

STATE OF COLORADO

DEPARTMENT OF REVENUE
State Capitol Annex
1375 Sherman Street, Room 409
Denver, Colorado 80261
Phone (303) 866-3091
FAX (303) 866-2400



Bill Ritter, Jr.
Governor

Roxanne Huber
Executive Director

GIL-2008-030

December 29, 2008

XXXXXXXXXXXXXXXXXXXX
Attn: XXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXX

Re: XXXXXXXXXXXXXXX

Dear XXXXXXXXX,

Your company represents XXXXXXXXXXXX ("Taxpayer") which requests a general information letter regarding the calculation of use tax on certain transactions more fully described below.

Issue

Is the contract price paid to third-party fabrication service providers to perform fabrication services on Taxpayer's materials excluded from Colorado use tax applicable to the materials that are incorporated into real property by or through Taxpayer in Colorado?

Background

You represent on behalf of your client the following facts. Taxpayer is a [another state] corporation that subcontracts with general contractors to erect steel into construction projects that are located in Colorado, as well as other states, under cost-plus or lump sum subcontracts. Taxpayer purchases the primary steel materials used for such subcontracting work from steel mills and vendors located outside Colorado. Generally, taxpayer ships purchase materials directly to its facility located in [other states] where taxpayer fabricates the material into the desired structures that will be incorporated into its projects. After Taxpayer fabricates these materials into the desired structure, Taxpayer ships the final fabricated pieces to project sites to be installed into the projects by its employees or its agents.

Due to the continued expansion of Taxpayer's business, the resulting increased volume of business coupled with Taxpayer's limited fabrication capacity has required Taxpayer to more frequently engage third parties to perform the fabrication services, in lieu of

Taxpayer, to form Taxpayer's material into the structures that will be incorporated by Taxpayer into its projects. However, Taxpayer's business need to use third-party fabricators must be balanced with Taxpayer's other business interests to retain favorable pricing of steel materials from the steel mills and vendors, to continue to control the quality and timing of the procurement of the materials, to track the materials for the quality specifications required for the various fabricated parts to be incorporated into Taxpayer's projects, and to retain title and security interests in the material to enable it to repossess the materials if necessary. To protect these other business interests, transactions with third-party fabricators will be structured as follows:

1. Taxpayer will purchase all primary steel beams/materials from third-party steel mills located outside Colorado.
2. Taxpayer will purchase all secondary/incidental materials (brackets, plates, etc.) required for fabrication from a retail vendor that may or may not be located outside Colorado. The third-party vendors may or may not also be the third-party fabricators utilized by Taxpayer.
3. Taxpayer will enter into a Fabrication Services Subcontract Agreement with third-party fabricators to perform fabrication services. Such Agreement does not include or relate to any transfer of tangible personal property. These services are independent and separate from all material purchases.
4. Possession of all materials necessary for the fabrication services (Taxpayer' primary and secondary materials) will be transferred to third-party fabricators. However, Taxpayer will retain title to such materials, security interest in such materials, and can repossess the materials upon a breach of contract by the fabricator.

Under these contractual relations, Taxpayer owns and retains title to and security interest in all materials necessary to fabricate its required structures. Any third-party fabricator provides services only and provides them in a contract that is separate from and independent of all purchases of tangible personal property.

Taxpayer argues that the holding in *International Business Machines v. Department of Revenue*, 374 601 P2d 622 (Colo. 1979), extends both (1) to fabrication services performed by third-party fabricators to whom Taxpayer provided materials that Taxpayer acquired from other suppliers, and (2) to fabrication services performed by third-party fabricators who are also suppliers of the materials. We agree that fabrication services in the first instance are not included in the use tax calculation, but disagree that the fabrication services in the second scenario are excluded from the calculation.

Discussion

A taxpayer who purchases outside of Colorado tangible personal property that is then brought into Colorado and incorporated into real property is considered the consumer of that property and must pay use tax. Use tax is computed based on the taxpayer's cost of acquisition and does not include the cost of its own labor to manufacture the property into

the finished product. *International Business Machines v. Department of Revenue*, 374 601 P2d 622 (Colo. 1979). Similarly, if a taxpayer purchases property from one supplier and then delivers the property to another party who performs fabrication services, the charges for those services are not included in the use tax computation.

However, when a taxpayer purchases both the materials and fabrication service from the same third-party, charges for fabrication labor are included in the use tax calculation. The true object of such a transaction is the acquisition of a custom made article. Department Regulation (39)26-102.12 specifically addresses the computation of use tax

Sales and use tax applies to charges for manufacturing, producing, fabricating, and processing tangible personal property which has been made-to-order or tailor-made for the customer.

Thus, use tax is computed on the purchase price paid to acquire the machined item and the service costs components are included in the use tax calculation.

Moreover, it is flatly inconsistent with §39-26-102(12), C.R.S.¹ to conclude that a seller of custom made products can, for purposes of sales or use tax computation, separately state the charge for materials from the charge for manufacturing services. *International Business Machines* does not otherwise hold. Nor is this circumstance governed by *AD Stores v Department of Revenue*, 19 P.3d 680 (Colo. 2001), which involved alteration services for finished goods.

Miscellaneous Matters

Please note that the department does not collect sales and use taxes for “home-rule” cities and counties. You can find a list of these jurisdictions by visiting our web site at:

www.revenue.state.co.us (go to Taxation > Forms > Businesses > Sales and Use > DRP 1002)

Contact those governments for information about their taxes.

This general information letter represents the advice of experienced members of the Department’s staff. However, it is not binding on the department. Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

¹ “Sales tax is imposed on the full purchase price of articles sold after manufacture or after having been made to order and includes the full purchase price for materials used and the service performed in connection therewith, ... [S]ales price is the gross value of all materials, labor, and service, and the profit thereon, included in the price charged to the user or consumer.”

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue
Telephone: (303)866-5627
Email: ntillquist@spike.dor.state.co.us