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GIL-12-005

April 4, 2012

XXXXXXXXXXXXXXXXXX
ATTN: XXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX

Re: Internal and External Fabrication Labor Costs

Dear XXXXXXXXXXXX,

You submitted on behalf of a client a request for guidance on the application of sales and use tax on internal and external fabrication labor costs of a client company.

The Department issues general information letters and private letter rulings. A general information letter provides a general overview of the relevant tax issues and is not binding on the Department. A private letter ruling provides a specific determination for a specific set of facts, is binding on the Department but not on the taxpayer, and requires payment of a fee. For more information about general information letters and private letter rulings, please see Department regulation 24-35-103.5 at www.taxcolorado.org > Tax Library > Rulings.

The Department initially treats your request as one of a general information letter. If you would like the Department to issue a private letter ruling on the issues you raise, you can resubmit a request and fee in compliance with regulation 24-35-103.5. It is important to remember that general information letters, such as this one, are general discussions of tax law and are not a determination of the tax consequence of any particular action or inaction.

Issue

1. Does Taxpayer qualify as a modifier and, is therefore, excluded from the definition of fabricator?
2. If Taxpayer is not a fabricator, would Colorado sales and use taxes be due on the internal fabrications?
3. If the Taxpayer purchases fabrication services from a third party, are the external labor costs subject to Colorado sales and use taxes?

Background

Taxpayer is a steel manufacturer with a facility in Colorado. Taxpayer performs a number of activities, including punching, drilling, welding, painting and cutting steel. Taxpayer sometimes contracts with third parties to perform some of these activities, primarily because of limited internal

capacity or a need for a special process. Taxpayer may affix the resulting steel product to real property, resell the steel product at wholesale, or sell the steel product at retail.

Discussion

We are unaware of any statutory provision that creates or defines a “modifier.” We assume that the crux of the questions is whether labor charges relating to activities you characterize as modifications are included in sales and use tax calculations. In general, and except as otherwise noted below, a retailer must collect sales tax on the purchase price paid by the customer, including any separately stated charges for retailer’s labor, overhead, or other costs associated with, and inseparable from, making goods to order. See, §39-26-102(12), C.R.S., which states, in part,

Except as otherwise provided in this subsection (12), the 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 material used and the service performed in connection therewith ...

This general rule is reflected in FYI Sales 14 (Fabrication Services),¹ in which we state,

"Fabricating, producing, and processing" includes any operation which results in the creation or production of an article of tangible personal property, or which is a step in a process or series of operations resulting in the creation or production of such an article; the terms exclude operations not so related for the creation or production of such an article.

An operation which changes the form or state of tangible personal property is one of fabrication. Persons regularly engaged in the fabrication or production of articles for sale at retail shall collect and remit the tax on the sales price. If the fabricator converts such property to his own use, he shall remit the tax based on his acquisition cost.

The tax applies to the total charges for the fabrication or production of an article of tangible personal property made to order. For example, if a manufacturer orders a machine part from a machine shop, the tax shall be paid on the total charge for the part, including labor, although charges for labor may be segregated from the cost of the materials. Similarly, the total charge for making drapes is subject to tax.

However, when the sale of goods is “separable” from the sale of related services, the charge for services is excluded from the sales tax calculation. *AD Stores v Department of Revenue, 19 P.3d 680 (Colo. 2001)*. There, the court determined that a garment was brought to market in a relatively finished state and that the alteration services were optional. Thus, among other things, we would consider whether materials at issue are, before the modification services are rendered, properly viewed as in a finished state. In any event, there are not sufficient facts to allow us to determine whether the modification or “alteration” services described in the letter are separable. Moreover, the Department does not make specific determinations of such issues in the context of general information letters such as this one.

The Department has previously addressed the application of sales and use tax to a variety of common transactions engaged in by a steel fabricator, including transactions that appear to be

¹ You can view this FYI on the Department's web site at www.colorado.gov/revenue/tax >Tax Library > FYI Publications > Sales

similar to the ones you describe. See, GIL-08-030.² There, we held that, as a general rule, fabrication labor cost performed by a fabricator on goods that the fabricator later converts to its own use are not included in fabricator's use tax calculation; but fabrication costs are included in the sales tax calculation if the fabricator sells its fabricated goods at retail. Charges for fabrication services performed by a third party are included in the sales tax calculation of the fabricator's retail sale of the fabricated goods to the ultimate consumer if the third party provides the fabricator both the materials and fabrication services. The third party fabrication charges are also included in the fabricator's use tax calculation if the fabricator converts the fabricated goods to its own use. Finally, fabrication services are not included in the fabricator's use tax calculation if the third party provided only fabrication services and did not supply the raw materials.

There is at least one significant exception to the Taxpayer's obligation to collect sales tax on fabrication services it performs. If Taxpayer, as a contractor, installs fabricated steel as a fixture into real property and title passes to the customer after the work is complete then Taxpayer is considered the consumer of the fabricated steel and must pay use tax on its acquisition costs for the fabricated goods. For more information about when and how contractor's pay sales and use tax, see, FYI Sales 18.³

Miscellaneous

This letter represents the good faith opinion of Department personnel who are knowledgeable on state taxes issues. However, the Department does not make a specific determination here on any of the issues raised and the Department is not bound by this general information letter.

The Department administers state and state-administered local sales and use taxes. This letter does not address sales and use taxes administered by home-rule cities and home-rule counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.revenue.state.co.us for more information about state and local sales taxes.

Enclosed is a redacted version of this letter. Pursuant to statute and regulation, this redacted letter 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 letter.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue

² You can view this GIL on the Department's web site at www.colorado.gov/revenue/tax > Tax Library > Rulings.

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