State of California Board of Equalization

M e m o r a n d u m

330.2958

To : --- --- – Auditing (BQW-PS) Date: 4/14/81

From : Headquarters – Legal (LS)

Subject : M--- T---, Inc. SR -- XX-XXXXXX

This is in response to your memorandum dated November 24, 1980 relating to the proper application of the Sales and Use Tax Law to a series of transactions entered into between M--- T---, Inc. (MT) and M--- E--- (ME) and between MT and --- --- Equipment Leasing Corporation (Name). Below is a summary of pertinent information pertaining to various of the transactions which will be followed by our opinion as to the proper application of the tax under these circumstances.

The MT ME Construction Contract Agreement
(Construction Contract)

On April 20, 1978, MT (a California corporation) contracted with ME (a Delaware corporation) for the construction by ME of four 37-ton yard Gantry Cranes. These huge cranes are of the overhead variety and are rail mounted to facilitate movement up and down the docks. The contract for their construction provided that ME was to furnish all labor, materials, supplies, and equipment, and was to perform all work necessary to construct, transport, erect, test, and deliver the cranes ready for operation at Berth XXX, Port of [Name 2], --- ---, --- ---, California. Berth XXX was and is leased by MT from the Port of [Name 2].

The Construction Contract provided for a total purchase price of $6,875,747 which breaks down into components of $5,938,347 (four cranes), $337,400 (transportation), and $600,000 (labor and services for erection, testing, and delivery). Partial payments of the purchase price were to be made by MT at monthly intervals during the course of construction. However, these partial payments were not to total more than 90% of the total price since the Construction Contract called for the final 10% to be paid upon acceptance of the cranes by MT.

The Construction Contract provided that title to all materials, supplies, and equipment assembled at ME's plant or elsewhere for the purpose of being incorporated in the crane during construction and erection was to be immediately vested in MT. It was further provided that if ME defaulted on the Construction Contract, MT could terminate it unilaterally and remove the cranes, supplies, and equipment purchased for use from ME's plant.

The Construction Contract Assignment
(Assignment)

On April 30, 1980, MT entered into an agreement with [Name] providing for the assignment of MT's rights and interest under the Construction Contract. [Name] agreed to purchase the cranes, on the acceptance date provided for in the MT [Name] Equipment Lease Agreement (Equipment Lease, below). Until such acceptance dates, MT- was to retain rights of a purchaser under the Construction Contract. The Assignment expressly provided for continuing liability of MT to ME under the Construction Contract.

The ME Consent and Agreement
(Consent)

On the same day the Assignment was entered into, ME signed the Consent. Essentially, it concurred in the Assignment. It also provided for execution and delivery by ME of a Bill of Sale for each crane which would operate to transfer marketable title from ME to [Name] free and clear of liens and encumberances [sic]. ME further agreed to provide [Name] with an itemized invoice for each crane stating the measure of sales tax for which ME would be responsible. Finally, it stated that nothing in the Consent should be construed to modify or amend any of the terms of the Construction Contract.

The MT [Name] Purchase and Lease Agreement
(Purchase and Lease)

The Purchase and Lease was entered into on April 30, 1980 between [Name] and MT. It referred to the Construction Contract and the Assignment and specified that MT desired to lease the cranes, not own them. The Purchase and Lease indicated [Name]'s willingness to purchase the cranes on the terms and conditions specified in the Purchase and Lease and in the Equipment Lease. MT was to inspect all cranes promptly upon delivery and accept each unit which conformed substantially to the Construction Contract. Certificates of Acceptance were to be delivered by MT to [Name] on the acceptance date of each crane. However, it was specifically provided that [Name] would not purchase any unit accepted by MT after December 31, 1980. MT was to be reimbursed by [Name] for progress payments made to ME under the Construction Contract and, with the exception of certain hold back amounts, any balance due under the Construction Contract was to be paid by [Name] to ME.

The Purchase and Lease provided, also, that upon acceptance by MT of each unit and payment by [Name] of the purchase price, [Name] was to acknowledge receipt of the Certificate of Acceptance, accept title to the unit from ME under a bill of sale and lease the unit to MT pursuant to the Equipment Lease.

The MT [Name] Equipment Lease
(Equipment Lease)

This lengthy document, which was signed on April 30, 1980, covered all aspects pertaining to MT's lease of the equipment from [Name]. Of particular relevance to our discussion are the provisions in the Equipment Lease granting MT the right to purchase the equipment for fair market value upon termination of the lease period and [Name]'s rights of removal of the equipment upon breach or termination of the lease.

Analysis

Before we render our opinion as to the tax consequences of the foregoing transactions, an important factor recently brought to our attention by your office should be mentioned. That is, only two of the cranes were accepted by MT prior to December 31, 1980. Under the terms of the Purchase and Lease, the two cranes which had not been completed by year's end were, accordingly, not purchased by [Name].

