OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18083543) CDTFA Case ID: 567515
TFCG, INC.	) CDTFA Acct. No. 100-101394)
	) Date Issued: November 13, 2019)

OPINION

Representing the Parties:

For Appellant:	Tony Wilhelm, President/CEO
For Respondent:	Mengjun He, Tax Counsel III Stephen Smith, Tax Counsel IV Lisa Renati, Hearing Representative

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, TFCG, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's timely petition for redetermination of a Notice of Determination (NOD), which assessed a tax liability $26,601.18, plus accrued interest, for the period October 1, 2006, through September 30, 2009.

Office of Tax Appeals (OTA) Administrative Law Judges Michael F. Geary, Sara A. Hosey, and Jeffrey G. Angeja, held an oral hearing for this matter in Fresno, California, on July 18, 2019. At the conclusion of the hearing, the record was held open to allow the parties to submit additional briefing to address the issue of interest relief. CDTFA submitted additional briefing, but appellant did not. The record closed effective October 3, 2019, and this matter was submitted for decision.

[1] Sales taxes were formerly administered by the State Board of Equalization (board). Effective July 1, 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) When referring to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, the board.

ISSUES

1. Whether appellant's transaction with Wild Electric, Inc. was a nontaxable sale for resale.
2. Whether relief of interest is warranted.

FACTUAL FINDINGS

1. Appellant is a construction contractor located in Fresno, California. During the audit period, appellant furnished and installed communication infrastructure, such as low-voltage cabling used for voice and data transmission, television, and cameras. Appellant worked under both lump-sum and time-and-material construction contracts. During the liability period, appellant purchased the materials at issue herein from out-of-state vendors without paying tax or tax reimbursement, or from in-state vendors to whom it issued resale certificates.
2. CDTFA audited appellant for the period October 1, 2006, through September 30, 2009, and determined a total deficiency measure of $338,897, consisting of three audit items: 1) a credit measure of $20,681 for overstated taxable sales based on a reconciliation between sales tax accrued and reported (audit item 1); 2) a deficiency measure of $145,117 for unreported use tax due on materials consumed in construction contracts, which appellant treated as nontaxable sales for resale (audit item 2); and 3) a deficiency measure of $214,461 for unreported use tax due on materials consumed in construction contracts, which appellant treated as nontaxable sales to Indians (audit item 3).
3. In a July 14, 2016 reaudit report, CDTFA reduced the deficiency measure of audit item 2 from $145,117 to $133,398, and reduced the deficiency measure of audit item 3 from $214,461 to $213,468. The remaining aggregate deficiency measure pursuant to that reaudit report is $326,185.
4. Appellant does not dispute item 1, and at the hearing in this matter, CDTFA conceded item 3. Thus, only a portion of item 2 (use tax on a measure of $122,400), remains at issue, and the remaining aggregate measure of tax is $112,717 ($326,185 - $213,468).
5. With regard to the item in dispute, appellant entered into a sub-contract with another construction contractor, Wild Electric, to furnish and install cables for a lump-sum price of $350,000. Pursuant to that contract, appellant issued an invoice to Wild Electric with a separately stated sales price of $122,400 for the materials. Wild Electric issued a resale

certificate to appellant in connection with this transaction, and appellant claimed this transaction as a nontaxable sale for resale on its sales and use tax returns. Neither Wild Electric nor appellant paid or reported any tax in connection with this transaction.

6. During the audit, CDTFA sent an XYZ letter[2] to Wild Electric to ascertain whether Wild Electric reported use tax on its use of these material (which would relieve appellant of its tax liability in connection with this transaction). However, in response to the XYZ letter, Wild Electric stated that appellant was responsible for the tax.

7. CDTFA determined that the subcontract was a lump sum contract, and that appellant as the consumer of the materials owed use tax on its use of $122,400 of cable furnished and installed in the Wild Electric subcontract.

3. CDTFA issued the above-referenced NOD, which appellant timely petitioned. This timely appeal followed.

DISCUSSION

Issue 1: Whether appellant's transaction with Wild Electric, Inc. was a nontaxable sale for resale.

