

**STATE BOARD OF EQUALIZATION**

(916) 445-5550

April 19, 1991

Mr. R--- P. T---  
Contracts Administrator  
A--- S--- S---  
XX --- ---, Suite XXX  
---, CO XXXXX

Dear Mr. T---:

This is in response to your letter dated February 19, 1991. A--- S--- A--- (ASA) has contracted with the N--- S--- F--- (NSF), an instrumentality of the United States, to perform a variety of services in Antarctica. You ask for exemption from sales and use tax on items purchased in California for use in the performance of this contract.

It is your opinion that title to the items ASA purchases for use in fulfilling the contract passes to the United States before ASA uses the item in performance of the contract. You have enclosed two letters from ASA to the NSF, one letter from the NSF to ASA, and an invoice from your predecessor which you believe support your assertion.

My understanding is that ASA takes delivery of the items in question in California prior to shipment of the items to Antarctica. The invoice from your predecessor states that it was acting as an agent of the N--- S--- F--- and is exempt from all state and local taxes on materials purchased pursuant to the prime contract for export to Antarctica. You believe that this shows that it had a permit from the State of California exempting it from sales and use tax. This is incorrect. The Board does not issue a tax exemption certificate. Your predecessor's invoice shows that it held a California seller's permit, which simply indicates that it was engaged in the business of selling tangible personal property in California and was therefore required to hold a seller's permit. The statement on the invoice merely indicates your predecessor's belief that it was acting as an agent and was exempt. The statement does not mean that we necessarily agreed with your predecessor's belief.

Prior to discussing the details of your contract, it is useful to note the general rules for application of tax to this type of transaction. My understanding is that ASA makes no functional use of the items in question in California except for inspection and preparation for shipment to Antarctica, and this opinion is based on this understanding.

A retailer's retail sale of tangible personal property in California is subject to sales tax unless specifically exempted by statute. (Rev. & Tax. Code § 6051.) A sale occurring outside California would not be subject to sales tax, but if purchased from a retailer for use in California, that use would be subject to use tax unless the use was specifically exempted by statute. (Rev. & Tax. Code § 6201.) Revenue and Taxation Code section 6009.1 excludes from the definition of use the keeping, retaining, or exercising any right or power over tangible personal property for the purpose of subsequently transporting it outside the state for use thereafter solely outside the state. Since your only use in California of the items in question are excluded from the definition of taxable use by this provision, when you make purchases outside California that pass through California as discussed above, no use tax applies. However, since sales tax is a tax upon the sale and not upon the use, the exclusion from the definition of taxable use provided by section 6009.1 is irrelevant when the sale is subject to sales tax. Sales to ASA in California will be subject to sales tax if not exempt or for resale, and the remainder of this opinion relates only to ASA's purchases in California.

As noted above, the sales tax applies to retail sales. A retail sale is a sale for any purpose other than resale in the regular course of business prior to use. (Rev. & Tax. Code § 6007.) With respect to any property you will resell prior to use, you may purchase that property ex tax by issuing the vendor a resale certificate in the form set out in Regulation 1668, a copy of which is enclosed. When you sell these items to the United States, that sale is exempt from sales tax.

Based upon the information provided us, we conclude that sales tax applies to California sales of tangible personal property to ASA when ASA takes delivery of that property in California and will not resell it to the United States prior to use unless that sale is specifically exempt by statute. Some contracts with the United States include a title passage provision that passes title to all property that the contractor purchases for use in performance of the contract to the United States prior to the contractor's use of the property. If the subject contract contained such a provision, ASA would be able to purchase all property for use in performance of the contract ex tax for resale to the United States, the sale to the United States being exempt from sales tax. My review of the contract indicates that it does not contain such a provision. The letters included with your inquiry confirm this conclusion. The two letters from ASA to NSF specifically address this issue, and warn NSF of ASA's belief that further contractual provisions are necessary to avoid such taxes in some states. Although NSF's letter to ASA states NSF's belief that "ASA has provided documentation which we believe support the position that these taxes do not apply to purchases under [the subject contract]," this is directly contrary to the concerns expressed in ASA's letters. We agree with ASA's concerns, and we conclude that the contract provided to us does not pass title to the United States prior to ASA's use.

