



STATE BOARD OF EQUALIZATION

September 2, 1992

Re:
Factory-Built School Buildings

Dear

I am responding to your letter to Senior Tax Counsel David H. Levine dated July 24, 1992 on the above topic. You wish to know whether or not your understanding of how sales or use tax applies to contracts for the sale and installation of such buildings is correct.

I. FACTUAL BACKGROUND

You describe your company's operation as follows:

--- --- --- is engaged in the business of leasing factory-built school buildings to school districts. These buildings are acquired from outside manufacturers. --- --- - -- purchases these buildings and stock-piles the equipment for inventory from an outside manufacturer and accepts delivery of these classrooms at the manufacturer's place of business. Once --- --- --- has an order for the rental of the equipment, the equipment is transported via a subcontractor (common carrier) from the manufacturer's location to the customer's site. Less frequently, --- sells new and used buildings which have been withdrawn from their rental fleet.

"Upon delivery of the buildings to the customer's site, the buildings are installed. The manufacturer typically provides the required materials for the initial installation of the building (foundation, plumbing connections, decking, skirting, closeup materials) and a separate subcontractor is hired by --- to complete the installation. The material costs are included in the initial cost of the building from the manufacturer."

I must admit I am a bit confused by your terminology. You initially indicate that the classrooms and equipment are separate categories of property, but later on seem to treat them as the same. Thus, for the purpose of this letter, we will assume that when you refer to "equipment" you mean the buildings themselves. We will also assume that you are referring to contracts effective after September 13, 1990.

Based on the above assumptions, it appears that purchases the buildings from a manufacturer, taking delivery and title at the place of manufacture, and stores them there as inventory. When it gets an order for a building, it takes one out of inventory where it is stored at

the manufacturer's premises and ships it to the site, where a sub-contractor affixes it to the real property. --- apparently has a separate lot where it stores the used building pending re-lease or sale.

II. OPINION

A. Sales of Factory-Built School Buildings

As you know, Revenue and Taxation Code section 6012.6, sets a portion of the of gross receipts from the sale of factory-built school buildings as the measure of tax. This section is interpreted and implemented by 18 California Code of Regulations, Regulation 1521(c) (4) which, in sub-division (B)2., defines "consumer" as either the school district or "a contractor who purchases a factory-built school building for the purpose of fulfilling the requirements of an existing contract with a school or school district to furnish and install such building."

Regulation 1521(c) (4) (D) discusses the application of tax to sales of such buildings, in part, as follows:

"1. Tax applies to 40 percent of the sales price of the building to the consumer excluding any charges for placing the completed building on the site. The sales price of the building shall include amounts representing tangible personal property installed in the building by a subcontractor, whether prior to or after installation of the building at the site, provided such installation is called for in the prime contract for the building.

"A separate contract to furnish and install tangible personal property in a factory-built school building after installation of the building at the site is a construction contract and tax applies [according to the normal rules regarding such contracts]. Any contract or subcontract for site preparation (e.g., foundation) is a construction contract and tax applies [according to the normal' rules regarding such contracts]."

Regarding leases of factory-built school buildings, Regulation 1660(d) (8) provides as follows:

"On and after September 26,1989, leases of factory built school buildings (relocatable classrooms) as defined [in Regulation 1521] will be treated as leases of real property with the lessor to the school or school district as the consumer If the lessor is other than the manufacturer, tax applies to 40% of the sales price of the factory-built school building to such lessor."

B. Tax Consequences to ---

You make four statements. I will organize my response around them.

Statement 1:

"Since leases of factory-built school buildings are treated as leases of real property with the --- as the consumer, --- customer (lessee) would not be charged tax on the rent, delivery and installation of the factory-built school building."

---s lessees would not be subject to tax on the rental payments because the lease is treated as a lease of real property. In other words, the relocatable classrooms are treated as tangible personal property in the hands of ---. That is, the sale of the classrooms is a retail sale of tangible personal property since --- will consume the property by leasing it in the form of real property. Tax thus applies to the sale to ---. The lease to the school district is, however, treated as a lease of real property. Use taxes apply only to leases of tangible personal property. For the tax treatment of the delivery and installation charges, see the discussion below under Statement 2.

