

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:)
THE MARBLE SHOP, LLC) Account Number: SR AC 100-449352
Petitioner) Case ID 305001
North Hollywood, Los Angeles County

Type of Business: Custom fabrication of stone

Audit period: 02/01/98 – 06/30/04

<u>Item</u>	<u>Disputed Amount</u>	<u>Tax</u>	<u>Penalty</u>
Unreported fabrication labor	\$9,866,530		
Unreported purchases of fixed assets	\$ 327,653		
Unreported sales of fixed assets	\$ 54,000		
As determined:		\$868,212.65	\$86,821.35
Adjustment - Appeals Division		- 24,379.86	- 86,821.35
Proposed redetermination		\$843,832.79	<u>\$ 00.00</u>
Less concurred		- 3,166.39	
Balance, protested		<u>\$840,666.40</u>	
Proposed tax redetermination		\$ 843,832.79	
Interest through 10/31/10		<u>659,119.76</u>	
Total tax and interest		\$1,502,952.55	
Payments		- 33,000.00	
Balance Due		<u>\$1,469,952.55</u>	
Monthly interest beginning 11/1/10		<u>\$ 4,729.86</u>	

UNRESOLVED ISSUES

Issue 1: Whether the labor charges at issue are taxable. We find that petitioner’s labor charges were for taxable fabrication labor.

Petitioner fabricated countertops, flooring, and edge detail from marble, granite, onyx, and other types of stone. Petitioner’s customers, the majority of whom were licensed construction contractors, furnished slabs of stone to petitioner, who cut, ground, and polished the stone according to the customers’ specifications. Petitioner believed this labor was not taxable, and it did not apply for a

1 seller's permit at any point during the audit period. The majority of petitioner's work involved making
2 countertops for kitchens, bathrooms, and bar or beverage stations.¹ The countertops were heavy,
3 expensive items, and sinks were not attached prior to installation because the risk of breakage was too
4 high.

5 The Sales and Use Tax Department (Department) found that petitioner was performing
6 fabrication labor, creating countertops and other items from slabs of stone. Fabrication is a sale under
7 Revenue and Taxation Code section 6006, subdivision (b), only if performed for a consumer. Where a
8 construction contractor furnishes and installs materials to become part of the real property, the
9 contractor is generally a consumer of the materials; where a construction contractor furnishes and
10 installed fixtures to become part of the real property for a person other than the United States, then the
11 contractor is the retailer of the fixtures. (Cal. Code Regs., tit. 18, § 1521.) Thus, if petitioner's
12 fabrication was of materials for contractors who furnished and installed the fabricated materials,
13 petitioner was fabricating for consumers and thus making sales, at retail, and tax applies. If, instead,
14 petitioner's fabrication was of fixtures for contractors who furnished and installed the fabricated
15 fixtures for customers other than the United States, then petitioner was not making a sale (effectively
16 making sales for resale) with the contractors making the retail sales of the fabricated fixtures.

17 The Department found that the countertops constituted materials, rather than fixtures, because
18 no sinks were attached prior to installation. Thus, the Department found petitioner was performing
19 fabrication for consumers (mostly construction contractors) and that such fabrication thus constituted
20 taxable retail sales. Moreover, the Department concluded that, even if some of the countertops were
21 fixtures, the fabrication labor would still be taxable because, although construction contractors would
22 be retailers of fixtures, petitioner had not provided resale certificates or any other evidence that the
23 sales were for resale. Accordingly, the Department concluded that all of petitioner's charges for
24 fabrication labor were subject to tax. The Department used petitioner's federal income tax returns and
25 sales records to establish the amount of unreported taxable fabrication labor.

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28 ¹ In its Request for Reconsideration, petitioner concedes that its fabrication charges for products other than countertops are
subject to tax. It protests only the application of tax to the labor involved in fabrication of countertops.

