

## 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 MAGNUM BREEZE II, INC., dba ) Account Number SR EH 100-158890  
 6 Woodcrest Vehicle Center ) Case ID 538790  
 7 Petitioner )  
 Riverside, Riverside County

8 Type of Business: Sales and installation of equipment for emergency vehicles

9 Audit period: 10/01/06 – 12/31/09

10 <u>Item</u>	<u>Disputed Amount</u>
11 Disallowed claimed exempt sales to the U.S. Government	\$ 16,885
12 Disallowed claimed/netted nontaxable labor	\$2,164,893
13 Failure-to-file penalty	\$ 1,885

	<u>Tax</u>	<u>Penalty</u>
14 As determined	\$207,703.00	\$1,945.10
15 Post-D&R adjustment	- 16,042.65	- 60.49
16 Proposed redetermination	\$191,660.35	\$1,884.61
Less concurred	- 17,779.69	00.00
17 Balance, protested	<u>\$173,880.66</u>	<u>\$1,884.61</u>
18 Proposed tax redetermination	\$191,660.35	
Interest through 02/28/14	76,421.36	
19 Failure-to-file penalty	<u>1,884.61</u>	
Total tax, interest, and penalty	\$269,966.32	
20 Payments	- 9,562.17	
Balance Due	<u>\$260,404.15</u>	

21 Monthly interest beginning 03/01/14 \$ 910.49

22 This matter was scheduled for Board hearing in February 2013, but was deferred at the request  
 23 of the Sales and Use Tax Department (Department) for further review. As a result of that review, we  
 24 recommend a reduction of disallowed claimed/netted nontaxable labor of \$203,553, as explained under  
 25 "Other Matters." The matter was rescheduled for Board hearing in October 2013, but was postponed  
 26 at taxpayer's request due to a scheduling conflict.

**UNRESOLVED ISSUES**

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2       **Issue 1:** Whether adjustments are warranted to the disallowed claimed exempt sales to the U. S.  
3 Government. We find no further adjustments are warranted.

4       Petitioner has sold and installed equipment, such as radios, sirens, and light bars, on emergency  
5 vehicles since January 2003. Petitioner provided adequate records for audit.

6       The Department reviewed sales invoices related to claimed exempt sales to the U.S.  
7 Government on an actual basis and disallowed claimed amounts related to three sales, one to the  
8 California State University, and two to Indians. Petitioner contends that the two sales to Indians were  
9 valid exempt sales, stating that the vehicles were delivered to an Indian reservation, and the determined  
10 tax liability related to those sales is “unjustified.”

11       The audit workpapers indicate petitioner sold vehicle parts to the Morongo Indian Nation and  
12 Pauma Band of Mission Indians, both of which may qualify as federally recognized Indian tribes.  
13 However, petitioner has not provided evidence that the vehicle parts were delivered to the purchasers  
14 on the reservation or that title to the property transferred there. Accordingly, we find that petitioner  
15 has not documented its assertion that the two sales at issue qualify for the exemption for sales to  
16 Indians living on reservations. (Rev. & Tax. Code, § 6352; Cal. Code Regs., tit. 18, § 1616, subd.  
17 (d)(4)(A).) Thus, we recommend no adjustment.

18       **Issue 2:** Whether adjustments are warranted to the disallowed claimed nontaxable labor and  
19 charges for labor that were netted from reported total sales. We find no adjustment is warranted other  
20 than the adjustment recommended under “Other Matters.”

21       The Department reviewed petitioner’s recorded charges for nontaxable labor and computed a  
22 total of \$3,062,313, which is somewhat greater than the amount of nontaxable sales claimed for the  
23 audit period of \$2,955,426. The Department determined that petitioner’s untaxed labor charges for  
24 installing emergency equipment onto new vehicles represented charges for taxable fabrication labor,  
25 since the labor was a step in the process or series of operations in the creation or production of tangible  
26 personal property (a fully equipped emergency vehicle). The Department examined sales invoices  
27 with labor charges for two quarters of the audit period and computed that 77.34 percent of the claimed  
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1 amounts represented taxable labor. The Department applied 77.34 percent to recorded nontaxable  
2 repair labor of \$3,062,313 to establish the disallowed amount of \$2,368,446.

3         Petitioner contends that the labor charges in question represent nontaxable labor for the  
4 installation of equipment on existing vehicles, rather than taxable fabrication labor. Specifically,  
5 petitioner asserts that the labor does not constitute a step in the process in the creation or production of  
6 tangible personal property, on the basis that the vehicles onto which it installs equipment are police  
7 vehicles prior to entering petitioner's facility. As explanation, petitioner has provided a summary of  
8 the ways in which the Police Interceptor differs from the standard Crown Victoria or Grand Marquis.  
9 Alternatively, petitioner contends that adjustments are warranted to the amount of disallowed claimed  
10 nontaxable labor because it sometimes installs equipment onto used vehicles.

11         Petitioner installs equipment such as light bars, sirens, and two-way radios onto vehicles to  
12 create fully equipped police vehicles and other emergency vehicles. The customer provides two  
13 separate products, the vehicles themselves and the equipment, and petitioner does the installation. We  
14 find that petitioner thus produces or fabricates tangible personal property (an emergency vehicle) that  
15 is distinguishable from the two separate products provided by the customer. Thus, we conclude that  
16 the labor at issue is a step in the process or series of operations resulting in the creation or production  
17 of tangible personal property and that the charges for such labor are subject to tax. (Cal. Code Regs.,  
18 tit. 18, § 1526, subd. (b).) We reject petitioner's assertion that the vehicles are police vehicles before  
19 they enter petitioner's facility because the vehicles do not meet their final performance specifications  
20 as emergency vehicles until the equipment is installed.

21         Since we found that there could be merit in petitioner's alternate contention that some of the  
22 vehicles on which it installs emergency equipment were used vehicles, we recommended a reaudit to  
23 establish the amount of charges for such installation. However, at the time the D&R was issued,  
24 petitioner had not provided the records necessary to show that it sometimes installed equipment on  
25 used vehicles or to compute the amount of charges for such installation. Accordingly, the D&R  
26 recommended no adjustment. However, as explained under "Other Matters," petitioner has since  
27 provided evidence that the Department has used to establish an adjustment.



1 Department of Motor Vehicles to determine when the vehicles had been registered. If installation  
2 occurred more than 60 days after the date of registration, the Department was to regard the labor as  
3 nontaxable installation of equipment on a used vehicle. Although the Department made several  
4 attempts to obtain the vehicle identification numbers, petitioner did not provide that information.  
5 Accordingly, the Department used a different method for determining how much of the labor at issue  
6 represented nontaxable labor for repairs made on used vehicles. Specifically, the Department asked  
7 petitioner to provide odometer readings for the vehicles included in the 2-quarter test of petitioner's  
8 labor charges. The Department regarded all vehicles with more than 500 miles on the odometer when  
9 they entered petitioner's shop to be used vehicles. All vehicles with 500 or fewer miles on the  
10 odometer were regarded as new vehicles. The Department computed the amount of nontaxable labor  
11 (repair labor related to used vehicles) for the test period and then applied the results of that revision to  
12 the remainder of the audit period to compute nontaxable repair labor of \$203,553 for the audit period.  
13 We concur with the Department's conclusion that vehicles which had been driven more than 500 miles  
14 should be considered used, and we recommend a reduction of the disallowed claimed/netted  
15 nontaxable labor of \$203,553, from \$2,368,446 to \$2,164,893.

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17 Summary prepared by Lisa Burke, Business Taxes Specialist III  
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