

**STATE BOARD OF EQUALIZATION**

(916) 445-3723

January 26, 1990

Mr. E. M. L---
E. M. L--- E--- & M---, Co.
XX --- Street – Bay XX
--- ---, CA XXXXX

SR --- XX-XXXXXX

Dear Mr. L---:

Your letter of December 26, 1989 addressed to Mr. H. L. Cohen was given to me for reply.

Before I became a lawyer, I used to operate a diamond lapping machine in a model shop - - although I cannot really say that my career has progressed since that time. I thus have some understanding of your specific questions, but I too may respond with legal obscurities.

Unfortunately your business activities are at the edge of the application of the Sales Tax Law. I will try to state the general law applicable to labor charges made for work performed on customer-furnished property.

Under the Sales Tax Law, tax is applied to all charges, including labor charges, for manufacturing the finished article to the customer's precise specifications. If property is delivered in a rough state, as for example clothing that has not been hemmed, tax applies to the labor charge for "finishing" the product - - whether the labor is performed by the person who sold the article in the "rough" state or whether the purchaser takes the article to someone else who finishes it. This rule - - that tax applies to charges for bringing the product to the customer's specification - - applies even where a product may have been delivered in a finished state but is altered at the request of the customer to the customer's own specification. Thus the charge for taking .010" of a new head for a jet ski head to improve performance is taxable. This is treated as an alteration of a product to meet its final performance specifications. Thus finishing work or alteration work to new products is taxable.

I can answer two tax application questions by you.

First, you inquire as to how tax applies in the following circumstance:

“We received an engine head from a Rolls and worth several thousand dollars if it had to be replaced. What happened was the owner never changed the antifreeze and corrosion attacked the cross passages between the head and block and eventually cause the water to leak into the cylinder. We ground the bad area clean and welded into it new aluminum and then machined it to about .010” proud of the original surface. What we did was repair to return to an existing condition. We billed it that way because it was still to original specs. Then the head went to a auto machine shop and they machined it flat so that it could be reused. Now is this a repair or is it an alteration that is to be taxed?”

This is a repair operation, not an alteration, and tax applies as provided in our Regulation 1546, copy enclosed for your reference.

The regulation provides that tax applies to the charge for the aluminum furnished, if the retail value of the material is more than 10 percent of the total charge. Thus, while repair labor is nontaxable, tax applies to charges for repair materials incorporated into the refurbished item, but not if the value of the materials is more than 10 percent of the contract price.

Taking .010” off of a used head is nontaxable. This is a repair to return the head (as close as possible) to its prior specifications to perform the function for which it was purchased. Taking .010” of a new head for a jet ski head to improve performance is taxable. This is treated as an alteration of a new product to meet its final performance specifications.

You are correct that there is no physical difference in the two cases. There is a legal difference, because the law has been written in such a way as to insure that tax applies to all charges for manufacturing new products to specifications for use by the consumer.

Second, we cannot audit your records monthly. We audit approximately every three years. We can answer in writing any questions concerning application of the tax which you may have. Write to me at:

State Board of Equalization
P. O. Box 942879
Sacramento, CA 94279-0001

Very truly yours,

Gary
Assistant Chief Counsell

GJJ:sr