

565.0635

916/445-6557

April 30, 1980

Gentlemen:

Re: U.S. Construction Contract

This is in response to your letter of April 11, 1980 addressed to Mr. Robert Nunes. You seek clarification of the application of tax under your contract with Begin deleted text REDACTED TEXT End deleted text, the prime contractor on a contract with the U.S. Department of Energy (DOE). The jobsite is in California. The documents submitted did not include detailed work description or specifications; however, the application of tax can be stated in general terms.

The project to be built is a geothermal pumping and gravity-head energy conversion system. The prime contract calls for Begin deleted text REDACTED TEXT End deleted text to undertake an experimental research project for DOE, and to act as field operator on the project as furnished and installed by you. Your firm is not an employee, agent or representative of either Begin deleted text REDACTED TEXT End deleted text or the U.S. Government under the contract. Your contract with Begin deleted text REDACTED TEXT End deleted text is a cost-plus-a-fixed-fee type contract.

From the Statement of Work, marked Exhibit A, it is apparent that the energy conversion system to be furnished and installed by you constitutes an improvement to real property within the meaning of Regulation 1521 (copy enclosed) which governs the application of tax to construction contracts (see subsection (a)(1)(A)).

Your firm would be a "United States construction contractor" under subsection (a)(3), and tax applies as set forth in subsection (b)(1), dependent on whether the property used in the construction is "Materials and Fixtures" under (b)(1)(A), or is "Machinery and Equipment" under (b)(1)(B). These terms are defined in (a)(4), (a)(5), and (a)(6), and typical examples in each category are listed in the appendices on continuation page 6. It appears that the items to be installed consist principally of materials and fixtures.

Paragraph (c) of your contract provides that title to all property purchased by you, the cost of which is reimbursable as a direct item of cost, shall pass to and vest in the Government upon

delivery by your vendor. The paragraph further provides that such vested title shall not be affected by incorporation in or attachment to non-Government property, nor shall any such Government property “become a fixture or lose its identity as personality (sic)” by reason of affixation to any realty.”

Contrary to the advice of Begin deleted text REDACTED TEXT End deleted text in its letter of January 8, 1980, sales tax does apply to the purchase of a U.S. construction contractor for use in effecting improvements to real property in California, notwithstanding the contract language above quoted. Tax would apply even if the contract stated that the purchases were made by you as an “agent” of the Government.

The authority for this rule is California Revenue and Taxation Code (R&T) Section 6007.5, which declares that such as purchase is a retail sale, and R&T Section 6384 which provides that the tax applies to the sales of property to contractors purchasing tangible personal property “either as agents of the United States or for their own account and subsequent resale to the United States” when the purchase is for use as contemplated in your contract, i.e., construction of real property improvements in this State.

Under the Regulation, (b)(1)(A), the U.S. contractor is the consumer, and under R&T 6007.5, the purchase is a retail sale. The sales tax is imposed upon the retailer (vendor) who sells to the contractor (R&T 6051). Whether the vendor may add sales tax reimbursement to the price of the contractor’s purchases depends upon the terms of the agreement of sale (Civil Code Section 1656.1). If the contractor pays sales tax reimbursement to its vendor, it has no further sales tax liability to the State (Regulation 1521 (b)(1)(A)). If the contractor does not pay such reimbursement but purchases the property for use in performing a U.S contract to improve real property in California, he is liable for use tax under R&T Sections 6094 and 6201.

The application of tax as outlined above has been sustained by the Supreme Court of both the State of California and the United States. See C.R. Fedrick, Inc. v. State Board of Equalization, 38 Cal. App. 385 cert. denied, 42 L. Ed. 2d 820, and Alabama v. King and Boozer, 314 U.S. 1, 86 L.Ed. 3.

We trust this answers your questions; if not, please write again.

Very truly yours,

Margaret H. Howard
Tax Counsel

MHH: ba

Cc: Mr. D.J. Hennessy
Mr. Robert Nunes