

CALIFORNIA STATE BOARD OF EQUALIZATION
APPEALS DIVISION SUMMARY FOR BOARD HEARING

In the Matter of the Petition for Redetermination)
Under the Sales and Use Tax Law of:)
APIC CORPORATION) Account Number: SR AS 100-206256
Petitioner) Case ID 447477
Culver City, Los Angeles County

Type of Business: Development and fabrication of prototype devices

Audit period: 01/01/04 – 12/31/06

<u>Item</u>	<u>Disputed Amount</u>
Disallowed claimed exempt sales to the U. S. Govt.	\$299,428
Tax as determined and proposed to be redetermined:	\$28,338.00
Less concurred	<u>- 3,635.12</u>
Balance, protested	<u>\$24,702.88</u>
Proposed tax redetermination	\$28,338.00
Interest through 02/28/14	<u>19,733.55</u>
Total tax and interest	\$48,071.55
Payments	<u>- 2,647.75</u>
Balance Due	<u>\$45,423.80</u>
Monthly interest beginning 03/01/14	<u>\$ 149.86</u>

This matter was scheduled for Board hearing in March 2011, but was deferred at the request of the Appeals Division in order to issue a supplemental D&R.

UNRESOLVED ISSUE

Issue: Whether petitioner owes use tax on its purchases of certain consumable supplies and materials used in the performance of a contract with the U. S. Government. We find that it does.

Petitioner is a U. S. Government supply contractor, specializing in the research, design, fabrication, and development of prototypes of highly integrated photonic circuits (chips). On sales and use tax returns filed for the audit period, petitioner claimed all reported sales as exempt sales to the U.S. Government. For most of its transactions, the Sales and Use Tax Department (Department) concluded that petitioner transferred title to direct consumable supplies and overhead materials to the

1 U. S. Government before making any use thereof. The only exception involved a somewhat simplified
2 research and development contract between petitioner and the U. S. Naval Air Systems Command.

3 The disputed contract required petitioner to establish a facility and to produce prototype chips
4 and physically transfer them to the U. S. Government for use in various military applications. If the
5 government was satisfied with the performance of the prototype chips, the chips would be mass
6 produced. To fulfill its obligations under the contract, petitioner purchased a clean room, as well as
7 materials and supplies, from vendors both within and outside California. Petitioner issued resale
8 certificates to the California vendors and to some of the out-of-state vendors. Petitioner used the
9 purchased items at its Culver City facility for the purpose of producing the prototype chips, and only
10 the chips were to be transferred to the government. Although petitioner maintained physical
11 possession of the purchased items in order to produce the chips, it did not report or pay any tax on the
12 purchases. The Department determined that the contract did not contain any standard Federal
13 Acquisition Regulations (FAR) clauses, which accelerate passage of title to direct consumable supplies
14 and overhead materials to the government, before a contractor takes possession or uses the property.
15 Since petitioner had purchased the items for resale, the Department assessed use tax on petitioner's
16 purchases of tangible personal property related to this contract. Petitioner disputes that conclusion,
17 arguing that the subject property was purchased with government funds and that title to such
18 equipment, procured with government funding, remains with the government.

19 A United States contractor is not immune from state sales and use taxes simply because the
20 United States reimburses (or even funds in advance) the contractor its cost of tangible personal
21 property purchased for use in performing its contract with the United States. (*United States v.*
22 *California* (1993) 507 U.S. 746,753.) The subject transactions were not sales by the vendors directly
23 to the United States, so the asserted tax is not a forbidden tax imposed directly on the United States.
24 Since petitioner purchased the property ex-tax either outside California or by issuing resale certificates
25 to California vendors, if it used the property prior to any resale to the United States, petitioner owes
26 use tax, which is imposed on petitioner. (Rev. & Tax. Code, §§ 6094, subd. (a), 6201, 6202.)

27 The measure of the audit item in dispute includes \$75,958 for materials and fixtures that
28 petitioner furnished and installed to build a clean room attached to real property. Although we believe

1 petitioner understands that this amount is subject to tax, petitioner has not specifically conceded the
2 issue. In any event petitioner, as a United States construction contractor, is the consumer of such
3 materials and fixtures. With respect to the remaining \$223,470, which pertains to tangible personal
4 property acquired for use in performing the contract, we note that the contract is not a procurement
5 contract entered into under applicable FAR provisions, which are commonly drafted to pass title to the
6 United States, prior to use, to property acquired by the contractor for use in the performance of a
7 contract with the United States. Rather, this contract is an “other transaction” under the authority of 10
8 U. S. C. section 2371. That is, the subject contract is of the type for which the stated bias of the United
9 States is to *not* take title to the type of property in dispute. The subject contract does not explicitly
10 pass title to such property to the United States prior to any use, and petitioner has not submitted any
11 other documentation of such title transfer.

12 We conclude that the materials and fixtures purchased pursuant to the contract for installation
13 to become real property were purchased by petitioner as a consumer, and could not be resold in the
14 form of tangible personal property to the United States prior to use. With respect to the remaining
15 disputed property that was used in the performance of the contract in the form of tangible personal
16 property, we conclude that petitioner purchased such property for use, and not for resale prior to such
17 use, since the contract did not include a provision passing title to the property to the United States prior
18 to any use by petitioner. Accordingly, petitioner owes use tax on its purchase of such property.

19 **OTHER MATTERS**

20 None.

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