject to tax, when reimbursement is computed on an amount in excess of the amount subject to tax, when reimbursement is computed using a tax rate higher than the rate imposed by law, and when mathematical or clerical errors result in an overstatement of the reimbursement on a billing.

“Whenever the board ascertains that a person has collected excess tax reimbursement, the person will be afforded an opportunity to refund the excess collections to the customers from whom they were collected. In the event of failure or refusal of the person to make such refunds, the board will make a determination against the person for the amount of the excess tax reimbursement collected and not previously paid to the state, plus applicable interest and penalty.”

First Scenario. Our understanding is that W--- contracts to reface existing kitchen cabinets, purchases materials for \$600, and pays the sales tax reimbursement on the materials to the vendor. W--- labor charges are \$1200. We assume these existing cabinets were previously installed. We understand that refacing means that the contractor takes the doors of the cabinets off for the purpose of replacing the cabinet doors with new doors, restaining existing cabinet doors, or veneering existing cabinet doors. We assume that the \$6 listed at Method (B) for materials is an error, and that the figure should be \$600, as listed in Method (A).

Of the two methods proposed for computing tax, Method (A) is correct. The cabinet doors, veneer, and stain are materials because they lose their identity when affixed to the cabinets, becoming an integral part of the real property to which they are affixed. Since contractors are consumers of the materials they furnish and install in the performance of a contract, sales tax applies to the cost of such materials to the construction contractor. Based on the facts provided, the contractor has paid tax or tax reimbursement with respect to the building materials now incorporated into the refaced cabinets, and no further tax applies to the furnishing of the building materials or labor.

Second Scenario. W--- contracts to remove old kitchen cabinets, supply, and install new cabinets. The materials purchased for fabrication of the cabinets were purchased for resale. Our understanding of the facts provided is that W--- manufactured the new cabinets. We assume the \$6000 charge to the customer for the cabinets is stated in the contract.

The method used to compute the tax is essentially correct. The first question is whether the cabinets are prefabricated cabinets and fixtures. If 90 percent of the total direct cost of labor and material used in fabricating and installing the cabinets is incurred prior to affixation to realty, then the cabinets are prefabricated and they are fixtures. Each cabinet must be considered separately in making this decision.

Based on the facts provided, if \$6000 is the direct cost of labor and materials prior to affixation to realty, and it is compared to the \$7200 for all labor and materials used in completely fabricating and installing the cabinet, then the sum of materials and labor expended prior to affixation to realty is less than ninety percent, meaning the cabinets are not prefabricated. Unless the \$1200 for installation includes removal of former cabinets or pre-installation labor, the cabinet is materials. If the \$1200 includes pre-installation labor and materials, the cabinets may be fixtures. The contract does not pass title prior to installation and billing is in a lump sum, so the contractor cannot be the retailer of materials. If the contractor is the retailer of fixtures, tax applies to the sale price of the fixtures if stated in the contract. If not stated in the contract, the sale price is the cost price of the fixture to the contractor. Contractors holding a valid seller's permit may purchase fixtures for resale by issuing resale certificates to their suppliers. They may not purchase materials for resale unless they are also in the business of selling materials. Since W--- has a valid seller's permit and the fixtures are being sold, it was appropriate to purchase the materials for resale.

Third Scenario. W--- removes old kitchen cabinets, supplies and installs new cabinets. In this case, the new cabinets are purchased from a manufacturer for \$5480, including tax. The cabinets are marked up to \$6480. We assume the price of the cabinets, including markup, is stated in the W--- contract.

The first question is whether, considering each of the new cabinets separately, any of the new cabinets is prefabricated; that is, whether ninety percent of the total direct cost of labor and material in fabricating and installing each of the cabinets is incurred prior to affixation to realty. Here the total direct cost of labor and materials prior to affixation to realty appears to be \$5480, less the included tax. After affixation to realty, the cost of labor and materials appears to be \$5480, plus \$1200 installation labor, or \$6680. Ninety percent of \$6680 is \$6012. Thus, it appears that less than ninety percent of the cost of labor and materials was incurred before affixation to realty. If the ninety percent rule is not met, the cabinets are materials. Since the contractor is the consumer of materials, sales or use tax applies to the sale to, or use by, the contractor. Regarding the correct method of computing tax if, in fact, the cabinets are materials, Method A is correct; Method B is correct if the cabinets, or any of them, are fixtures. In such a

case, if W--- paid tax reimbursement, it may take a tax paid purchases resold deduction on line 10(b) of the retailer's return.¹

Fourth Scenario. W--- removes old windows and replaces them with new vinyl windows. The new windows are purchased from the manufacturer for \$5000, tax included, and marked up \$1000. W--- charges \$1680 for installation labor.

Of the two methods proposed for computing tax, Method (A) is correct because windows and window frames² are materials and, as a construction contractor, W--- is generally the consumer of materials furnished and installed pursuant to a construction contract, as previously stated. This means that sales or use tax applies to the sale **to** W--- of such materials.

Fifth Scenario. Under this scenario, W--- contracts for the removal and replacement of windows. Since you say that the windows will be purchased from the manufacturer and installed by the manufacturer, we assume the manufacturer furnishes and installs the windows.