Under a contract without a title passage provision which passes title to all property to the United States prior to use, the general rules related to whether a person purchases property for resale or use applies. For example, ASA apparently will be performing repairs on behalf of the United States. It is not clear how ASA will bill the United States for those repairs. Regulation 1546, a copy of which is enclosed, discusses the application of tax to repairs. If the retail value of the parts and materials ASA furnishes in connection with its repairs is 10 percent or less of ASA's total

charge for that repair and if ASA makes no separate charge for that property, then ASA is the consumer of that property. (Reg. 1546(b)(2).) On the other hand, if ASA makes a separate charge for the property it furnishes, or if the retail value of that property is more than 10 percent of ASA's total charge for the repair, then ASA is regarded as selling that property to the United States. When ASA is regarded as selling the property to the United States, it may purchase that property ex tax by issuing a resale certificate. Sales tax applies to sales of any property which ASA will consume when performing repairs.

You also provide certain food. Tax generally does not apply to sales of food products for human consumption. (See Reg. 1602, a copy of which is enclosed.) When ASA purchases food for human consumption in Antarctica, the sale of that food to ASA would be exempt from sales tax. Additionally, sales tax may not apply in some circumstances because ASA may be purchasing the food for resale to the United States. (See Reg. 1603, a copy of which is enclosed.) Please note that some items purchased by ASA to provide as food under the contract will not constitute exempt food products under California law. For example, carbonated beverages and alcoholic beverages are not exempt food products. (Reg. 1602(a)(2).) When ASA purchases these items and is regarded as reselling them to the United States, it may purchase the property ex tax for resale. However, if ASA is regarded as the consumer, sales tax will apply if the sale occurs in California.

ASA will also provide medical supplies. The sale of medicines meeting certain requirements are exempt from sales tax as explained in Regulation 1591, a copy of which is enclosed. When you purchase medical supplies in transactions which are not exempt under this regulation, the question arises whether ASA will sell those supplies to the United States or will consume them. We do not have sufficient information to reach a conclusion to this question.

ASA will also act as a construction contractor under the contract. This subject is discussed in Regulation 1521, a copy of which is enclosed. Please refer to subdivision (a)(1) of Regulation 1521 for the definition of when ASA will be regarded as performing a construction contract. Please note also that ASA will be a United States construction contractor when performing construction contracts for the NSF. (Reg. 1521(a)(3).) As explained in the regulation, ASA will be a consumer of materials and fixtures it furnishes and installs pursuant to construction contract with the United States. (Reg. 1521(b)(1)(A).) It will be a retailer of machinery and equipment it furnishes and installs, and it may therefore purchase such machinery and equipment ex tax for resale to the United States.

Since ASA will be a consumer of materials and fixtures it consumes in performance of any construction contract for the NSF its purchases of that property in California are generally subject to sales tax. I note that there is a specific exemption for property sold to a construction contractor who holds a valid California seller's permit if the contractor will use the property outside this state to improve real property. (Rev. & Tax. Code § 6386.) This is explained in subdivision (b)(6)(B) of Regulation 1521. My understanding is that the subject contract is ASA's only business. This would mean that ASA makes no sales of tangible personal property in California except exempt sales in interstate commerce to the United States. If such is the case, the ASA is not required to hold a

seller's permit. (Reg. 1699(b).) We would not issue a permit for the sole purpose of qualifying for the exemption provided by section 6386.

There is a variety of other tangible personal property involved in ASA's contract. As noted above, there apparently is no provision in the contract which passes title to all property to the United States prior to use by ASA. It is therefore necessary to determine whether ASA will be regarded as a consumer or a seller of any property in question. We do not have sufficient information to reach conclusions with respect to the tangible personal property involved that has not been discussed above. If you wish further guidance from use, please feel free to write us again. If you do so, please provide a complete description of the property involved and how it will be used. Please also provide copies of any contractual provisions not written out in the contract you have provided us (such as FAR provisions incorporated into the contract by reference) which are relevant to your inquiry.

Sincerely,

David H. Levine  
Senior Tax Counsel

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Enclosures



**STATE BOARD OF EQUALIZATION**

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April 13, 1993

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*Executive Director*

Mr. R--- P. T---  
Contracts Administrator  
A--- S--- A---  
XX --- ---, Suite XXX  
---, CO XXXXX

Dear Mr. T---:

This is in response to your letter dated December 14, 1992 concerning contract DPP 89-22832 between A--- S--- A--- (ASA) and the N--- S--- F--- (NSF), an instrumentality of the United States.