In our opinion, the cranes were "fixtures" and the Construction Contract is a "construction contract" within the purview of Regulation 1521. ME was the retailer of these fixtures to MT and, pursuant to the explicit title provisions in the Construction Contract, the sale to MT occurred upon ME's acquisition of the cranes' components. Since ME's manufacturing plant is in Ohio, we assume all components were delivered to MEn there and, hence, were sold to MT in Ohio.

Insofar as the cranes which were accepted or will be accepted after December 31, 1980, MT owes use tax measured by the sales price of the cranes. Since the transportation charges were separately stated, the transportation was by facilities other than ME's, and title to the cranes passed prior to shipment from ME's Ohio plant to MT's jobsite in California, the transportation charges are not includible in the sales price (Rev. & Tax Code § 6011; Reg. 1628). It would appear that the only labor taxable with respect to these cranes would be jobsite fabrication labor, if any, performed by ME prior to attaching the cranes to the realty (Reg. 1521 (b) (2) (B) 2.b.). ME owes sales tax based on this amount.

Regarding the two cranes accepted by MT before December 31, 1980, the Assignment, Consent, and Purchase and Lease indicated title to the cranes was to pass from ME to [Name] upon acceptance by MT. However, as discussed above title to the crane components was, by this time, no longer in ME but was in MT. Accordingly, notwithstanding the language in the foregoing documents, title actually passed from MT to [Name] upon MT's acceptance. We view the sales from ME to MT as sales for resale and, as will be explained below, the transfers from MT to [Name] as taxable retail sales.

Normally, sales of fixtures in place are deemed sales of realty and, accordingly, are not subject to sales tax. An exception to this rule is provided when the purchaser is also the lessor of the fixtures, has the right to remove the fixtures upon termination or breach of the contract, and is not also the lessor of the realty whereon the fixtures are located. Under such conditions, the fixtures remain tangible personal property (Rev. & Tax. Code 6016.3). Here, the fixtures transferred to [Name] clearly remained tangible personal property. What, then, are the tax consequences of these transfers?

Where property is leased in substantially the same form as acquired and where the acquisition of that property by the lessor was by a retail sale with respect to which sales tax reimbursement was paid to the vendor based upon gross receipts or use tax was paid by the lessor based upon the purchase price, the lessor owes no further tax (Rev. & Tax. Code §§ 6006 (g)(5), 6010(e)(5); Reg. 1660(c)(2)). If these conditions are not met, however, tax is due from the lessor measured by rental receipts (Reg. 1660(c)(1)).

In the instant matter, the facts show the property was leased in substantially the same form as acquired. Also, the sale was at retail (Rev. & Tax. Code § 6007). The final criteria to be met in order to deem the cranes as tax paid in the hands of Wells Fargo, then, are that [Name] has either paid sales tax reimbursement on gross receipts or use tax based on the purchase price.

The record discloses that [Name] remitted to ME amounts designated as "use tax" on the two invoices which ME submitted to [Name]. The "use tax" on the invoices was measured by "Equipment Cost" only. Excluded from the measure were amounts designated as "Transportation," "Storage," and "Labor & Services for erection, testing and delivery." The transportation charges are identifiable as those incurred in transporting the crane components from Ohio to California and, as previously discussed, are not subject to tax. The storage charges were incurred through retention of the property for the purpose of sale in MT's regular course of business and, therefore, were also properly excluded from the taxable measure (Rev. & Tax. Code § 6008). The portions of the charges for labor and services for erection, testing and delivery which are identifiable as charges for installing or applying the property sold were also properly excluded (Rev. & Tax. Code § 6012(c)(3)). However, the remainder of the labor and service charges should not have been excluded from the measure (Rev. & Tax code § 6012(a)(20 and (b)(1)).

A literal construction of the provisions in the law relating to tax paid property leased in substantially the same form as acquired (Rev. & Tax. Code §§ 6006(g)(5), 6010(e)(5); Reg. 1660(c)(3)) indicates that our fact pattern falls outside those provisions. This is because the tax was not measured either by total gross receipts or the total purchase price. However, insofar as [Name] is concerned, we are of the opinion that, under the unique circumstances of this matter, its payment of "use tax" to ME should give it tax paid status. In reaching this conclusion, we note that the amount upon which tax was not measured was no more than 10% of the total taxable measure. Further, [Name] remitted the tax reimbursement to ME, rather than to MT or directly to the Board, in good faith pursuant to the various agreements negotiated by the three parties.

Based on our discussions with your office, it is our understanding that ME has registered with the Board for Sales and Use Tax purposes and is bound to report taxes under a related California company's permit number. Under these conditions, regardless of whether or not ME has remitted the tax reimbursement paid it by [Name], [Name] is absolved of liability for such amounts. Of course, [Name] is still liable for any unpaid liability with respect to the aforementioned labor and service charges.

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