



S--- R--- M--- C---, INC.  
E--- R--- M--- C---, INC.  
J--- B---

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### Petitioner's Contention

1. The applicable provision of Sales and Use Tax Regulation 1596 is subdivision (a), and under that subdivision, the transfers of the batch plants are not taxable sales of tangible personal property.

2. Even if subdivision (c) of Regulation 1596 applies, the transfers are not taxable because petitioners had no present right of removal.

### Summary

Petitioner J--- B--- was engaged in the business of producing and selling concrete as a sold proprietor. He was also a shareholder in several corporations, including petitioners S--- R--- M--- C--- and E--- R--- M---, which were engaged in the same business at different locations.

The proprietorship's plant was located in S--- D---, S---'s plant was in C--- and E---'s plant was in E---. E---'s plant was on land which E--- was leasing from a third party; the other two plants were on land leased from third parties by Mr. B---.

All three leases were for a term of years with limited options to extend. Each lease allowed the lessee to end the lease before term if certain conditions were met, such as inability to use the land for a concrete-mixing facility. The rental on the E--- lease was a flat rate per month (with adjustments for inflation) or, if certain conditions were satisfied, a reduced rate based on the amount of concrete sold from the facility. The other two leases were for a flat rate (inflation adjusted) per month.

Section 11 of the E--- lease provided that, upon termination, the lessee would have 90 days to remove from the premises "all of its plants, equipment, personal property, buildings and improvements...." Section 7 of the S--- lease stated that all improvements constructed on the premises by the lessee, including "buildings and batch plant equipment", would remain the property of the lessee and that the lessee would have 60 days to remove them at the end of the lease. Section 4 of the S--- D--- lease provided that improvements to be built on the premises, namely "a complete and modern concrete plant", would remain the property of the lessee; that the lessee would have 180 days to remove the improvements upon termination of the lease; and that the lessor would have a right of first refusal if the lessee elected to sell the improvements.

In January 1989, all three petitioners agreed to transfer certain of their assets to M--- D--- Corporation (MCC) for a consideration. As part of the agreement, MCC was to immediately transfer the assets to a partnership formed by it and Mr. B---. The three lease agreements were to

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be assigned directly to the partnership by the lessees. The transaction was consummated on or about February 3, 1989.

The assets transferred to MCC at each location including equipment, an operations building, a material-handling system and a concrete batch plant. Each petitioner reported and paid tax on the sales of equipment, but not on the other assets. Upon audit, the staff agreed that the operations buildings and material-handling facilities were not taxable because they were improvements to realty, but concluded that the batch plants were tangible personal property and were subject to tax.

Our files include photographs of the batch plant and other property at the S--- D--- location, which we understand is typical of the three facilities in question. The batch plant is a large mixing device which is used to combine cement, sand and gravel to form concrete. It is held above the ground by a frame of steel girders so that trucks can drive underneath it to receive the freshly mixed concrete. The frame is welded to steel plates which in turn are bolted to a concrete foundation.

The batch plant is connected to the material-handling system (which the staff regards as real property) by a large conveyor. The conveyor runs through a tunnel underneath bunkers where the sand and gravel are stored and continues up to the top of the batch plant where the materials are dumped into the mixer. The batch plant is also connected to the operations building by a metal catwalk which is welded both to the building and to the batch plant frame.

This plant and the one in C--- each weigh about 150 to 200 tons, but the one in E--- is somewhat smaller. According to petitioners, all three batch plants were intended to remain permanently in place until termination of the respective leases.

#### Analysis and Conclusions

Revenue and Taxation Code Section 6051 imposes tax on retail sales of tangible personal property in this state. Petitioners contend that the batch plants are real property, and thus not subject to tax, while the staff contends that they are tangible personal property.

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Both sides draw our attention to Sales and Use Tax Regulation 1596, which provides in relevant part:

“(a) The transfer of buildings or minerals or the like affixed to land is taxable as a sale of personal property if, pursuant to the contract or agreement of sale, the buildings or minerals or the like are to be severed by the seller thereof. If, pursuant to the contract or agreement of sale, such building or minerals or the like are to be severed by the purchaser thereof, such a transfer is not taxable as a sale of personal property.

