

**CALIFORNIA STATE BOARD OF EQUALIZATION**  
**APPEALS DIVISION BOARD HEARING SUMMARY**

In the Matter of the Petition for )  
 Redetermination and Claim for Refund )  
 Under the Sales and Use Tax Law of: )  
 RC MARKETING, INC, dba ) Account Number: SR EH 97-983783  
 Bunkbeds, Bunkbeds, & More ) Case ID's 461615, 377842  
 Petitioner/Claimant ) Temecula, Riverside County

Type of Business: Wall bed manufacturer and installer  
 Audit period: 04/01/04 – 06/30/07  
 Claim period: 07/01/03 – 12/31/05

<u>Item</u>	<u>Disputed Amount</u>
Underreported taxable measure	\$59,079
Disallowed claimed labor deduction	\$11,125
Disallowed claimed sales tax included	\$ 2,774
Claimed overpayment of tax	\$ 4,921
Tax as determined and protested	\$5,798.05
Interest through 10/31/11	<u>2,683.37</u>
Total tax and interest	<u>\$8,481.42</u>
Monthly interest beginning 11/01/11	<u>\$ 28.99</u>

This matter was scheduled for Board hearing on March 24, 2011, but was postponed to allow petitioner additional time to prepare for the hearing. It was rescheduled for Board hearing on June 23, 2011, but was postponed to allow petitioner additional time to retrieve additional documentation and prepare for the hearing.

**UNRESOLVED ISSUES**

**Issue 1:** Whether adjustments are warranted to the unreported sales of wall beds and disallowed claimed nontaxable labor. We recommend no adjustment.

Petitioner manufactures wall beds and matching cabinetry from components it purchases without payment of tax or tax reimbursement, either by furnishing its vendors resale certificates or by making the purchases from unregistered out-of-state vendors. During the audit period, petitioner furnished most of these wall bed units under lump-sum construction contracts, and sold some as kits without installation (some of which were for resale or were exempt sales in interstate commerce). For

1 its lump sum construction contracts, petitioner separately recorded its cost of tangible personal  
2 property, offsite labor costs, and jobsite labor costs. Petitioner did not allocate the jobsite labor costs  
3 between on-site assembly labor and labor to affix the units to the wall.

4 For periods prior to the first quarter 2006 (1Q06), petitioner reported receipts from its contracts  
5 for installation of wall bed units on line 1 of its returns, taking deductions for the amount of tax  
6 reimbursement it calculated was included in the contract price and for jobsite labor. Beginning with its  
7 return for 1Q06, petitioner started reporting these transactions as a consumer by reporting its cost of  
8 the property incorporated into the wall bed units on line 2 of its sales and use tax returns as purchases  
9 subject to use tax. Based on the same theory, that it was the consumer of the wall bed units it  
10 furnished and installed, petitioner filed claims for refund totaling \$4,921 for some (but not all) of the  
11 quarters from 3Q03 through 4Q05. For its taxable sales of wall bed kits without installation  
12 throughout the audit period, petitioner took deductions for the amount of tax reimbursement it  
13 calculated was included in the sale price.

14 The Sales and Use Tax Department (Department) concluded that petitioner's contracts to  
15 furnish and install wall bed units should be examined under the "cabinet rule" of California Code of  
16 Regulations, title 18, section (Regulation) 1521, subdivision (c)(2), to determine whether petitioner  
17 was selling fixtures or consuming materials. Applying this rule, the Department regarding the wall bed  
18 units to have been installed as fixtures if 90 percent or more of petitioner's total direct cost of labor and  
19 material in fabrication and installation was incurred prior to affixing the units to the real property;  
20 otherwise, the Department regarded the units as having been installed as materials. The Department  
21 computed direct material and labor costs based on petitioner's records and considered 50 percent of  
22 jobsite labor to represent installation labor.<sup>1</sup> Based on the Department's calculations, all but two of the  
23 units were furnished and installed by petitioner as fixtures.<sup>2</sup> For these contracts to furnish and install

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26 <sup>1</sup> Petitioner originally estimated that 25 percent of the jobsite labor cost represented installation labor, and later increased its  
27 estimate to 75 percent without providing evidence to support that increase. The Department concluded that, based on its  
understanding of the installation process and the instruction sheets included with wall-bed kits, the actual percentage was  
closer to 25 percent than to 75 percent, but used 50 percent to give petitioner the benefit of doubt.

28 <sup>2</sup> The contracts for which the Department concluded petitioner installed the wall beds as materials were not included in the  
Department's calculation of the deficiency.

1 wall beds as fixtures, the Department calculated the tax due by deducting installation labor from the  
2 contract price, based on 50 percent of the charges petitioner had allocated to jobsite labor.

3 For petitioner's lump sum construction contracts performed prior to 2006, where it had reported  
4 its receipts on line 1 and then had taken tax-included and labor deductions, the Department included  
5 the amount of the tax-included deductions in audit item 1 ("underreported taxable measure") and  
6 included 50 percent of the amounts of labor deductions in audit item 2 ("disallowed claimed labor  
7 deduction"). For petitioner's lump sum construction contracts performed beginning January 1, 2006,  
8 the Department compared the measure of tax it had computed was due (contract price less installation  
9 labor) to the measure reported on line 2 of petitioner's returns, and included the difference as  
10 underreported taxable measure in audit item 1. For petitioner's sales of wall bed kits without  
11 installation throughout the audit period, the Department disallowed the claimed tax-included deduction  
12 in audit item 3.

