STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION
450 N STREET, SACRAMENTO, CALIFORNIA
PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082
916-323-2549 • FAX 916-323-3387
www.boe.ca.gov

BETTY T. YEE
First District, San Francisco

SEN. GEORGE RUNNER (RET.)
Second District, Lancaster

MICHELLE STEEL
Third District, Rolling Hills Estates

JEROME E. HORTON
Fourth District, Los Angeles

JOHN CHIANG
State Controller

KRISTINE CAZADD
Executive Director

December 15, 2011

Re: Tax Opinion Request 11-391
(No Taxpayer Account Number)

Dear Mr.

This is in response to your letter, dated September 1, 2011, wherein you request advice from the Legal Department's Tax and Fee Programs Division on behalf of (Ranch) with regard to a planned purchase of a solar facility. We are aware of two prior email inquiries, which were dated December 20, 2010, and April 14, 2011, and which were responded to by the Sales and Use Tax Department's (SUTD) Tax Policy Division's Information and Advisory Unit. Based on the information provided at those prior times, the responses to both emails indicated that tax should be applied to Ranch's purchase of the solar facility. In response to the additional information provided in your September 1, 2011, letter, as well as the additional supporting documentation submitted with this letter, SUTD's Tax Policy Division and the Legal Department's Tax and Fee Programs Division discussed your inquiry further and now advise that the farm equipment and machinery partial tax exemption applies to the proposed purchase of the "solar power project" or "solar generating facility" (solar facility) based on the facts and assumptions discussed in this letter. Your letter states, in relevant part, the following:

> I am writing to request an opinion regarding the proper application of sales and use tax regarding our proposed purchase of a solar power project that will provide power for our irrigation equipment used in the agricultural operations at [Ranch in California]. Specifically, I would like an opinion as to whether such a purchase qualifies for the partial exemption provided under Regulation 1533.1, *Farm Equipment and Machinery*. . . . [¶] . . . [¶]
>
> For your background, [Ranch] is approximately acres whose primary products are cattle and hay. [Ranch] is the largest user of power on the [electric cooperative], with over 900 horsepower of connected load or approximately 675 kw. Our proposed 0.5 MW (500 kw) project will generate enough electrical power to cover 90% of our annual agricultural power demands.
>
> Originally, the system was designed with individual projects behind each of the eight metered agricultural pumps. However, because of the large power usage of the 125 horsepower pumps, connection of the solar power source directly to the

> irrigation pump is not feasible. The [electric cooperative] requires the solar power to be tied directly to the distribution lines on our property to control fluctuations in power and reduce disruption to the regional power grid.
>
> Upon completion, our proposed solar generating facility will not sell power to the utility company or to [the electrical cooperative]. Rather, there is a net energy metering agreement (copy attached) under which solar power will be provided by [Ranch] to [the electrical cooperative] which will then net the value of the power provided from our utility bill. The terms of contract explicitly provide that the value of the solar energy provided can only be used to net against the value of the energy consume[d]. Just to be perfectly clear, [Ranch] cannot and is not in the business of selling energy to [the electrical cooperative]. . . . [¶]
>
> [¶] . . . Developing power storage devices for each pump is not practical, not only due to costs of storage devices to retain the electricity, but the existing power grid will still be required to be available to account for the fluctuation between the power demands of irrigation pumps and center pivot sprinklers and the availability of solar resources to power our project; i.e., it will take a year's worth of solar generation to power our pumps and sprinklers during our five[-]month growing season.
>
> With respect to whether the solar project is primarily used in agricultural operations, it is not in dispute that the electricity consumed is to power our irrigation equipment, as further evidenced by the agricultural rate afforded to [Ranch] by [the electrical cooperative]. Since the design and size of our project was based on a three[-]year average of our irrigation power requirements, the total power consumed in our agricultural operations will be directly proportional to the power provided by the solar project. In other words, if it is determined that [Ranch] consumes 90% of its power to meet its irrigation requirements[,] it should be assumed that 90% of the solar power generated by the solar project is for an agricultural purpose, even though the power is commingled on the grid.

Provided that the facts as discussed in this letter (both summarized and assumed) are accurate and verifiable by audit, Ranch may rely on this response for purposes of Revenue and Taxation Code section 6596. (See Cal. Code Regs., tit. 18, § (Regulation or Reg.) 1705, subd. (b) [describing the circumstances under which relief from liability is available for reasonable reliance on written advice given by the Board].)

DISCUSSION

As a starting point, California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in California unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code, §§ 6012, 6051.) A sale includes any transfer of title or possession, in any manner or by any means whatsoever, of tangible personal property for a consideration. (Rev. & Tax. Code, § 6006, subd. (a).) The sales tax is imposed on the retailer, who may then collect reimbursement from its customer if the contract of sale so provides. (Civ. Code, § 1656.1; see Reg. 1700.)