California imposes a sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. (R&TC, § 6051.) All gross receipts are presumed subject to tax, and the seller has the burden of proving the contrary unless it timely and in good faith takes from the purchaser a certificate that the property is purchased for resale. (R&TC, §§ 6091, 6092; Cal. Code Regs., tit. 18, § 1668(a).) When sales tax does not apply, use tax is imposed on the purchaser's use in California of tangible personal property purchased for use in this state from a retailer, measured by the sales price, unless the use is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6201, 6202, 6401.) A purchaser who issues a resale certificate is liable for use tax if the purchaser makes any use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business. (Cal. Code Regs., tit. 18, § 1668(g).)

As relevant here, a construction contract includes a contract – whether on a time and material, lump sum, cost plus, or other basis – to erect, alter, or repair any building or other

[2] "XYZ letters" are letters in a form approved by CDTFA that are sent to some or all of the seller's purchasers inquiring as to the purchaser's disposition of the property purchased from the seller. (Cal. Code Regs., tit. 18, § 1668(f).)

structure, project, development, or other improvement on or to real property, including wiring, pipes, ducts, vents, and other conduit embedded in or securely affixed to the land or a structure thereon. (Cal. Code Regs., tit. 18, § 1521(a)(1)(A).) A "time and material contract" means a contract under which the contractor agrees to furnish and install materials or fixtures, or both, and which separately sets forth a charge for the materials or fixtures and a charge for their installation or fabrication. (Cal. Code Regs., tit. 18, § 1521(a)(7).) A "lump sum contract" means a contract under which the contractor, for a stated lump sum, agrees to furnish and install materials or fixtures, or both. (Cal. Code Regs., tit. 18, § 1521(a)(8).) A lump sum contract does not become a time and material contract when the amounts attributable to materials, fixtures, labor, or tax are separately stated on the invoice. (*Ibid.*) "Materials" means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property. (Cal. Code Regs., tit. 18, § 1521(a)(4).)[3]

In general, construction contractors are the consumers of materials they furnish and install in the performance of construction contracts, and either sales tax or use tax applies with respect to the sale of the materials to or the use of the materials by the construction contractor. (Cal. Code Regs., tit. 18, § 1521(b)(2)(A)1.) A construction contractor may be deemed the retailer of materials it installs if the contract explicitly provides for the transfer of title to the materials prior to the time the materials are installed, and separately states the price of the materials, exclusive of the charge for installation. (Cal. Code Regs., tit. 18, § 1521(b)(2)(A)2.) In the case of a time and material contract, if the contractor bills the customer an amount for "sales tax" computed on the contractor's marked-up billing for materials, it will be assumed, in the absence of convincing evidence to the contrary, that the contractor is the retailer of the materials. (*Ibid.*) However, a contractor cannot avoid liability for sales or use tax on materials furnished and installed by it by taking a resale certificate from the prime contractor. (Cal. Code Regs., tit. 18, § 1521(b)(6)(A).)

[3] Conduit, electric wiring and connections, piping, valves, pipe fittings, power poles, towers, and lines, are relevant examples of materials. (Cal. Code Regs., tit. 18, § 1521, App. A.)

When CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (See *Schuman Aviation Co. Ltd. v. U.S.* (D. Hawaii 2011) 816 F.Supp.2d 941, 950; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (See *ibid.*; see also *Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

On appeal, appellant contends that it sold the materials to Wild Electric in a time and material contract, thereby proving that the sale to Wild Electric was a nontaxable sale for resale. Appellant also argues that the resale certificate that Wild Electric issued to appellant relieves appellant of any tax liability in connection with this transaction.

