

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petition for Redetermination)
4 Under the Sales and Use Tax Law of:)

5 ALLIED MODULAR BUILDING SYSTEMS, INC.)

6 Petitioner)

Account Number SR S EA 97-916866
Case ID 506774

) Orange, Orange County

7 Type of Business: Manufacturer of modular buildings

8 Audit period: 07/01/05 – 06/30/08

9 ItemDisputed Amount

10 Disallowed claimed nontaxable sales for resale

\$274,419

11 Disallowed claimed exempt sales to the U. S. Government

\$429,252

TaxPenalty

12 As determined

\$93,970.09

\$9,397.13

13 Post-D&R adjustment

- 30,030.30

- 3,003.17

14 Proposed redetermination

\$63,939.79

\$6,393.96

15 Less concurred

- 7,815.32

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15 Balance, protested

\$56,124.47\$6,393.96

16 Proposed tax redetermination

\$ 63,939.79

17 Interest

29,907.34

17 Negligence penalty

6,393.96

18 Total tax, interest, and penalty

\$100,241.09

18 Payments

- 66,734.76

19 Balance Due

\$ 33,506.33

20 This matter was scheduled for Board hearing in August 2014, but was postponed at petitioner's

21 request due to a scheduling conflict. It was rescheduled for Board hearing in October 2014, but was

22 deferred by the Legal Department for further review and analysis. Upon further review, the Sales and

23 Use Tax Department (Department) performed a reaudit, which resulted in a reduction of \$36,286 to the

24 amounts of disallowed claimed nontaxable sales for resale and exempt sales to the U. S. Government.

25 The matter was rescheduled for Board hearing in November 2015, but was postponed at petitioner's

26 request to allow additional time to prepare.

UNRESOLVED ISSUES

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2 **Issue 1:** Whether adjustments are warranted to the disallowed amounts of nontaxable sales for
3 resale or exempt sales to the U. S. Government. We find no further adjustments are warranted.

4 Petitioner manufactures and installs modular building systems under time and material
5 contracts. Petitioner bolts steel tracks to the floor of the existing structure and screws the wall panels
6 into the tracks. During the audit period, petitioner purchased supplies ex-tax, manufactured the
7 modular building systems at its manufacturing facility, and shipped the materials for the modular
8 building systems to the installation site, where it performed final assembly and installation.

9 The Sales and Use Tax Department (Department) examined claimed nontaxable sales for resale
10 and claimed exempt sales to the U. S. Government in amounts of \$50,000 or greater on an actual basis,
11 and it examined claimed amounts less than \$50,000 on a test basis (reviewing sales for resale for three
12 quarters and sales to the U. S. Government for six months). In both categories, the Department found
13 transactions in which petitioner had furnished and installed modular building systems and had claimed
14 the transactions as nontaxable or exempt. The Department concluded that petitioner was a
15 construction contractor with respect to the modular building systems. Thus, with respect to claimed
16 sales for resale, the Department found that petitioner was liable for use tax on its consumption of
17 materials and for sales tax with respect to its sales of fixtures it furnished and installed on construction
18 contracts, and that petitioner was not allowed to avoid liability for sales or use tax on materials or
19 fixtures furnished under construction contracts by taking a resale certificate from a prime contractor,
20 interior decorator, or others. With respect to claimed sales to the U. S. Government, the Department
21 found that, as a U. S. construction contractor, petitioner was the consumer of materials and fixtures it
22 installed in the performance of construction contracts.

23 However, in preparing for the Board hearing scheduled in October 2014, the Legal Department
24 noted that some of the disallowed transactions appeared to involve sales of movable and reconfigurable
25 modular wall systems. Such modular wall systems are classified as tangible personal property when
26 they are intended to be movable and reconfigurable, they are not permanently affixed to realty, and
27 they may be used in almost any building without requiring any special adaptation. The Legal
28 Department noted that sales of modular wall systems may qualify as nontaxable sales for resale when

1 supported by proper documentation, and asked the Department to examine sales invoices, sales
2 contracts, or other evidence of the terms of sale for the disputed transactions in order to distinguish
3 modular wall systems sold as tangible personal property from modular building systems furnished and
4 installed by petitioner under construction contracts. As requested, the Department reviewed copies of
5 sales invoices provided by petitioner and made adjustments for movable and reconfigurable modular
6 wall systems sold for resale or sold to the U. S. Government. The reaudit resulted in reductions to the
7 amount of disallowed claimed nontaxable sales for resale, from \$302,561 to \$274,419, and to the
8 amount of disallowed claimed exempt sales to the U. S. Government, from \$437,396 to \$429,252.

