

**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: )  
 )  
 )  
5 UNITED STATES TILE COMPANY ) Account Number: SR Y EH 23-656080  
 ) Case ID 402951  
6 Petitioner )  
 )  
 ) Corona, Riverside County

8 Type of Business: Manufacturer of clay roofing tiles

9 Audit period: 10/01/02 – 09/30/05

<u>Item</u>	<u>Disputed Amount</u>
11 Taxable assembly labor	\$242,295
12 Taxable transportation and insurance charges	\$ 39,217
13 Tax as determined and proposed to be redetermined:	\$34,769.00
Less concurred	<u>- 12,951.81</u>
14 Balance, protested	<u>\$21,817.19</u>
15 Proposed tax redetermination	\$34,769.00
Interest through 10/31/10	<u>15,395.69</u>
16 Total tax and interest	\$50,164.69
Payments	<u>-16,210.00</u>
17 Balance Due	<u>\$33,954.69</u>
18 Monthly interest beginning 11/1/10	<u>\$ 108.26</u>

**UNRESOLVED ISSUES**

20 **Issue 1:** Whether certain labor charges included in the cost of purchases of equipment from  
21 out-of-state vendors is nontaxable. We find the labor charges at issue are subject to tax.

22 Petitioner manufactures clay roof tiles. In 2003, petitioner purchased manufacturing equipment  
23 from the foreign companies Cerasec, Manfredini and Schianchi, and Alpina Industries. Petitioner  
24 reported use tax due on the purchase price for these purchases after excluding certain labor charges.  
25 The Sales and Use Tax Department (Department) determined that some of these labor charges were  
26 subject to tax.

27 The total contract price for the purchases from Cerasec was \$4,141,600, which included charges  
28 totaling \$616,500 for “setting up and starting up” some of the equipment. The Department noted that

1 the contract terms stated Ceratec employees would perform “mechanical and electrical assembly” of  
2 the equipment. The Department concluded that a portion of the charges for labor represented Ceratec’s  
3 installation labor, and it estimated the amount of nontaxable labor at \$414,160 (10 percent of the total  
4 equipment selling price). The Department concluded that the remainder of the charges for labor of  
5 \$202,340 (\$616,500 - \$414,160) represented taxable charges for labor related to set-up and assembly.

6 The contract for the equipment purchases from Manfredini and Schianchi included charges for  
7 “Know-How/Engineering/Labor” and charges for “Setting up and Commissioning.” Based on  
8 information from petitioner’s project manager, the Department concluded that 80 percent of the  
9 charges for “know how” represented amounts related to production design and engineering labor,  
10 which were subject to tax. With respect to the charges for setting up and commissioning, the  
11 Department concluded that the charges were for the seller’s services in setting up complex equipment  
12 and that the labor involved assembly and design labor that were part of the selling price of the  
13 equipment. The Department estimated, however, that 20 percent of these labor charges represented  
14 nontaxable labor. The total amount of labor regarded as taxable with respect to the purchases from  
15 Manfredini and Schianchi is \$24,115.

16 With regard to the equipment purchases from Alpina Industries, the Department determined  
17 that a portion of the charges for reassembly of the equipment at petitioner’s plant were taxable because  
18 the charges were not separately stated and petitioner was required to hire Alpina for the reassembly.  
19 Based on information from the contract and petitioner’s project manager, the Department concluded  
20 that \$15,840 (20 percent of the total labor charges) were taxable.

21 Petitioner contends that all of the labor at issue represents nontaxable installation labor.  
22 Petitioner asserts that any reassembly was required because of the physical shipping limitations of the  
23 cargo containers and that the cost for reassembly was included in the cost of each piece of equipment,  
24 which petitioner included in the reported taxable measure. Alternatively, petitioner argues that any  
25 charges for reassembly that were included in the labor charges were nontaxable because the charges for  
26 reassembly were separately stated, the title to the equipment passed prior to each reassembly, and  
27 petitioner was not required to hire any of the sellers to do the reassembly. In addition, petitioner  
28 asserts that the charges at issue were nontaxable charges for factory-trained service employees to set up

1 and supervise the initial operations and that no fabricating, assembling, or processing occurred in the  
2 setting up of the equipment. Further, petitioner asserts that the Department's estimated amount of  
3 installation labor with respect to the purchases from Ceratec was completely arbitrary, has no basis in  
4 fact, and should be increased.

5 In general, when reassembly is performed in connection with the taxable sale of tangible  
6 personal property, the charges are taxable as part of that sale unless: 1) the charges are separately  
7 stated, 2) title to the property passes to the purchaser prior to reassembly, and 3) the purchaser was not  
8 required to hire the seller to do the reassembly. (BTLG annot. 435.0143 (12/29/86).)<sup>1</sup> With respect to  
9 the equipment purchased from Ceratec, although we find that petitioner was not required to hire  
10 Ceratec to perform the reassembly, we find that the charges were not separately stated and that title to  
11 the equipment passed to petitioner after the reassembly was performed. With respect to the equipment  
12 purchased from Manfredini and Schianchi and from Alpina Industries, although we find that title to the  
13 purchased equipment passed to petitioner prior to the reassembly, we find that the charges were not  
14 separately stated and that petitioner was required to hire Manfredini and Schianchi and Alpina  
15 Industries to reassemble the equipment because their employees were the only persons with the  
16 necessary knowledge and expertise to do so. We thus conclude that the charges for reassembly at issue  
17 are taxable because none of the charges meet all three requirements outlined above. Regarding  
18 petitioner's argument that the Department's estimate of nontaxable installation labor included in the  
19 contract with Ceratec is arbitrary, we find that, in the absence of documentation to support an increase  
20 in the allowance for nontaxable labor, no adjustment is warranted.