1 Petitioner contends that its charges for fabrication labor are not subject to tax. It asserts that
2 over 850 marble shops in this state fabricate and install stone products, and none of their fabrication
3 labor is subject to sales tax. Petitioner finds it inequitable to apply tax to its fabrication labor merely
4 because it does not also perform the installation of the finished product. As support, petitioner
5 submitted a letter dated January 8, 2007, addressed to Sistone, Inc. from the Department's Tax Policy
6 Division.² That letter discusses taxable fabrication labor in relation to construction contracts. The
7 letter states that the 90-percent prefabrication test used to determine whether cabinets are fixtures or
8 materials also applies to countertops.³ Based on the letter, petitioner argues that it satisfies the 90-
9 percent prefabrication test with regard to a majority of the countertops it produces, and, as such, the
10 countertops it sells are fixtures and its customers, as retailers of the fixtures, are responsible for any
11 sales tax due.

12 Generally, countertops are considered to be materials, not fixtures. (BTLG annot. 190.2200
13 (12/4/61).)⁴ However, where a countertop with a cut out for a bowl or sink is combined with the bowl
14 or sink into a single unit *prior* to the entire unit's installation to become part of the real property, we
15 have regarded the integrated unit (countertop with installed sink or bowl) as a fixture. On the other
16 hand, where a countertop with a cut out for that bowl or sink is installed to become part of the real
17 property *before* the sink or bowl is installed, we have regarded the bare countertop as a material. (See,
18 e.g., BTLG annots. 190.0170 (7/5/79, 8/23/82, 6/10/85, 12/11/85).) Here, the countertops without
19 cutouts were clearly attached to real property without bowls or sinks, and they thus maintained their
20 status as materials upon attachment. Petitioner has argued that for at least some of the countertops in
21 which it had fabricated a cutout for a bowl or sink, that bowl or sink was installed onto the countertop
22 before the countertop with the bowl or sink was installed to become part of the real property.

23 However, the Department's research indicates that the sinks are installed onto a wood frame on the
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25 ² A similar letter was distributed by that division to numerous companies in the marble, stone, and granite industry in
January 2007.

26 ³ Under California Code of Regulations, title 18, section 1521, subdivision (c)(2), a cabinet is considered to be
"prefabricated" and a fixture when 90 percent of the total direct cost of labor and material in fabricating and installing the
27 cabinet is incurred prior to affixation to the realty (90-percent prefabrication test).

28 ⁴ Annotations do not have the force or effect of law, but are intended to provide guidance regarding the interpretation of the
Sales and Use Tax Law with respect to specific factual situations. (See Cal. Code Regs., tit. 18, § 5700, defining
"annotations" and explaining their use.)

1 cabinet and the countertop is then installed on top of the sink, and petitioner has not presented any
2 evidence to the contrary. Accordingly, we conclude that petitioner fabricated countertops that
3 constituted materials, which it sold at retail, primarily to construction contractors. Thus, we find that
4 petitioner's fabrication charges were subject to tax.

5 With regard to petitioner's argument regarding the 90-percent prefabrication test, this test does
6 not apply to countertops. California Code of Regulations, title 18, section 1521, subdivision (c)(2),
7 specifically provides that this test applies to *cabinets*, and nowhere in the regulation is there mention
8 that it applies to countertops. Further, the application of the 90-percent prefabrication test to
9 countertops, in general, would be contrary to decades of consistent practice and contrary to logic.
10 Logically, the countertop is similar to a door in its relationship to a cabinet, vanity, or counter, and the
11 countertop must be regarded as a material, just as a door would be. As explained in more detail in the
12 D&R, we conclude that the letter issued by the Department's Tax Policy Division in January 2007, is
13 simply incorrect when it states that the 90-percent prefabrication test applies to countertops.