\* \* \*

“(c) The transfer ‘in place’ of affixed fixtures, machinery and equipment, or draperies is taxable as a sale of personal property when removal of the fixtures, machinery or equipment, or draperies by the seller or purchaser is contemplated by the contract of sale. The transfer ‘in place’ of affixed fixtures, machinery and equipment, or draperies owned by a lessee of land or buildings to which those items are affixed, is also taxable as a sale of personal property when the lessee-seller has the present right to remove the items either as trade fixtures under Section 1019 of the Civil Code or under the express terms of the lease.”

Petitioners contend that the batch plants are “buildings...or the like” because of their size, manner of affixation to the realty, integration with other facilities and permanence of installation, and conclude that subdivision (a) of the regulation must apply. The staff contends that subdivision (c) applies because the batch plants are “machinery and equipment” used in manufacturing operations.

Petitioners also contend, in the alternative, that subdivision (c) of the regulation should not apply even if the batch plants are machinery and equipment. In support, they allege that they had no present “right” to remove the batch plants from the leased premises, but only an “obligation” to remove at the end of the lease term. Petitioners point out that the rental price at the E--- facility was potentially based on the amount of concrete sold, and argue that the lessor would therefore have objected if the batch plant had been removed. (Since the flat monthly rental price was higher than the alternative rental based on concrete sales, it seems unlikely that any such objection would have been forthcoming.)

We find it unnecessary to decide whether the batch plants are “buildings...or the like” under subdivision (a) of the regulation. Subdivision (a) applies only when property affixed to land is sold under a contract which contemplates severance from the land. The sales to MCC did not contemplate severance; subdivision (a) of the regulation is therefore irrelevant.

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We also find it unnecessary to decide whether the batch plants are machinery and equipment. If they are, their taxability depends on whether they are real or tangible personal property, which in turn will depend in part on petitioner's right to remove; if they are not machinery and equipment, their taxability will still depend on whether they are real or tangible personal property. The issue in either case is whether the batch plants are tangible personal property, and our analysis of that issue is the same regardless of whether subdivision (c) of the regulation does or does not apply.

In our view, the controlling authority is Standard Oil Co. v. State Bd. Of Equal., 232 Cal.App.2d 91. Plaintiff in that case purchased buildings, gasoline pumps and other property used in service station operations. The service stations were located on property which the vendor was leasing from a third party. All the property in question was transferred in place with no contemplation of severance. The Board classified the transaction as a sale and purchase of tangible personal property and the Court of Appeal agreed. The court stated:

“The nature of the use intended to be made of this property was made clear not only by the agreement between the seller and buyer but by their agreement with the owners of the leased properties. The equipment in the hands of the buyer -- notwithstanding its affixation -- was to be regarded at all times as personalty which the buyer could consume, remove, replace, and consume the replacement, etc., at its unrestrained will and pleasure. In other words, there was no distinction between the use to be made of this affixed equipment and the use of the unattached tools and equipment (i.e., wrenches, grease guns, etc.) of the service stations. The parties, by their express agreement, had just as effectively removed all possibility of classifying the equipment as real property (because of physical annexation) as though manual severance had taken place.” (232 Cal.App.2d at 96.)

As in Standard Oil, the items in question here were affixed to the land in a manner which might normally warrant their classification as improvements to realty. Also as in Standard Oil, however, the parties agreed that the “improvements” would remain the property of petitioners and would be removed from the premises upon termination of the leases. Thus, the parties “just as effectively removed all possibility of classifying the [batch plants] as real property...as though manual severance had taken place.” The batch plants are therefore tangible personal property and the sales are subject to tax.

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Recommendation

Redetermine without adjustment to the protested items.

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James E. Mahler, Senior Staff Counsel

3-24-92

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Date