21 **Issue 2:** Whether an adjustment is warranted to the audited amount of taxable mandatory  
22 insurance included in the transportation charges. We recommend no adjustment.

23 In 2005, petitioner purchased equipment from Italiforni, and the purchase included a  
24 transportation charge of \$175,828, which was listed in the contract documents as "CIP [Carriage and  
25 Insurance Paid] transport cost" and "Total CIF [Cost of goods, Insurance and Freight] Corona  
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27 <sup>1</sup> Annotations do not have the force or effect of law, but are intended to provide guidance regarding the interpretation of the  
28 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 California cost.” The contract separately listed a charge of \$32,238 for insurance. Petitioner  
2 subsequently incurred an additional \$71,709 in transportation and insurance charges to be paid to  
3 Italiforni for these purchases, and those charges were contained in an amendment to the contract. The  
4 Department found that the \$32,238 included in the CIF charges was a mandatory insurance charge and  
5 was therefore taxable. Since petitioner could not provide the amendment to the contract that included  
6 the charges for \$71,709, the Department estimated that 18.34 percent ( $\$32,238 \div \$175,828$ ) of the  
7 \$71,709, or \$13,147, represented mandatory insurance. In addition, the Department determined that  
8 the contracts for the Manfredini and Schianchi purchases did not separately state the transportation  
9 charges, and it therefore concluded that tax was due on the CIF charges totaling \$31,883.

10 Petitioner concedes that the \$32,238 mandatory charge for insurance on the Italiforni contract is  
11 subject to tax. Petitioner also concedes that tax applies to \$839 and \$4,974, respectively, of the  
12 \$13,147 and \$31,883 described above. Petitioner disputes the remainder of \$31,217 (\$77,268 total  
13 mandatory insurance - \$32,238 - \$839 - \$4,974). With respect to the \$13,147, petitioner disputes the  
14 Department’s calculation of those costs. Petitioner argues that insurance costs are more appropriately  
15 correlated to the value of the goods shipped than to the transportation cost. On that basis, petitioner  
16 asserts that the taxable portion of the \$71,709 should be computed at \$839 using 1.17 percent ( $\$32,238$   
17  $\div \$2,752,672$ , the total value of the property claimed by petitioner).<sup>2</sup> Regarding the \$31,883, petitioner  
18 contends that a portion of the CIF charges were clearly for transportation, and thus those charges  
19 should not be disallowed. Also, petitioner asserts that the \$31,883 assessment is too high in  
20 comparison to the value of the goods insured. Relying on its argument regarding the Italiforni  
21 purchases, petitioner states that the taxable amount should be computed at \$4,974, which represents  
22 1.17 percent of the value of the equipment purchased.

23 California Code of Regulations, title 18, section 1628 clearly states that transportation charges  
24 will be regarded as separately stated only if they are separately set forth in the contract for sale or in a

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26 <sup>2</sup> Not only do we reject petitioner’s argument regarding the use of 1.17 percent, but also we note that petitioner’s proposal is  
27 not in accordance with its arguments. Petitioner states that the charges for mandatory insurance should be calculated at  
28 1.17 percent of the *value of the property*. However, it argues here that the 1.17 percent should be applied to the *additional transportation charges*, rather than the property value. Accordingly, even if we were convinced that the appropriate percentage is 1.17 percent (which we are not) we would still reject this argument in relation to the additional transportation charges on the Italiforni purchases.

1 document reflecting that contract, issued contemporaneously with the sale, such as the retailer's  
2 invoice. The fact that transportation charges can be computed from the information contained on the  
3 face of the invoice or other document will not suffice as a separate statement. With respect to the  
4 \$13,147 estimate of mandatory insurance established for the Italiforni purchases, the Department has  
5 made an estimate based on petitioner's representation that the charges were similar in proportion to the  
6 prior contract with the same vendor. Petitioner has not established that the Department's estimate was  
7 inappropriate nor are we aware of any legal basis supporting the alternative calculation petitioner  
8 proposes. Accordingly, we recommend no adjustment. Regarding the charges with respect to the  
9 purchases from Manfredini and Schianchi, we find that, with the exception of the \$2,857 charge for  
10 "Transport F.O.B. Italian porto in container," the remaining charges include the term "CIF," which, by  
11 its terms combines the charges for freight, cost of goods and insurance. Thus, those transportation  
12 charges simply are not separately stated and thus cannot qualify for exclusion. While the \$2,857 is  
13 clearly a separately stated transportation charge, it appears to be a charge for transport to the Italian  
14 port, from which the seller shipped the equipment F.O.B. Therefore, the transportation occurred prior  
15 to title passage, and the charge is not excluded from the measure of tax. For all these reasons, we  
16 recommend no adjustment.

17 **OTHER DEVELOPMENTS**

18 None.

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