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May 20, 1997

Ms. C--- -. L---, Controller  
 S--- S--- Company  
 P. O. Box XXXXX  
 ---, -- XXXXX

**Re: S--- S--- Company  
 SS - XX-XXXXXX**

Dear Ms. L---:

This responds to your letter dated March 6, 1997, written on behalf of S--- S--- Company (S---). You write that S--- is an Arizona construction contractor licensed in California. Our records show that S--- holds a California seller's permit. The application for the permit indicates S--- is a corporation which is a retailer of structural steel and a construction contractor.

Your letter states:

"When we fabricate material here at our plant in --- prior to its installation in California, no tax is due on our processing costs, i.e., our labor. Only our material cost is subject to the tax. When we sublet fabrication to an 'outside firm,' such fabrication labor is considered part of the taxable cost of the materials. As such it is subject to tax.

"Recently, our company acquired 100% of the stock of another --- fabrication company. They are a wholly-owned subsidiary of our company. From a legal standpoint, they are a separate corporation, and maintain their own federal identification number. If we sublet fabrication of materials to them prior to its installation in California, is such fabrication considered part of the taxable cost of the materials? For this purpose, are they an 'outside firm?' Or can I exclude the cost of their fabrication labor from the actual cost of the materials that are subject to the tax?"

For purposes of this opinion letter, I assume that the material which S--- fabricates is steel, and that the steel is purchased by S---, as well as fabricated, outside of California. I further assume that when you use the terms "fabricate," "construction contractor," and "materials," you mean those terms as they are defined below in the statutes and regulations of the California Sales and Use Tax Law.

Under the California Sales and Use Tax Law, sales tax is imposed on the gross receipts from retailers' retail sales of tangible personal property occurring in California, unless the sale is otherwise excluded or exempted by statute. (Rev. & Tax. Code § 6051.) When sales tax does not apply, use tax applies to the use of tangible personal property purchased from a retailer for use in California. (Rev. & Tax. Code §§ 6201, 6401.)

Regulation 1521 (copy enclosed) applies the California Sales and Use Tax Law to construction contractors. Subdivision (a)(1)(A)1. of Regulation 1521 generally defines a construction contract to include a contract to “[e]rect, construct, alter, or repair any building or other structure, project, development, or other improvement to real property. . . .” However, a construction contract does not include the furnishing of tangible personal property if the person furnishing the property is not responsible under the construction contract for the final affixation or installation of property furnished. (Reg. 1521(a)(1)(B)2.) A “construction contractor” is one who performs a construction contract. (Reg. 1521(a)(2).)

Regulation 1521 defines the term “materials” as that term applies to construction contractors. Materials are construction materials and components, and other tangible personal property incorporated into, attached or affixed to real property, such as a building, by a construction contractor, which when combined with other tangible personal property lose their identity to become an integral and inseparable part of the real property. (Reg. 1521(a)(4).) Appendix A to Regulation 1521 lists typical items regarded as materials, including steel.

“Fabricating,” producing, and processing are defined as including any operation which results in the creation or production of tangible personal property or which is a step in a process or series of operations resulting in the creation or production of tangible personal property. (Reg. 1526(b).) Tax applies to charges for the producing, fabricating, or processing of tangible personal property for a consideration (usually money) for consumers who furnish the property used in the producing, fabricating, or processing. (Reg. 1526(a).)

A construction contractor is generally the consumer of materials which the contractor furnishes and installs in the performance of a construction contract. Sales tax or use tax applies with respect to the sale of those materials to or the use of those materials by a construction contractor who is a consumer. (Reg. 1521(b)(2)(A)1. Compare with Reg. 1521(b)(2)(A)2.) Thus, if S--- as a construction contractor is the consumer of steel which it furnishes and installs in this state, California use tax applies to S---’s use of the steel in the performance of its construction contract in this state, measured by the sales price of the steel *to* S---. (Rev. & Tax. Code § 6011.)

The fabrication which S--- performs itself is not a part of the sales price of the materials (steel) to S---. Consequently, the cost of fabrication of steel done by S--- at its own plant is not subject to tax when S--- consumes the materials in the performance of a construction contract in California.

On the other hand, when the fabrication is done by another person, the charge for or cost to S--- for that fabrication is a part of the sales price of the materials to S--- which is subject to California use tax. (Rev. & Tax. Code § 6011(a); Reg. 1526(a).) Person is defined to include any corporation. (Rev. & Tax. Code § 6005.) Thus, when S--- has materials fabricated by another corporation, such as its wholly-owned subsidiary, the charges for the fabrication are a part of the sales price of the materials which S--- consumes in the performance of a construction contract in California. As such, California use tax applies to those charges.

I hope this information is of assistance. Please note that this opinion letter discusses the California Sales and Use Tax Law as it applies to construction contractors. In instances in which S--- makes retail sales of steel, such as when it is not *both* furnishing and installing the steel, its entire sales price to its customer is taxable. If you have further questions, please write again and describe the transactions in more detail.

Sincerely,

Sharon Jarvis  
Senior Tax Counsel

SJ:cl  
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Enclosure (Regulation 1521)

cc: --- District Administrator (--)