



STATE BOARD OF EQUALIZATION

LEGAL DIVISION (MIC: 82)
450 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082)
Telephone: (916) 324-2634
FAX: (916) 323-3387

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Executive Director

February 27, 1998

Mr. J--- J. M---, CPA
XXX S. ---
---, Kansas XXXXX

Re: Modular Units
(Unidentified Taxpayer)

Dear Mr. M---:

I am writing in response to your letter dated December 3, 1997 to the California State Board of Equalization requesting written advice concerning the application of the California Sales and Use Tax Law to transactions of a client who sells and leases modular units.

Please be advised that while we are happy to provide you with a written response to your inquiry, under California's Revenue and Taxation Code section 6596 (copy enclosed) a person's failure to make a timely sales and use tax return, or payment, due to reasonable reliance upon written advice from the Board may only be relieved when the person for whom the advice is sought is identified. In other words, since your letter does not identify your client, this response does not protect your client under the provisions of section 6596.

Facts

You write to confirm your understanding of how the California Sales and Use Tax Law applies to your client. You describe the facts as follows:

“Our client subcontracts the building of modular units to the specification of the purchaser. Our client then ships the units to the jobsite and remains the prime contractor over the job until it is completed. Currently the contract states,

‘Seller proposes to furnish, deliver and set onto a foundation provided by Purchaser, the complete package of building and equipment, as outlined by attached exhibit “A” drawing and exhibit “B” specification for the sum of _____, plus any applicable sales tax. Delivery and set charges are included and based on the normal working hours of 8am to 5pm, Monday through Friday (holidays excluded). In the event that the Purchaser requests Seller’s crews to perform in an exception to the standard hours as stated above, then the delivery and set charge will be adjusted accordingly to allow fair and reasonable compensation to Seller.’

“Our client also leases these buildings to the purchaser.

“Our client also sells and/or leases modular units which are used for portable school buildings.

“Our client has no nexus with California. They receive their sales in Kansas from Industrial shows and do not have any sales representatives in California.”
(Quoted as written.)

For purposes of this opinion letter, I assume that the modular units are neither “factory-built housing” as that term is used in Revenue and Taxation Code section 6012.7 and Regulation 1521.4, nor “mobilehomes” as that term is used in Revenue and Taxation Code sections 6012.2, 6012.8, and 6012.9. I also assume that the modulars are not prefabricated units registered or licensed with either California’s Department of Motor Vehicles or Department of Housing and Community Development. (See Reg. 1521(c)(3).) I further assume that the modular units which are used for portable school buildings and sold or leased to school districts are “factory-built school buildings” as that term is defined in Revenue and Taxation Code section 6012.6 and Regulation 1521(c)(4). Lastly, I assume that your client’s contracts are not with the United States government.

You ask the following questions:

- (1) You state your understanding that *sales* of the modular units are considered construction of real property and that *leases* of the modular units are leases of real property under the California Sales and Use Tax Law; and that your client would owe use tax on the cost of the materials brought into California. You ask whether, in such instances, your client may receive credit for the *sales* tax it pays on the materials in other states.

(2) You state your understanding that as to the sales and leases of modular units which your client makes to school districts in California, your client would owe use tax on 40% of the sales price from the manufacturer to your client. You ask whether, in such instances, your client may receive credit for the *sales* tax it pays on the materials in other states.

Since you do not inquire concerning the application of tax to fixtures or machinery and equipment furnished and installed in connection with the modular units, I assume that you understand how the California Sales and Use Tax Law applies to such items, and will not discuss that matter.

Discussion

(1) Sales and Leases of Prefabricated or Modular Buildings

Sales and Use Tax Regulation 1521(copy enclosed) explains the application of the California Sales and Use Tax Law to contracts to erect, construct, alter, or repair any building or other *structure* or otherwise improve *real property*. (Such contracts are referred to in the Sales and Use Tax Law as “construction contracts.”)

Subdivision (c)(3) of Regulation 1521 discusses prefabricated or modular buildings and the circumstances in which they are considered improvements to real property, as opposed to tangible personal property. In pertinent part the regulation reads:

“.... A contract to furnish and install a prefabricated or modular building which is not a factory-built school building (relocatable classroom) is a construction contract whether the building rests in place by its own weight or is physically attached to realty. It is immaterial whether the building is erected upon or affixed to land owned by the owner of the building or is leased to the landowner or lessee of the land.” (Reg. 1521(c)(3).)

