

M e m o r a n d u m**190.2810**

To: Mr. Eugene Crane
Audit Review & Refunds

Date: April 20, 1993

From: John L. Waid
Tax Counsel

Subject: S- -- XX-XXXXXX
Claim for Refund (Fixed-Price Contract)

I am answering your memorandum to me of March 11, 1993. You indicated that the taxpayer, [R], has submitted a claim for refund on the grounds that the contract at issue was for a fixed price, and so, tax should have been applied at the rate in effect prior to July 15, 1991, per Revenue and Taxation Code Section 6376.1(a). (Unless otherwise noted, all statutory references are to the Revenue and Taxation Code.) You stated your concerns as (a) the acceptance date of the contract and (b) the lack of a provision fixing the obligation (citing my memorandum to James Stillwell of Audit Evaluation and Planning, dated December 13, 1991, regarding the standard for determining a fixed-price contract).

You attached to your memorandum a portion of my above-mentioned memorandum and a letter dated February 18, 1993, from a [Mr. P], taxpayer's Sales and Property Taxes Manager for the Western Region. Mr. [P] indicates that tax was reported and paid at the rate of 7.75% on a sales price of \$27,378,000.00, but that subsequent to the billing [R] 'was advised' that the rate should have been 6.75%. He gives the contract date as September 27, 1990.

Mr. [P] attached a copy of a Sales and Purchase Agreement dated February 7, 1992 ('the Agreement'), to his letter. It states that it 'acknowledges the Agreement between the parties as of June 25, 1990.' Paragraph 1.0 states that the purchase price FOB supplier's shipping point is \$27,378,000.00 with an installation price of \$2,460,000.00, for a total price of \$29,838,000.00, and the machinery would be installed in [city], California. Other provisions of the contract pertinent to this issue are as follows:

‘2.0 SELLER’S RESPONSIBILITIES

* * *

‘2.4 Delivery

‘2.4.1 Delivery of the Machinery shall be F.O.B. the Buyer's Installation Site. Upon completion of manufacture and assembly of the Machinery. Seller shall

deliver the major components of the Machinery consisting of the printing units, folders, RTP's and substructure columns from Seller's principal manufacturing facility Auxiliary equipment and certain other components ... shall be scheduled for phased delivery from the respective OEM supplier to coincide with the anticipated date and sequence for installation with the Machinery at Buyer's Installation Site

'2.4.2 Seller shall store the Machinery, if necessary, at its sole risk and expense ... at a warehouse mutually acceptable to Seller and Buyer until shipment to Buyer's Installation site is required as scheduled in Seller's Installation bar Chart which is attached to Exhibit D hereof

* * *

'2.5 Installation and Training

'2.5.1 Seller shall, at its sole cost and expense, performs the Work and conduct training of Buyer's personnel in accordance with the provisions of the Agreement, including Exhibits C and D attached hereto. In that regard, Seller's obligations shall include, at Seller's expense, (i) sufficient competent Goss supervising erector(s), trainers, technicians and (ii) mechanical, electrical and plumbing contractors to install and supervise the erection of the Machinery

* * *

'6.0 PAYMENT

* * *

'6.2 Adjustment: The Purchase Price as set forth in Section 1.1 is firm and subject to adjustment only in the event (i) Seller does not complete delivery of the Machinery by the Phase One Delivery Date of within 180 days thereafter, and (ii) such delay in delivery is caused by circumstances beyond the reasonable control of Seller as provided in Section 10.0 (Force Majeure), then in such event the unpaid portion of the Purchase Price will be subject to adjustment upward or downward in accordance with the formula, set forth in Exhibit H attached hereto, such Purchase Price as adjusted is herein called the 'Adjusted Purchase Price.'

'6.3 Taxes

'6.3.1 Buyer will responsible for all taxes including, but not limited to, sales, use, transit, or any tax of a similar nature (except income tax of Seller) which are imposed on the sales, use, storage, transportation or delivery of the equipment by

any municipal, state, federal, or other taxing agency.

* * *

'8.0 TITLE, INSURANCE, AND RISK OF LOSS

'8.1 title to the Machinery shall remain with the Seller until such time as the Machinery has been unloaded and upon completion of rigging, set in place of final installation of the pressroom floor of the Buyer's location. At that time, title shall be transferred to Buyer.

* * * *

Although the Agreement recited that Exhibits A-H and a Drawing were attached, only Exhibit G was attached to the copy you sent. It was the Payment Schedule, including the Installation Payments. They were to be made after the following events (in order: Install & Align Reels and Y Columns, Install and Align Units, Install and Align Superstructure, Install & Hook-up Drive Controls, Test Run all equipment, Test print successfully, and On edition.

OPINION

It appears that there are two issues: (1) the measure of tax; and (2) the rate of tax.

A. Measure of Tax.

As you are aware, in California, except where specifically exempted by statute, Section 6051 imposes an excise tax, computed as a percentage of gross receipts, upon all retailers for the privilege of selling tangible personal property at retail in this state. 'Gross receipts' means the total amount of the sale price, valued in money, (§ 6012(a)) and include the 'cost of the material used, labor or service cost, interest paid, losses or any other expense.' (§ 6012(a)(2).) They do not include the 'price received for labor or services used in installing or applying the property sold.' (§ 6012(c)(3).) If the item purchased is shipped in parts and must be assembled at the site, such assembly goes beyond installation and is considered fabrication services which are included in gross receipts. (Reg. 1526(a); Annots. 435.0020 & 435.0040.)

The Agreement states that the Machinery sold will be shipped in components. The Seller is responsible for installation of the components, and title to the Machinery stays with the Seller until after final installation. It appears that the Machinery is shipped in pieces which are assembled on the site by Seller with the Seller retaining title thereto until the job is done. We are of the opinion that the 'installation' described in the contract comes up to the level of 'assembly'; the charges for such services should be included in the measure of tax. Assuming this conclusion is correct, the measure of tax is thus the full contract price of \$29,838,000.00.

B. Tax Rate.

As you note, in determining whether a contract is a 'fixed-price' contract we have consistently required that it satisfy the following criteria: (1) it be binding prior to July 15, 1991; (2) the agreement must fix the amount of all costs at the outset; and (3) the agreement must include a provision which fixes the tax obligation on a tax-included basis or sets forth either the amount or the rate of tax and does not provide for an increase in the amount of tax.

The Agreement is dated February 7, 1992. Executed after July 15, 1991, it does not meet the first of the criteria set forth above. However, it recites that it acknowledges an agreement between the parties dated June 25, 1990, and Mr. [P]'s letter says the sales agreement at issue is dated September 27, 1990. Assuming, then, that the Agreement does relate back to one of those two dates, could it still be for a fixed price.

We are of the opinion that the Agreement does not meet either of the two remaining criteria. The price is not fixed but may be adjusted pursuant to Paragraph 6.2. In addition, Paragraph 6.3.1 provides that the Buyer shall be responsible for all taxes, including state sales and use taxes. We have previously concluded that where a contract makes the Buyer responsible for 'all' taxes, the tax obligation is not fixed. Thus we conclude that the Agreement at issue is not for a fixed price under Section 6376.1. Tax was reported and paid at the proper rate.

In sum, we conclude that the measure of tax was the full contract price of \$29,838,000.00, and tax was properly reported and paid at the effective rate in San Bernardino County - 7.75%.

JLW:es