When sales tax does not apply, use tax may be imposed measured by the sales price of tangible personal property purchased from a retailer for storage, use or consumption in California. (Rev. & Tax. Code, §§ 6011, 6201, 6401.) The use tax is imposed on the person actually storing, using or otherwise consuming the property. (Rev. & Tax. Code, § 6202.) A retailer "engaged in business" in California is required to collect this tax from its customers and remit it to the Board. (Rev. & Tax. Code, §§ 6202, 6203.) The measure of tax is generally the same regardless of whether the applicable tax is a sales tax imposed on the retailer, or a use tax imposed on the purchaser. (See Rev. & Tax. Code, §§ 6011, 6012.)

As relevant to this inquiry, Revenue and Taxation Code section (Section) 6356.5, subdivision (a) provides for a partial tax exemption for:

> **Farm equipment and machinery**. (a) There are exempted from the taxes imposed by this part the gross receipts from the sale of, and the storage and use of, or other consumption in this state of, farm equipment and machinery, and the parts thereof, purchased for use by a qualified person to be used primarily in producing and harvesting agricultural products.

In summary, to qualify for the partial exemption there must be (1) a qualified person who (2) purchases qualifying farm equipment and machinery and (3) uses that equipment and machinery primarily in producing and harvesting agricultural products. (Rev. & Tax. Code, § 6356.5; Reg. 1533.1, subd. (a).)

I. Qualified Person for Partial Exemption

First, Section 6356.5, subdivision (b)(1) explains: "'Qualified person' means any person engaged in a line of business described in Codes 0111 to 0291, inclusive, of the Standard Industrial Classification [SIC] Manual." In your letter, you state that Ranch's primary products are cattle and hay. Alfalfa farms and hay farms are included in SIC 0139. Those establishments primarily engaged in the production or feeding of beef cattle, except feedlots, are described in SIC Code 0212. We assume Ranch is a hay farmer as described in SIC Code 0139 and/or is a cattle rancher as described in SIC Code 0212, and is therefore a qualified person.

II. Qualifying Farm Equipment

Second, Regulation 1533.1, subdivision (b)(1)(A) in relevant part, defines "farm equipment and machinery" as implements of husbandry, which include:

> Any new or used tool, machine, equipment, appliance, device or apparatus used in the conduct of agricultural operations, except where such items are intended for sale in the ordinary course of business. Such items include, but are not limited to, combines, harrows, tractor implements, agricultural heating and cooling equipment, fuel storage equipment, wind machines, handling and packing equipment and conveyors, ginning equipment, feeding, watering and waste disposal systems for livestock, incubators and equipment used for egg and poultry production, harvesting trays and bins, farm tools such as rakes and hoes, plant support equipment such as trellis systems, *irrigation systems*, fencing systems, milking systems, agricultural operating structures, squeeze chutes, portable panels, corrals, loading chutes, veterinary instruments, free stalls, cages and tack

> items such as saddles and rope. *Farm equipment and machinery also includes any equipment* or device *used* or required *to operate*, control, or regulate *machinery* not limited to computers, data processing equipment, and computer software, including both operating programs and application programs.

(Emphasis added.)

A solar facility, such as the one at issue, which is subject to a net metering agreement and attached to the local power grid, may meet the above definition of farm equipment and machinery if it constitutes equipment used to operate qualifying machinery. More specifically, due to the inability to trace the exact electric power produced from the solar facility to the grid and then to the qualifying machinery (unlike a generator or battery where the energy flows directly from the generator or battery to the qualifying machinery), taxpayer needs to demonstrate that the solar facility is specifically designed to provide power to qualifying machinery in order to qualify for the exemption.[1]

In your letter, you state that the solar power project will provide power for Ranch's irrigation equipment used in the agricultural operations at Ranch. You state that the design and size of the solar project was based on a three-year average of Ranch's irrigation power requirements. Further, you indicate that it will take a year's worth of solar generation to power Ranch's irrigation pumps and center pivot sprinklers during Ranch's five-month growing season. You also state that the proposed project will generate enough electrical power to cover 90 percent of Ranch's annual agricultural demands. Based on these statements, we assume that the solar facility will generate 90 percent of the amount of the electric power that the irrigation pumps will consume each year.

You further state that the system was originally designed with individual projects behind each of the eight metered agricultural pumps. However, because of the large power usage of the agricultural pumps, you indicate that the electric cooperative and practical engineering considerations require that the solar power be tied directly to the distribution lines on Ranch's property (we assume you mean that it is tied to the regional power grid) rather than directly to each of the irrigation pumps. In other words, it is our understanding that Ranch was prohibited by the electric cooperative from attaching the solar facility directly to the irrigation pumps. Finally, it is our understanding that the agricultural pumps require electric power in order to operate.