Here, it is undisputed that appellant, as a construction contractor, entered into a construction contract with Wild Electric to furnish and install materials (cable), and that appellant purchased those materials ex tax. While petitioner refers to its contract with Wild Electric as a time and material contract, and there is a separate invoice for materials, the contract itself simply states a lump-sum price of $350,000 for appellant to furnish and install the materials, which means the contract is a lump sum contract. (Cal. Code Regs., tit. 18, § 1521(a)(8).) Appellant's subsequent issuance of an invoice with a separately stated charge for the materials does not convert the lump sum contract into a time and material contract. (*Ibid.*) Further, appellant has not provided evidence of a title transfer provision that transferred title to the materials to Wild Electric prior to installation. Therefore, appellant was the consumer of the materials in the performance of the lump sum contract with Wild Electric (Cal. Code Regs., tit. 18, § 1521(b)(2)(A)), and appellant owes use tax measured by the purchase price of the materials ($122,400).

Next, Wild Electric's issuance of a resale certificate does not change the foregoing conclusion because appellant did not sell the materials to Wild Electric prior to appellant's installation, but instead appellant consumed the materials in the course of performing a lump

sum construction contract. Moreover, even if appellant established that it sold the materials to Wild Electric prior to installation in a time and material contract (which is not the case), the law is clear on this issue: a construction contractor cannot avoid liability for sales or use tax on materials furnished and installed by him or her by taking a resale certificate from the prime contractor or others. (Cal. Code Regs., tit. 18, § 1521(b)(6)(A).) Because it is undisputed that appellant furnished and installed the materials used in its subcontract with Wild Electric, and because it is also undisputed that appellant purchased these materials ex-tax, sales or use tax applies to appellant's sale or use of the materials notwithstanding Wild Electric's issuance of a resale certificate. Therefore, CDTFA's inclusion of these materials in the deficiency measure for audit item 2 was appropriate, and appellant has not shown that an adjustment to this deficiency measure is warranted.

Issue 2: Whether relief of interest is warranted.

During the hearing in this matter, appellant asserted that the appeal has taken 10 years, which is unreasonably long. As a result, appellant argues that interest should be relieved.

The law provides that the amount of the determination shall bear interest from the last day of the month following the quarterly period for which the amount should have been paid to the date of payment. (R&TC, § 6482.) Interest may be relieved only under narrow circumstances: 1) where the failure to pay the tax was due to a disaster (R&TC, § 6593); 2) where the failure to pay the tax was due to an unreasonable delay or error on the part of a CDTFA employee (R&TC, § 6593.5); and 3) where the failure to pay the tax was due to erroneous advice received from CDTFA (R&TC, § 6596). A taxpayer seeking relief from the interest must file a statement under penalty of perjury setting forth the facts upon which the request for relief is based. (R&TC, §§ 6592, subd. (b), 6593, 6593.5, subd. (c).) An error or delay shall be deemed to have occurred only if no significant aspect of the error or delay is attributable to an act of, or a failure to act by, the taxpayer. (Cal. Code Regs., tit. 18, § 1703(b)(1).)

The relevant basis for relief in this appeal is unreasonable error or delay by a CDTFA employee. In its post-hearing briefing, CDTFA provided a timeline for the duration of this appeal, and based on its review, CDTFA conceded that relief of interest is warranted during two periods: from April 28, 2012 through June 28, 2012; and from May 22, 2017 through November 22, 2017. Our review reveals that the remaining delays were attributable to factors

such as appellant's requests for postponements, appellant's requests for additional time to produce evidence, or the reasonable, active processing of this appeal in due course. Accordingly, we conclude that relief of accrued interest is warranted only for the two periods identified by CDTFA.

HOLDINGS

1. Appellant has not established that the transaction with Wild Electric constitutes a nontaxable sale for resale.
2. Relief of interest is warranted for the periods April 28, 2012 through June 28, 2012; and from May 22, 2017 through November 22, 2017.

DISPOSITION

CDTFA's action in reducing the aggregate measure of tax to $112,717, relieving accrued interest for the periods April 28, 2012 through June 28, 2012, and from May 22, 2017 through November 22, 2017, and otherwise denying appellant's petition for redetermination, is sustained.

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Jeff Angeja
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Jeffrey G. Angeja
Administrative Law Judge

We concur:

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Michael F. Geary
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Michael F. Geary
Administrative Law Judge

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Sara A. Hosey
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Sara A. Hosey
Administrative Law Judge