This office had previously written to you on April 19, 1991, concluding that some of your purchases may be exempt from use tax. However, in that letter we also concluded that sales tax applies to California sales of tangible personal property to ASA when ASA takes delivery of that property in California and does not resell the property to the United States prior to use. We noted that if the contract contains a title passage provision that passes title to all property that the contractor purchases for use in performance of the contract prior to the contractor's use of the property, ASA may be able to purchase all property for use in performance of the contract ex tax for resale to the United States. We asked you to provide us copies of any contractual provisions not written out in the contract (such as FAR provisions incorporated into the contract) which are relevant to your inquiry.

You have since provided us with a copy of Federal Acquisition Regulation Clause 52.245-5 which the contract incorporates by reference on page 72. This regulation reads, in pertinent part, as follows:

“(c) Title. (1) The Government shall retain title to all Government-furnished property.

“(2) Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed as a direct item of cost under this contract shall pass to and vest in the Government upon the vendor’s delivery of such property.

“(3) Title to all other property, the cost of which is reimbursable to the Contractor, shall pass to and vest in the Government upon

“(i) Issuance of the property for use in contract performance;

“(ii) Commencement of processing of the property or use in contract performance; or

“(iii) Reimbursement of the cost of the property by the Government, whichever occurs first.”

Except for property used by ASA when it acts as a construction contractor, the two important questions concerning property which ASA purchases in California to fulfill its contractual obligations is whether the property is sold to the government and if so, whether the sale to the government occurs before ASA makes any use of the property other than retention, demonstration, or display.

Before discussing those questions, we note that the contract incorporates a number of FAR provisions. You have provided us a copy of the one you believe is relevant. The opinion below is based on the assumption that the transactions in question are governed by FAR 52.245-5. If, instead, the title passage provisions for these transactions are governed by another of the incorporated FAR provisions, this opinion would not apply. We also assume that the sole activity and business of ASA, which is a joint venture, is the contract in issue.

As to the first question, title to property passes to the government if the property purchased by ASA is property for which ASA is entitled to be reimbursed as a direct item of cost or property for which the cost is reimbursable to ASA. FAR 52.245-5(c). Thus, there is a sale of such property since title passes to the government for a consideration. Rev. & Tax. Code § 6006(a).

With respect to the second question, title to direct item of cost property (FAR 52.245-5(c)(2)) passes to NSF prior to any use by ASA since title passes to NSF when such property is delivered by the vendor. Therefore, the sale of such property by the vendor to ASA is a sale for resale, and ASA may issue a resale certificate to the vendor when purchasing such property. ASA’s sales of such property to NSF are exempt under Revenue and Taxation Code section 6381 which exempts sales of tangible personal property to instrumentalities of the United States.

ASA may also purchase ex tax property which is governed by FAR 52.245-5(c)(3) by issuing a resale certificate if such property is purchased for resale pursuant to this contract. If ASA makes no functional use of such property prior to the sale of the property to NSF (which occurs when title passes pursuant to the guidelines in the regulation), ASA is not liable for use tax, and its sales of such property to the NSF are exempt under Revenue and Taxation Code section 6381. If, however, ASA functionally uses such property prior to passage of title to the NSF, ASA must pay use tax measured by its purchase price of the property. Its sale of such property to the NSF, though, will always be exempt.

On page 4 of our prior letter we noted that ASA will be a consumer of materials and fixtures it consumes in performance of any construction contract for the NSF and that ASA's purchase of such materials and fixtures in California are generally subject to sales tax. Rev. & Tax. Code § 6384. If such property is purchased in California, it is immaterial when title to the materials and fixtures passes to NSF. We also noted that there is a specific exemption for property sold to a construction contractor who holds a valid California seller's permit if the contractor will use the property outside of this state to improve real property. Rev. & Tax. Code § 6386.

If all of ASA's sales to the NSF are exempt sales in interstate commerce, ASA is not required to hold a seller's permit, and this exemption does not apply. Regulation 1699(b). If any property is functionally used in California after ASA has sold the property to NSF but prior to shipment out-of-state, the sale of such property by ASA to NSF is not made in interstate commerce and ASA is required to hold a seller's permit. If ASA is required to hold a seller's permit, sales of materials and fixtures in California to ASA are exempt from tax if ASA uses the materials and fixtures outside of California in performance of a construction contract to improve realty and, as a result of such use, the materials and fixtures are incorporated into and become a part of real property located outside of this state.

Sincerely,

Elizabeth Abreu  
Tax Counsel

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