14 Petitioner alternatively argues that, even if the countertops were materials, it does not owe tax
15 on its fabrication charges because, as it interprets Audit Manual section 1203.05, fabrication of
16 materials for a construction contractor who installs the fabricated material onto real property is
17 nontaxable. Directly contrary to petitioner's interpretation of the audit manual provision, section
18 1203.05, subdivision (a), states: "Where the contractor sublets fabrication or processing of material to
19 an outside firm, such fabrication is considered part of the taxable cost of materials." Thus, we find that
20 the audit manual section cited by petitioner is consistent with our finding that petitioner's charges for
21 fabrication of materials were taxable. As part of this argument, petitioner asserts that many of its
22 countertops were fabricated for a related company, and states that the two companies have common
23 ownership and are treated as one by the state for purposes of insurance. The implication of petitioner's
24 argument is that, for purposes of determining whether the fabrication labor is taxable, the two
25 companies should be regarded as one entity. We disagree. Petitioner and the related company chose
26 to operate as two separate persons, and they are thus entitled to the advantages of being separate legal
27 entities and must also suffer the disadvantages applicable to that arrangement.

1 Petitioner also argues there is considerable insistency within the law and the Board's
2 publications as to whether countertops are materials or fixtures. Consequently, petitioner argues it
3 would be unfair to hold it liable for the tax on the charges for fabrication labor because it had no
4 reasonable way of determining whether the charges were taxable or not. Petitioner relies primarily on
5 the January 2007 letter, which we find was incorrect. The fact that a single letter, even one sent to
6 various taxpayers, misstates the rule does not establish that the rule is not clearly stated in the statutes,
7 regulations, annotations, and publications. We find that our conclusion is consistent with the
8 regulation, annotations, numerous opinion letters issued by the Board's Legal Department, and the
9 applicable tax tip publications.

10 **Issue 2:** Whether relief is warranted because petitioner's failure to report and pay tax on its
11 charges for fabrication labor was the result of its reasonable reliance on erroneous advice from the
12 Board. We find no basis to recommend relief.

13 In addition to having received incorrect advice in the January 8, 2007 letter, petitioner asserts
14 that the Department itself is confused as to the application of this test to countertops and as to the
15 question of whether countertops are fixtures or materials, and believes that it is therefore unfair to
16 "penalize" petitioner.

17 The only possible basis for relieving petitioner of the tax due is Revenue and Taxation Code
18 section 6596 which allows the Board to relieve a taxpayer of the tax due when (1) the person made a
19 written request to the Board requesting advice about whether a particular activity or transaction was
20 taxable (with a full description of the specific facts and circumstances of the activity or transaction),
21 (2) the Board responded in writing to the person's request, stating whether or not the described activity
22 or transaction was taxable, and (3) in reasonable reliance on the Board's written advice, the person did
23 not charge or collect sales tax reimbursement or pay use tax in connection with the described
24 transaction. Here, petitioner never made a written request to the Board asking for advice regarding the
25 application of tax to its charges for fabrication labor, and the January 2007 letter was not prepared or
26 distributed by the Tax Policy Division letter in response to a request by petitioner. In any event, the
27 letter was not issued until January 2007, several years after the reporting periods in the audit, and thus
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1 petitioner's failure to report and pay tax on its fabrication charges at issue here clearly was not in
2 reliance on that letter. We find there is no basis for relief under section 6596.

3 **Issue 3:** Whether adjustments are warranted to the unreported cost of fixed asset purchases
4 subject to use tax. We recommend no further adjustments.

5 Based on its review of the depreciation schedule attached to petitioner's federal income tax
6 returns, the Department found that petitioner had purchased fixed assets for which it could not
7 document that it had paid tax or tax reimbursement. After the adjustments recommended in the D&R,
8 the remaining amount subject to use tax is \$366,253, \$327,653 of which petitioner disputes.

9 There is no dispute that petitioner stored, used, or consumed in this state the tangible personal
10 property remaining at issue and did not report use tax in connection with those purchases. However,
11 petitioner argues that these acquisitions were nontaxable transactions because they represented initial
12 contributions of machinery and equipment to petitioner in exchange for an interest in the LLC. As
13 support, petitioner has provided a letter dated December 22, 1997, along with three additional pages,
14 each with a company name and a list of equipment. Some of the equipment has cost amounts typed in,
15 and other items have costs that have been hand-written. We find the documents lack credibility. The
16 typed lists of equipment all appear incomplete, with additional equipment listed in hand-writing, and
17 most of the values are hand-written. Also, the information in the letter conflicts with the ownership
18 information provided in petitioner's 2000 California Limited Liability Company Tax Return. Based on
19 that discrepancy and the questionable credibility of the list of equipment, we find that petitioner has
20 failed to establish that the equipment listed was acquired as part of a transfer to a commencing LLC, or
21 that the transfer was *solely* in exchange for a first issue membership in the commencing LLC, with no
22 assumption of liabilities or other consideration. Thus, we find the evidence does not support a
23 conclusion that petitioner's acquisition of those assets was not subject to tax.

