

M e m o r a n d u m**190.2844**

To: Mr. Frank Zuppan
Return Review

July 10, 1991

From: John L. Waid
Tax Counsel

Subject: F--- A---, Inc.
SZ --- XX-XXXXXX

The Legal Division has assigned your memorandum to it of June 17, 1991, to me for a response. You ask if the subcontract which you attached to your memorandum qualified as a "fixed-price" contract for purposes of the earthquake tax (former Section 6376). That subcontract, dated September 19, 1999, was between H--- Contractors as the General and the taxpayer as the Sub.

OPINIONA. Fixed Price

You set forth this portion of your question as follows:

"First, in article four of the contract is the phrase 'complete performance of the work, subcontractor shall be paid: \$541,580.00'. Is this verbiage the same as the phrase 'machinery, \$10,000.00' which is acceptable for a fixed amount in that it contains no provisions at all regarding the sales and use tax? (See memorandum dated August 11, 1982)"

The memorandum to which you refer was attached to your memorandum and was from the Principal Tax Auditor (PTA) to the District Administrators.

In determining whether a construction contract or other contract is a "fixed-price" contract for the purpose of the earthquake tax we have consistently required that it satisfy the following criteria: (1) it be binding prior to December 1, 1989, (2) neither party has an unconditional right to terminate the contract; 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. We have also previously concluded that, where the contract gives a total sales price but does not make provision for sales tax that the seller is agreeing to not seek reimbursement for tax from the buyer. Under such

conditions, we consider that the buyer's obligation is fixed, and the seller has agreed to pay the sales tax (including district tax) at the rate in effect on the date the agreement became binding.

On the face of it, this agreement seems to fall into the area discussed by the PTA's memorandum. It specifies that the contract amount is \$541,580.00 and does not mention sales tax. However, Article 1, Section 1.1, of the Subcontract specified that the terms and conditions of the contract between the Owner and the General are part of the Subcontract. If that contract contains a term providing for increased taxes, then that term is incorporated by the above clause into the Subcontract with the result that it could not be considered to be for a fixed price.

B. Termination Clause

You state you question so:

“Article thirteen “termination” states that if the contractor and owner have the right to terminate the general contract then the contractor can terminate the contract with F---. Does this wording exempt this contract from being fixed price as called for by the August 11, 1982 memorandum... Would we consider this wording such that either party is not bound by the contract or that the contract is contingent upon its occurrence or act? ...”

As noted above, the subcontract incorporates by reference the terms of, among other documents, the general contract. Thus, if the general contract provides the parties the right to cancel the contract unconditionally, then neither contract qualifies as being for a fixed price.

Additionally, when dealing with the earthquake tax, if the general contract qualifies as being for a fixed price, we consider that the subcontracts do also. This rule does not apply to the fixed-price contract exemption from district taxes, however. In that case, each contract must qualify on its own.

JLW:es
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