Based on these facts, the manufacturer has the obligation to install the windows. BTLG Annot. 190.1180 (11/4/64) states:

“A window supplier cannot qualify as a consumer unless under the terms of the contract, he is obligated to install the window and is responsible for its proper installation. In such a case, he may make the installation himself or engage a subcontractor who is other than the prime building contractor and consumer. If the window supplier installs the window under the contract, he is the consumer.”

Of the two methods proposed for computing tax, Method A is correct. As stated in the annotation, windows are materials. The manufacturer pays tax or tax reimbursement on the cost of the materials since the manufacturer is the consumer. The manufacturer cannot collect reimbursement from W---, since sales tax applies only to the cost of the materials to the manufacturer. Tax does not apply to W---'s sale to its customer.

¹As explained in Regulation 1701, "A retailer who resells tangible personal property before making any use thereof ... may take a deduction of the purchase price of the property if, with respect to its purchase, he has reimbursed his vendor for the sales tax or has paid the use tax. If such a deduction is taken by the retailer, no refund or credit will be allowed to his vendor with respect to the sale of the property. The deduction under the caption 'Tax-paid purchases resold' must be taken on the retailer's return in which his sale of the property is included. If the deduction is not taken in the proper quarter, a claim for refund of tax must be filed."

²Business Taxes Law Guide (BTLG) Annot. 190.2400 (11/21/51).

REPAIRS OR FABRICATION

As explained in Regulation 1546 regarding installation, and repairing:

“(a) INSTALLATION GENERALLY. Charges for labor or services used in installing or applying the property sold are excluded from the measure of tax. Such labor and services do not include the fabrication of property in place.

“(b) REPAIRMEN.

(1) WHEN RETAILERS. If the retail value of the parts and materials furnished in connection with repair work is more than 10 percent of the total charge, or if the repairman makes a separate charge for such property, the repairman is the retailer and tax applies to the fair retail selling price of the property.

If the retail value of the property is more than 10 percent of the total charge, the repairman must segregate on the invoices to his customers and in his records the fair retail selling price of the parts and materials from the charges for labor or repair, installation, or other services performed. ‘Total charge’ means the aggregate of the retail value of the parts and materials furnished or consumed in making the repairs, charges for installation, and charges for labor or repair or other services performed in making the repairs, including charges for in-plant or on-location handling, disassembly and reassembly. It does not include pick-up or delivery charges. If the retailer does not make a segregation, the retail selling price of the parts and materials will be determined by the board based on information available to it.

“(2) WHEN CONSUMERS. If the retail value of the parts and materials furnished in connection with the repair work is 10 percent or less of the total charge, as defined in (b)(1) above, and if no separate charge is made for such property, the repairman is the consumer of the property, and tax applies to the sale of the property to him.” (Reg. 1546(a) and (b)(1) and (2).)

Sixth Scenario. W--- cuts a nine foot table into three foot sections and installs hardware. Our understanding of these facts is that hardware is installed on a table which remains a table following installation of hardware and, thereafter, can be used by putting the cut sections together or, the table is restyled by installing hardware which will make it possible to fold the table for storage. We assume the charges for parts and materials are separately stated.

This question does not involve a construction contract. Instead, the answer to this question depends on whether this is fabrication or repair labor. With an analogy to fur alteration, repair, and remodeling, if a fur coat is repaired or restyled but remains a coat, it is a non-taxable repair; if it is remodeled into a cape or a stole, it is taxable fabrication labor. (Rev. and Tax.

Code § 6006(b).) Here, for example, you have not said that W--- was attaching legs to make three tables or that the labor will result in a table and two chairs; instead, hardware is installed on a table which remains a table thereafter. Thus, if the table is made into something different, such as three small tables, the labor is fabrication labor and it is taxable as a part of the gross receipts of W---. On the other hand, if it is repair labor (the table remains a single table), it is not taxable. (See also, BTLG Annots. 315.0300 (9/2/55), 315.0260 (6/18/57), and 315.0720 (2/2/51).) Based on our assumptions and understanding of the facts, we regard the labor on the table as repair labor, rather than fabrication labor.

When it is repair labor, the application of tax depends on the cost of the parts and materials. Repairmen are retailers when the retail value of the parts and materials furnished in connection with their work is more than ten percent of the total charge or, if the repairman makes a separate charge for such property, and tax applies to the fair retail selling price of such parts and materials. Based on the facts, the cost of the materials is stated as more than ten percent of the total charge and repair charges are lump sum billed. If the cost of the materials is a fair retail selling price, the repairman is considered a retailer and tax applies to the fair retail selling price of the parts used for the furniture. In that case, Method (A) is the correct way to compute the tax.

Seventh Scenario. W--- contracts to shorten three foot table sections by trimming the length of the sections. The charge is \$90. We assume the table sections still combine to make a table.

As in the Sixth Scenario, the issue is whether the labor is non-taxable repair labor or taxable fabrication labor. Using a similar analogy to the fur coat, where the fur coat is restyled into a jacket, it is non-taxable repair labor. Thus, where the sections of the table are restyled to be shorter sections but remain sections of a table, it is non-taxable repair labor. Method A is correct.

We enclose a copies of Regulations 1521 and 1546, relevant BTLG Annotations, and the pamphlet "Tax Tips for Construction and Building Contractors." If you have further questions, feel free to write again.

Sincerely,

Pat Hildebrand
Staff Counsel

PH:cl
Enclosures

cc: --- --- District Administrator