STATE BOARD OF EQUALIZATION
1020 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
916/ 445-3723

March 31, 1980

Mr. J--- R. K---
General Manager – State and Local Taxes
C--- D--- Corporation
P. O. Box ---
M---, Minnesota XXXXX

Dear Mr. K---:

SZ -- XX-XXXXXX

This is in response to your request of February 13, 1980, that we clarify application of the California sales tax law to contracts under which your subsidiary A--- Industries, Inc., may undertake to furnish and install computer systems in conjunction with the installation of automated water, electricity, and sewage control systems. Specifically, you have raised the question as to whether contracts for the furnishing and installation of computer systems may qualify as construction contracts under our Regulation 1521, "Construction Contracts," in accordance with the rationale of the California Court of Appeals in Bank of America v. County of Los Angeles, 22 Cal.App2d 108 (1964).

In Bank of America property tax was levied on electronic systems owned by the bank. The judgment of the trial court, that the systems were fixtures and improvements to real property rather than personal property, was affirmed by the appellate court, which commented upon the following facts:

(1) The buildings themselves were special purpose buildings.

(2) The components of each system were interconnected by hundreds of signal and power cables; the floor of the buildings was raised to accommodate the cables

(3) Air conditioning and humidity control was installed for optimum operating efficiency.

(4) Substantial expense was entailed in relocation of any of the components.

(5) In the case of some of the machines, connections to air compressors were made by rigid iron pipes.

(6) Great expense would have been incurred in moving the heavy equipment.

(7) The size and weight (11 tons to each system) militated against moving the equipment.

It was clear that by reference to the standard three-part analysis, the units in question constituted permanent improvements to realty. That is, by the intentions of the parties as manifested by their actions, by the type of use to which the property was to be put, and by the method of attachment of the property to the realty in relation to its size, the equipment in question manifested the characteristics if immovability and permanency of attachment normally associated with improvements to realty.

The opinion of the court thus reflected the historic principle that the fact that property may be firmly attached to realty is not alone determinative of its classification as a permanent improvement.

We are of the opinion that the Bank of America applies generally in the sales tax context as in the property tax context. But what does it mean to make this statement? A closer examination of various factual situations is required.

Title Transfer Sales – Non-United States Government

In a situation where a contractor undertakes to furnish and install equipment items of the type discussed in Bank of America, the Board would conclude that the contract is a construction contract under its Regulation 1521 and that those items actually affixed permanently to realty, whether by their own weight or by mechanical attachment, are fixtures under the regulation. In accordance with the regulation, the contractor would be the retailer of fixtures, such as central processing units, and the consumer of materials, such as wiring, flooring, etc. Other items such as software, desks, chairs, etc. not actually becoming a permanent part of the realty would be taxed as machinery and equipment or other tangible personal property, as provided by the regulation. Property to be treated as a fixture under Regulation 1521 must be integrated with the realty in such a manner as to manifest the permanent nature of the installation.

Lease Sales – Non-United States Government

In a situation where a contractor undertakes to install equipment integrated with the realty in the manner described in the Bank of America case but retains title to the equipment and leases the equipment to the landowner, we are of the opinion that the equipment cannot be regarded as a permanent improvement to real property-no matter what the manner of affixation-because the agreement between the parties, i.e., the lease agreement, which would manifest an intention that the property not be in place on a permanent basis. This concept is recognized in Revenue and Taxation

Code Section 6016.3, which provides that "'Tangible personal property,' for the purpose of [the sales tax law], includes any leased fixtures if the lessor has the right to remove the fixtures upon breach or termination of the lease, unless the lessor is also the lessor of the realty." Thus, in the situation described in Bank of America decision, if the property had been leased to the bank by the person who installed it, the Board would have regarded such lease as a lease of tangible personal property. See Regulation 1521(b)(2)(B)(3). In short, there is no construction contract; there is a lease of tangible personal property taxable as a sale if the lessor is the manufacturer of the property of if the lessor has not paid tax with respect to its acquisition of the property.

Lease Sales – United States Government Contracts

With respect to installations made for the United States, the initial analysis would be the same. The property when installed remains tangible personal property in accordance with Section 6016.3. Revenue and Taxation Code Section 6381, which describes sales to the United States as being generally exempt from the tax, states that "This exemption does not extend to the rentals payable under a lease of tangible personal property." The Board would have attempted to assert the tax on such leases, but, as you know, we are enjoined from collecting tax on leases to the United States in accordance with the order of the court in United States of America v. Board of Equalization, United States District Court, Central District, CV 79-03359.

As is apparent, it is the view of the staff of the State Board of Equalization that we are required to recognize the holding of the California court in the Bank of America case. However, the ramifications of such recognition seem more fortuitous than deliberate.

Very truly yours,

Gary J. Jugum
Assistant Chief Counsel