Thus, under Regulation 1521 your client’s modular units which are *not* factory-built school buildings are considered prefabricated or modular buildings and improvements to real property. Your client’s contracts to furnish and install these prefabricated or modular buildings are construction contracts, and your client is a construction contractor. As such, tax applies to your client’s contracts to furnish and install the modular units, whether the buildings are sold or leased, as it does to other construction contracts. (See also Reg. 1660(d)(7).)

As concerns construction contracts, Regulation 1521 defines the term “materials” and how tax applies to same. 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. A construction contractor, such as your client, is generally the consumer of materials which the contractor furnishes and installs in the performance of a construction contract. Tax applies to the sale to, or use by, the contractor of those materials. (Reg. 1521(b)(2)(A)1.)

Since the sales of materials to your client are made outside of California, those transactions are not subject to California sales tax. (Reg. 1660(a)(2).) However, as the consumer of the materials furnished and installed in the performance of a construction contract in this state, your client owes California use tax on the cost of the materials to it. (Reg. 1660(b).)

Under Revenue and Taxation Code section 6406, copy enclosed, your client may claim a credit against the amount of that use tax to the extent it has paid a retail sales or use tax, or reimbursement therefore, with respect to that property imposed by another state. The section provides that the credit shall be apportioned to the taxes against which it is allowed in proportion to the amounts of those taxes.

(2) *Sales and Leases of Factory-Built School Buildings*

Regulation 1521 also discusses factory-built school buildings, and their classification as tangible personal property. In pertinent part the regulation states:

“On or after September 26, 1989, a contract to furnish and install a factory-built school building is not a construction contract but rather is a sale of tangible personal property....

“The term ‘factory-built school building’ (relocatable classroom) means and includes ... effective September 13, 1990, any building which is designed or intended for use as a school building and is wholly or substantially manufactured at an offsite location for the purpose of being assembled, erected, or installed on a site owned or leased by a school district or a community college district. A factory-built school building must be designed and manufactured in accordance with building standards adopted and approved pursuant to Chapter 4 (commencing with Section 18935) of Part 2.5 of Division 13 of the Health and Safety Code and must be approved by the structural safety section in the office of the State Architect.

“.... It is immaterial whether the building is erected upon or affixed to land owned by the owner of the building or is leased to the landowner or lessee of the land.”
(Reg. 1521 (c)(4); Rev. & Tax. Code § 6012.6(b).)

A contractor, such as your client, who purchases a factory-built school building for the purpose of fulfilling the requirements of an existing contract of sale with a school district or a community college district to furnish and install such a building is a consumer of the building. (Reg. 1521(c)(4)(B)2.B.) Tax applies to 40% of the sales price of the building to the contractor, excluding any charges for placing the completed building on the site. The sales price includes amounts representing tangible personal property installed in the building by a subcontractor, whether prior to or after installation of the building at the site, provided such installation is called for in the prime contract for the building. (Reg. 1521(c)(4)(D)1.)

Thus, as a consumer of tangible personal property, i.e., the factory-built school buildings, in this state, your client owes California use tax on 40% of the sales price of the buildings to it.

Under Revenue and Taxation Code section 6406, your client may claim a credit against the amount of that use tax to the extent your client has paid a retail sales or use tax, or reimbursement therefore, with respect to that property imposed by another state.

As to leases of factory-built school buildings, on and after September 26, 1989, such leases are treated as leases of real property with the lessor to the school or school district as the consumer. If the lessor is other than the manufacturer, such as your client is, tax applies to 40% of the sales price of factory-built school building to the lessor. (Reg. 1660(d)(7).) The appropriate tax as applied to your clients is the use tax, and Revenue and Taxation Code section 6406 permits your client to claim a credit for sales or use taxes or reimbursement paid in another state.

Summary

In summary, your client will owe California use tax on the cost to it of the materials which are consumed in the performance of its construction contracts to furnish and install prefabricated or modular buildings in this state, other than factory-built school buildings. As to its contracts to furnish and install factory-built school buildings pursuant to contracts of sale or lease, your client will owe California use tax measured by 40% of the sales price of the buildings to it. In all of these instances, your client may claim as a credit against this liability, any sales or use tax or reimbursement paid in another state.

Mr. J--- J. M---

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February 27, 1998
570.1675

I hope this information is of assistance. Please write again, and identify your client, if we may answer any further questions.

Sincerely,

Sharon Jarvis
Senior Tax Counsel

SJ:rz

Enclosures: Revenue and Taxation Code sections 6012.6, 6406, and 6596; Regulation 1521.

cc: Out-of-State District Administrator - OH