13 Petitioner contends that there was no understatement of taxable measure related to installed  
14 wall beds and that all claimed nontaxable labor represented installation labor. Petitioner states that,  
15 beginning in 2006, it determined (based on a review of Board publications and discussions with Board  
16 staff) that its wall beds were not fixtures, but were materials that became a permanent part of the real  
17 estate when affixed to the wall. Petitioner claims that the units cannot be removed without destroying  
18 the unit and the wall where it is affixed. Petitioner further asserts that the jobsite assembly labor is  
19 either part of the nontaxable installation labor, or minimal compared to the total jobsite labor, because  
20 the wall bed and cabinet units are large, heavy, and installed on walls that sometimes are not straight,  
21 thus requiring time-intensive finish work.

22 Construction contractors are generally consumers of the materials and retailers of the fixtures  
23 they furnish and install in the performance of construction contracts. (Cal. Code Regs., tit. 18, § 1521,  
24 subd. (b)(2).) "Materials" are tangible personal property which, when incorporated into or attached to  
25 real property, lose their identity to become an integral and inseparable part of the real property. (Cal.  
26 Code Regs., tit. 18, § 1521, subd. (a)(4).) "Fixtures" are tangible personal property which are  
27 accessory to a building or other structure, and which do not lose their identity as accessories when  
28 installed. (Cal. Code Regs., tit. 18, § 1521, subd. (a)(5).) One example of a fixture is a prefabricated

1 cabinet. (Cal. Code of Regs., tit. 18, § 1521, Appendix B.) A cabinet is considered prefabricated and a  
2 fixture when 90 percent of the total direct labor and material cost to fabricate and install the cabinet is  
3 incurred before the contractor affixes the cabinet to the realty. (Cal. Code Regs., tit. 18, § 1521, subd.  
4 (c)(2).) Jobsite fabrication labor includes assembly labor performed prior to attachment of a  
5 component of a fixture to a structure or other real property. (Cal. Code Regs., tit. 18, § 1521, subd.  
6 (b)(2)(B)(2).)

7         The wall bed units here are essentially cabinets that contain a structure that can support a  
8 mattress. While the wall bed units cannot be removed without some damage to the unit or wall, the  
9 units are not necessary to the integrity of the structure and do not lose their identity after they are  
10 attached to the wall. Accordingly, we consider the wall beds and matching cabinetry at issue to be  
11 fixtures. However, since the subject wall bed units were not fully assembled prior to their delivery to  
12 the job-site and since they include cabinetry, rather than automatically treating all such units as having  
13 been installed as fixtures, we believe further analysis is required. In that regard, we find it was  
14 appropriate for the Department to utilize the cabinet rule of Regulation 1521 to determine whether any  
15 of the wall beds constituted materials at the time of installation, resulting in a lower measure of tax.  
16 (As noted above, the Department did conclude that two of the contracts were for the installation of  
17 materials, which would not have been the case had the Department simply treated the wall beds as  
18 fixtures at the time of installation and not applied the cabinet rule.)

19         Petitioner's description and photographs of the wall units evidence large units, with multiple  
20 cabinets, that would require significant assembly labor. Petitioner's installation instructions show that  
21 the first eight of the ten steps in the installation instructions are for pre-installation assembly, and  
22 actual installation is performed only in the final two steps. Thus, these instructions show that a  
23 substantial percentage of the jobsite labor involves assembly rather than affixation. We conclude that  
24 the Department's allocation of 50 percent of the jobsite labor as installation labor is reasonable, if not  
25 generous. When the audited cost of on-site assembly labor is added to the off-site assembly labor and  
26 cost of materials, the result is that least 90 percent of the total direct cost of labor and material in  
27 fabricating and installing was incurred prior to affixation to the realty for the units the Department  
28 regarded as fixtures. Thus, we find that the Department has correctly regarded the pre-fabricated wall

1 bed units as fixtures. Despite the confusing nature of how the Department assigned the deficiency for  
2 periods prior to January 1, 2006, we conclude that the actual calculation of the combined deficiency  
3 was correct. Accordingly, we recommend no adjustments to the underreported wall bed sales or the  
4 disallowed claimed nontaxable labor. For the same reason, we find that petitioner did not overpay the  
5 tax it owed prior to January 1, 2006, and thus recommend that the claims for refund be denied.

6 **Issue 2:** Whether adjustments are warranted to the disallowed claimed deductions for sales tax  
7 included for the sales of wall bed kits without installation. We recommend no adjustment.

8 Although the contracts for petitioner's sales of wall bed kits, without installation, did not  
9 indicate that sales tax reimbursement was included in the contract price, petitioner claimed deductions  
10 on its returns totaling \$2,774 for the audit period related to these sales. The Department found that the  
11 contract prices for wall bed kits did not include sales tax reimbursement, and therefore disallowed the  
12 claimed deductions. Petitioner contends that its sales of wall bed kits did include tax reimbursement  
13 and asserts that is what it told its customers.

14 Petitioner has provided no contracts that provided sales tax reimbursement was included in the  
15 sale price. In addition, the Department visited petitioner's business location and did not see any  
16 written notices, in any form, indicating that sales tax reimbursement was included in the total price of  
17 wall bed kits, nor did petitioner furnish any documents, such as price tags or advertisements, or any  
18 statements from customers, to support its claim that the sale price included tax reimbursement. We  
19 recommend no adjustment to the disallowed claimed deductions for sales tax included.

20 **OTHER DEVELOPMENTS**

21 None.

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23 Summary prepared by Thea Etheridge, Business Taxes Specialist II  
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