

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

In the Matter of the petition)
for Redetermination Under the) DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)
)
)
Petitioner)

The petition was heard on Thursday, March 22, 1979 at 3:00 p.m. in San Mateo, California. Donald J. Hennessy, Hearing Officer.

Appearing for Petitioner:

REDACTED TEXT President

REDACTED TEXT President REDACTED TEXT

Appearing for the Board:

Howard J. Frohlich
Field Audit Supervisor

Protested Item
(Audit Period 10/1/74 to 12/31/77)

Petitioner protests a Notice of Determination dated June 23, 1978 for tax and interest in the total amount of \$6,305.55. Specific protest is to Item G of the Report of Field Audit dated March 27, 1978 which reads as follows:

Sales For Resale Overstated

G. Sales of fixtures to U.S. Government Construction Contractors \$44,533

Contention of Petitioner

We have been denied the exemption for "Machinery and Equipment" provided for in Sales and Use Tax Regulation 1521.

Summary of Petition

Petitioner is a corporation engaged in the business of selling specialized commercial and industrial heating items such as boilers, furnaces, and heat exchangers. This is the first audit of the corporation which was formed from a previous individual proprietorship. The tax has been paid on the unprotested audit items, leaving a balance of tax and interest of approximately \$2,300.

The issue here involves three sales by Petitioner to REDACTED TEXT (REDACTED TEXT) in 1977. REDACTED TEXT plans to reimburse Petitioner for the tax if it is paid and is, therefore, an interested party in these proceedings.

The items sold were hot water generator tanks (heat exchangers) and expansion tanks for installation by REDACTED TEXT at Travis Air Force Base (Travis) pursuant to a contract between REDACTED TEXT and the U. S. Government. The heat exchanger units are in the nature of water heaters. They are used in conjunction with steam-producing boilers. The steam from the boilers is passed through a coil inside the heat exchanger tank. Cold water from Travis's wells passes through mains and flows into the heat exchanger tank. The heat from the steam inside the coil passes by conduction to the water.

Extremely hot water is produced for light industrial uses such as in the laundry and the cleaning racks in the motor pool. Some of the heated water is blended with cooler water for domestic, residential, and barracks use such as in the kitchens and showers. The water is piped from the buildings where the heat exchangers are located to the buildings where the water is used by both underground and overhead pipes. The expansion tanks serve a holding function for hot water which has expanded beyond the desirable point in the heat exchanger tank. Both the heat exchanger and the expansion tank are separately removable but usually remain in place for their useful life unless careless use causes corrosion which necessitates their replacement.

The audit considers the heat exchanger and expansion tanks as "fixtures" used by REDACTED TEXT in improving U. S. Government real property and, therefore, their sale to REDACTED TEXT as subject to sales tax pursuant to Revenue and Taxation Code Sections 6007.5 and 6384. Petitioner believes that the tanks are "machinery and equipment" as defined in Sales and Use Tax Regulation 1521 (Title 18, California Administrative Code) and, therefore, were sold to REDACTED TEXT in a nontaxable sale for resale to the U. S. Government.

Analysis and Conclusion

As the contracts and the sales in question here occurred in 1977, Regulation 1521 as amended effective April 1, 1976 applies to the sales. Appendix B to Regulation 1521 includes in a list of typical items regarded as fixtures "Furnaces, boilers, and heating units". That the Board staff has long considered items similar to those we have here as "fixtures" is evident from two annotations in the Business Taxes Law Guide, i.e., Annotation 190.2000, dated 3/4/70 and 3/24/70, states that "...steam generators (heat exchangers)...in the primary system of nuclear generating station are 'fixtures'"; Annotation 190.2360, dated 12/21/53, states that "A water heater is considered a 'fixture' and as such the sale thereof by a contractor is a taxable sale." In the sale of any home, factory, plant, hotel, etc., the Board considers water heaters of all types as "fixtures"; if a lump sum construction contractor purchases the water heater ready made and tax

paid, there is no further tax due on his sale of the water heater, which is seen as an accessory to the building in which it is installed. (See definition of "fixture" in Regulation 1521(a) (5).)

Such conclusion, i.e., that water heaters are fixtures, seems to likewise apply when we turn to the definition of "machinery and equipment" in Regulation 1521(a) (6). To be classified as "machinery and equipment", the item must be used for a purpose not essential to the building itself. Water heaters, of all types, are considered essential to, and accessory to, buildings and structures. At least since the revision of Regulation 1521, effective April 1, 1976, water heaters, of all types, which are connected to water systems have been classified as fixtures, not machinery and equipment.

Prior to April 1, 1976, in deciding what purposes were essential to a building, the Board staff had long distinguished between items that served a housekeeping or creature comfort purpose (fixture) on the one hand, and items that serve a manufacturing or service purpose (machinery and equipment) on the other. In order to give some flexibility to decisions on items that served dual or multiple functions, the Board staff had applied a "de minimis" rule, i.e., that if no more than 5 percent of the output of an item served housekeeping or creature comfort purposes, the item would still be classified as "machinery and equipment".

Here the hot water produced by the heat exchangers and expansion tanks is admittedly used for multiple purposes. Some of the purposes are housekeeping or creature comfort, i.e., laundry, kitchen, showers; at least one of the purposes is a type of service, i.e., cleaning racks in the motor pool. But there has been no attempt by Petitioner to prove that only 5 percent or less of the hot water is for housekeeping or creature comfort purposes, and we believe for the very good reason that such attempt would be futile.

Therefore, even if we applied the pre-April, 1976 rule and considered the heat exchangers and expansion tanks as property that could be either "fixtures" or "machinery and equipment" depending on their purpose (which we do not decide), the audit classification of the heat exchangers and expansion tanks as "fixtures" would be correct, due to their substantial use for purposes essential to the buildings.

Our study of the file reveals that, during discussions with the audit staff, Petitioner raised the argument that certain of the "tanks" in question were of less than 500 barrel capacity, and were, therefore, "machinery and equipment" because Appendix C to Regulation 1521 states that large tanks (i.e., over 500 barrel capacity) are not "machinery and equipment". If this conclusion was correct, the hot water heater in every home would be "machinery and equipment".

Appendix C does not state that every tank of less than 500 barrel capacity is "machinery and equipment", but leaves this question open for case by case analysis depending on the type and purpose of the tank. While the heating units we have here may be called "tanks", they are a very specific type of tank, and their classification within Regulation 1521 must be according to the most specific applicable class, i.e., heating units, rather than by reference to a general statement negating large tanks as "machinery and equipment". The rule of statutory or regulatory interpretation is always that the more specific, i.e., heating units, controls the more general, i.e., large tanks.

Recommendation

Redetermine without change.

Donald J. Hennessy, Hearing Officer

May 10, '79
Date