9 Petitioner contends that the remaining disallowed transactions were not construction contracts,
10 arguing that the modular building systems retained their identity as tangible personal property, and did
11 not become improvements to realty. Petitioner asserts that it sold modular rooms that were not self-
12 operating buildings or structures with their own central plumbing or water source. It states that the
13 systems were intended to be temporary and portable to another property. Petitioner also claims that the
14 modular rooms would not be considered tenant improvements in a lease and that they can be
15 disassembled with minimal damage to existing property. Petitioner further argues that the building or
16 room size should not be a determining factor, asserting that, if size, weight, and appearance were
17 determining factors, then a sale of large equipment would be considered a construction contract.
18 Moreover, petitioner argues that, even if the transactions are found to be construction contracts, the
19 modular buildings meet the definition of machinery and equipment, for which petitioner was the
20 retailer.

21 It is undisputed that the transactions at issue did not involve relocatable classrooms or small
22 buildings (the size of a shed or kiosk). Thus, contracts to furnish and install the modular buildings at
23 issue were construction contracts, regardless of whether the buildings were physically attached to
24 realty or not. (Cal. Code Regs. tit. 18, § 1521, subd. (c)(3).)¹ Therefore, we find that the transactions

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27 ¹ In addition to its other arguments, petitioner asserts that the relevant regulation is Regulation 1583, which explains the
28 application of tax to modular systems furniture. Although we began our analysis in the D&R with our conclusion that a
regulation related to sales of furniture does not apply here, we note in the SD&R that we should have focused our analysis
on Regulation 1521, subdivision (c)(3), which directly addresses prefabricated buildings.

1 at issue were construction contracts. We are not persuaded otherwise by petitioner's assertion that the
2 modular structures were rooms rather than buildings, since they lacked central power and plumbing.
3 On that issue, we note there is no requirement in subdivision (c)(3) that a structure include lighting and
4 plumbing in order to be regarded as a modular building.² Also, as evidence, petitioner has asserted that
5 it has made sales for resale of modular buildings to Power Machinery Center (PMC), and that the
6 Department has accepted those transactions as valid sales for resale in audits of PMC. We note that
7 the sales to which petitioner refers were made in 2011, which is well after the audit period at issue
8 here, and note that there is no evidence that the Department specifically reviewed any of PMC's
9 purchases of modular buildings from petitioner. Thus, we find that petitioner's claim regarding its
10 transactions with PMC is irrelevant. In addition, petitioner states that the purchasers report sales tax on
11 their sales of the modular buildings to their customers and has provided evidence of some transactions
12 where that is the case. We find that the purchasers' reporting of sales tax does not alter the nature of
13 the construction contracts, although the Department has made adjustments to the liability for sales tax
14 reported by the purchasers. We also reject petitioner's argument that the buildings meet the definition
15 of machinery and equipment since the buildings are structures, while machinery and equipment is used
16 to produce, manufacture, or process tangible personal property. Thus, we conclude that no additional
17 adjustments are warranted.

18 **Issue 2:** Whether petitioner was negligent. We conclude that it was.

19 The Department imposed a negligence penalty because the errors found in this audit were the
20 same types of errors addressed in a prior audit. Petitioner disputes the penalty, asserting that it
21 believed it was selling tangible personal property rather than performing construction contracts. Also,
22 petitioner asserts that "the issue of resales was not raised in the prior audit."

23 Two of the audit items in the prior audit were disallowed claimed nontaxable sales for resale of
24 \$121,754 and disallowed claimed exempt sales to the U. S. Government of \$278,365. Thus,
25 notwithstanding its assertion to the contrary, petitioner was explicitly informed in the prior audit that it
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27 ² We also note that this argument is inconsistent with the name of petitioner's business ("building" systems) and with
28 petitioner's Request for Reconsideration, which describes the buildings as freestanding units that contain their own fixtures
for lighting and plumbing.

1 had incorrectly claimed those transactions as nontaxable or exempt. Further petitioner's argument that
2 the transactions were sales of tangible personal property rather than construction contracts was
3 explicitly rejected in the prior audit. Thus, petitioner's continued reliance on its flawed reasoning is
4 clear evidence of negligence.

5 **OTHER MATTERS**

6 None.

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8 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III
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