Statement 2:

"Materials purchased directly, if any, by --- instead of by the manufacturer upon initial delivery and installation of the factory-built school building from the manufacturer is viewed as --- being the consumer of the materials and tax is due on the cost of such materials (foundation, plumbing connections, awnings, electrical, decking, skirting, close-up materials). Additionally, if --- separately hires a subcontractor to complete the installation and the subcontractor provides any materials, the subcontractor is the consumer of those materials and must pay the sales tax related to the materials used. Again, no sales taxes is charged to the lessee."

Under Regulation 1521(c) (4) contracts to install relocatable classrooms are construction contracts. While --- is the consumer of the installation materials it supplies, the installing subcontractor is the consumer of the materials it purchases to complete its portion of the contract - e.g., paving materials, fill, etc. (Reg. 1521(b) (2) (A); Annat. 190.0980.) The suppliers collect use tax or sales tax reimbursement from --- and the subcontractor when each purchases the materials that each will consume. Although the subcontractor's costs are presumably passed on to --- in the subcontract to install the building who presumably passes them on to lessee, you are correct the lessee is not subject to these taxes directly.

You suggest that when ---, purchases installation materials it could pay use tax or sales tax reimbursement directly to the vendor or purchase the materials ex-tax by issuing the vendor a resale certificate and accruing use tax when it withdrew them from inventory for its own consumption. Unless intends to resell these materials prior to use when it purchases them, it may not issue a resale certificate. Tax applies at the time of purchase. If it does resell some of these materials, it may take a tax-paid purchases resold deduction under Regulation 1701. If, however, --- resells (prior to use) a significant portion of the installation materials it purchases (your letter indicates that it does not), it may issue resale certificates when it purchases all of the materials and report in the quarter of use tax measured by the cost of those materials that it withdraws from resale inventory for its own consumption.

You mentioned that a minor part of ---'s business is selling new and used relocatable classrooms which it has withdrawn from its rental fleet. --- may not purchase for resale nor take a tax-paid purchases resold deduction for those relocatable classrooms that it sells after renting them out as there is an intervening use prior to resale. (See, e.g. .. Kirk v. Johnson (1940) 37 Cal.App.2d 224, 99 P.2d 297.) Where --- purchases a particular building with the intent of reselling it in the form of tangible personal property prior to use, it may issue the manufacturer a resale certificate. Tax will apply when --- resells the structure to a consumer.

Statement 3:

"After the first customer's lease term is completed, the equipment is returned to ---'s inventory center. Materials purchased directly, if any, by --- to complete any repair or maintenance items (repair broken windows or lights, repair flooring, wall, doors, or rook damage) is viewed as --- being the consumer of the materials and tax is due on the cost of such materials. Again, no sales taxes is charged to the lessee who is charged for those repairs."

As noted above, --- is the consumer of the relocatable classroom. As a result, in this case, it is repairing its own property and is subject to tax when it purchases the materials. We agree that the lessee who pays for the repairs is not directly subject to the tax, but, of course, it becomes part of the costs which --- passes on in the lease payments.

Statement 4:

"A second customer orders the equipment returned in Statement 3 above. --- delivers the building to the customer's site and arranges for a subcontractor to install the building. Materials purchased directly, if any, by --- for the re-installation of the factory- built school building from ---s inventory is viewed as -- - being the consumer of the materials and tax is due on the cost of such materials (foundation, plumbing connections, awnings, electrical, decking, skirting, closeup materials). Additionally, if --- separately hires a subcontractor to complete the installation and the subcontractor provides any materials, the subcontractor is the consumer of those materials and must pay the sales tax related to the materials used. Again, no sales taxes is charged to the lessee."

This is the same situation as in Statement 1 - a lease of real property with --- as the consumer under Regulation 1660(d) (8) - with the same tax consequences. Just as a reminder, though, --- cannot purchase materials for resale unless it intends to resell a significant portion of them prior to use. Please note, however, that if --- were to sell one of its used school buildings to a school district, the district would be the consumer under Regulation 1521(c) (4) (B)2. with tax due on the sale.

For your information, I have enclosed copies of Regulations 1521, 1660, and 1701. I hope the above discussion has answered your questions. If you need anything further, please do not hesitate to write again.

Sincerely,

John L. Waid
Tax Counsel

JLW:es

Enclosures: Regs. 1521, 1660 & 1701