Based on these specific facts and assumptions, the solar facility is specifically designed to provide power to the irrigation pumps. As such, the solar facility is equipment used to operate (i.e., to power) qualifying machinery, irrigation pumps or an irrigation system, and thus, the solar facility itself constitutes farm equipment and machinery as defined in Regulation 1533.1, subdivision (b)(1)(A).

III. Primary Usage of Farm Equipment

Regulation 1533.1, subdivision (b)(4) provides that "'primarily' means used 50 percent or more of the time in producing and harvesting agricultural products as defined in

[1] All relevant facts and circumstances of a taxpayer should be considered in determining whether or not a solar facility, such as the one at issue, is specifically designed to provide power to qualifying machinery.

subdivision (b)(5)." Subdivision (b)(5) of Regulation 1533.1 provides, in relevant part, that "'producing and harvesting agricultural products' means those activities described in Major Groups 01, 02 and 07 of the SIC Manual."

To determine whether the solar facility is primarily used in producing and harvesting agricultural products, more than half (i.e., 50 percent) of the annual energy generated by the solar facility must be consumed by Ranch's irrigation pumps in producing and harvesting agricultural products. Specifically, this should be calculated by dividing the total annual amount of power consumed by Ranch's irrigation pumps in producing and harvesting agricultural products by the total annual amount of power generated by the solar facility. We regard power generated by the solar facility when the irrigation pumps are not operating as power that is effectively "banked" in the local grid such that the calculation is not limited to those periods when the irrigation pumps are operating.

Here, we assume that the irrigation pumps, which are powered by the qualifying solar facility, are used solely for those activities described in SIC Code 0139 (which is in Major Group 01 of the SIC Manual) and/or SIC Code 0212 (which is in Major Group 02 of the SIC Manual). As discussed above, we assume that the solar facility generates 90 percent of the amount of electric power that the irrigation pumps consume each year. In other words, 100 percent of the total amount of the electric power generated by the solar facility effectively is consumed by the irrigation pumps in producing and harvesting agricultural products. Based on these facts and assumptions, the solar facility is clearly used 50 percent or more of the time in producing and harvesting agricultural products.[2]

Ranch will need to document the annual amount of electric power consumed by the irrigation pumps for the first 12 months the solar facility operates. Data from the meters on the irrigation pumps would be the best evidence to document consumption (we note that your letter indicates that there are eight metered agricultural pumps). However, if meter information is not available, Ranch may also document the irrigation pumps' annual consumption by providing satisfactory evidence of the number of irrigation pumps, number of hours the irrigation pumps are in operation, and how much power is consumed by the pumps per hour. Ranch will also need documentation to evidence the total amount of power produced by the solar facility. For purposes of audit, all supporting documentation related to the first 12 months the solar facility operates should be retained by Ranch for a period of at least four years from the date of the solar facility's purchase. (Reg. 1698, subd. (i).)

IV. Application of Regulation 1521 – Construction of the Solar Facility

We understand the solar facility is being furnished and installed by a construction contractor. Regulation 1521 governs the application of tax to construction contracts. To the extent the construction contractor is regarded as a retailer under Regulation 1521, the partial exemption applies to the sale of such items to Ranch. On the other hand, to the extent the construction contractor is regarded as the consumer under Regulation 1521, the partial exemption is not applicable to the construction contractor's purchases of materials for use in constructing the solar facility.

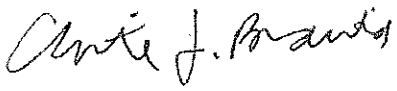
---

[2] We note that, if the solar facility produces more than twice as much power than the irrigation pumps consume in a year, our analysis and conclusion would be different. In such circumstances, the solar facility would be used more than 50 percent of the time in something other than producing or harvesting agricultural products.

V. Conclusion

In conclusion, if the facts are as stated and assumed in this analysis, the farm equipment and machinery partial exemption applies to Ranch's purchase of the solar facility and Ranch should complete and provide the seller with the enclosed partial exemption certificate. If it turns out that the solar facility is used in a manner not qualifying for the partial exemption, or the partial exemption is otherwise inapplicable, Ranch will be liable for the applicable tax. (Reg. 1533.1, subd. (g)(1).)

Sincerely,



Christine J. Bisauta
Acting Assistant Chief Counsel

CJB/yg
J:/Bus/Use/Finals/Bisauta/1533.1/11-391.doc

Enclosure: Partial Exemption Certificate

cc: Ms. Susanne Buehler (MIC: 92)
Sacramento District Administrator (KH)