

**STATE BOARD OF EQUALIZATION**

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June 23, 1993

D--- B. B---, CPA  
City Internal Auditor  
City of R--- Finance Department  
XXXX --- Street  
---, CA 92522

Re: SR -- XX XXXXXX

Dear Mr. B---:

This is in response to your letter of April 8, 1993, requesting our opinion concerning the applications of use tax to the portion of the contract price which is reduced by liquidated damages. There is no charge of this opinion.

A Canadian firm contracted to fabricate and install an electrical transformer. The contract was for a lump sum without a separate charge for installation. The contract provided for liquidated damages to be deducted from the contract price for late completion.

Your letter concluded that the cost for custom installation “apparently cannot be segregated from the other labor” in determining the amount to which a sales or use tax will apply. Revenue and Taxation Code § 6012 (c) (3) provides that gross receipts do not include the price for installing the property. This is true even if not separately stated, so long as it is possible to reasonably determine the portion of the total price which is properly allocated to installation. It should be noted, however, that “installation” means “emplacement” only. It does not include assembly or fabrication in place.

The primary concern in your letter was the proper treatment of liquidated damages. We do not have the exact terms of your contract, but liquidated damages are commonly deducted from the sales price, on a daily or other unit of time basis, for late completion. For example, \$100.00 per day is deducted from the sales price for each day beyond a specified date that it takes for the contractor to complete the contract.

Such damage payment or credit do not reduce the gross sales price, but are a convenient formula for determining civil damages payable for breach of contract. The California Supreme court has held that adjustments made to the sales price which represent damages, shall not be used to reduce the sales price. In Southern California Edison Co.; and San Diego Gas &

*Electric Co. vs. State Board of Equalization* (1972) 7 Cal.3d 652, 661, 663, they held that the legislature intended that the terms “sales price” and “gross receipts” as used in Revenue and Taxation Code §§ 6011 & 6012 refer to “the price agreed upon at the initial sales transaction” (emphasis in original text), that an “adjusted’ [settlement] price, an entirely fictitious figure, can hardly justify the return of taxes based upon actual sales prices properly collected....”

If you have any other questions, please contact me.

Sincerely,

Donald L. Fillman  
Tax Counsel

DLF:es

bc: --- --- – District Administrator