24 Petitioner contends that another asset, an AGM Bullnose Machine, was purchased from a
25 California retailer, which is liable for the sales tax. For this transaction, petitioner has provided
26 evidence that it made payments to AGM, which does have a business office in California. According
27 to the Department, an employee of AGM at the Anaheim location stated that, while a few salespersons
28 and engineers worked at the Anaheim facility, deliveries were made from out of state to the customer,

1 and no deliveries were made from the Anaheim location. AGM would be liable for sales tax if the sale
2 occurred in California and a California location of AGM participated in the sale. (Cal. Code Regs., tit.
3 18, § 1620, subd. (a) (2).) If either or both these conditions are not met, then the applicable tax is use
4 tax owed by petitioner. Since petitioner has not shown that either of these conditions was satisfied, we
5 find that the applicable tax is use tax owed by petitioner.⁵

6 For two assets, petitioner asserts that the machines were purchased from a California vendor
7 but has not provided a sales invoice or other evidence of the identity of the seller. For another asset,
8 petitioner contends the transaction was an occasional sale but has provided no evidence to support its
9 assertion that the seller was a service enterprise that was not required to hold a seller's permit. We find
10 the evidence is insufficient to conclude that these three purchases of assets were not subject to use tax.

11 **Issue 4:** Whether adjustments are warranted to the unreported sales of fixed assets. We
12 recommend no further adjustments.

13 Petitioner sold various assets during the audit period. After the adjustments recommended in
14 the D&R, there are two sales in dispute. Petitioner contends that it should not be held liable for use
15 tax on items it purchased as well as sales tax on items it sold. Petitioner asserts that the purchaser
16 should be liable, just as petitioner was held liable for use tax on its purchases.

17 It is undisputed that petitioner sold assets that it had used in the course of its business.
18 Although petitioner did not hold a seller's permit during the audit period, it was *required* to hold a
19 seller's permit because it was engaged in the business of making retail sales of tangible personal
20 property in this state (its fabrication for consumers). Thus, petitioner's retail sales of tangible personal
21 property it used in the course of its activities requiring a seller's permit were subject to sales tax. Since
22 petitioner has not overcome the presumption that its sales were taxable retail sales (Rev. & Tax. Code,
23 § 6091), we find that petitioner's sales of assets were subject to sales tax, and there is no basis for
24 adjustment. Petitioner's argument that the purchasers should be held liable for the tax on petitioner's
25 sales to them is simply not correct.

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27 ⁵ The SD&R also discusses the possibility that petitioner entered into a sale and leaseback agreement for this equipment
28 with First Sierra Financial (First Sierra) in Houston, Texas. However, even if that were the case, we find that the evidence
presented does not support a conclusion other than that petitioner is liable for the use tax.

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AMNESTY

The amnesty interest penalty is not applicable in this case because petitioner timely filed an application for amnesty and entered into a qualifying installment payment plan. However, since petitioner did not fully pay all taxes and interest due by June 30, 2006, the failure-to-file penalty was not waived as a result of petitioner's participation in the amnesty program.

RESOLVED ISSUE

Petitioner failed to file returns and thus the failure-to-file penalty was imposed. Petitioner has submitted a statement signed under penalty of perjury requesting relief of this penalty. Although petitioner was wrong, we believe it had a good faith belief that its fabrication charges were not taxable, and that it was not required to file returns. We recommend that petitioner be relieved of the failure-to-file penalty.

OTHER DEVELOPMENTS

None.

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