

**STATE BOARD OF EQUALIZATION**

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July 7, 1981

Mr. W. S--- T---  
B---, P--- & H---  
--- --- Plaza  
--- ---, CA XXXXX

Re: Proposed Windplant Construction Contract

Dear Mr. T---:

This is response to your letters of May 14 and June 10, 1991 relative to the subject contract. You asked that we review the proposed transaction and render our opinion as to the potential sales and use tax consequences flowing from it.

Below is the description of the transaction taken from your letter of May 14 followed, first, by the three "rulings" which you request we make and, finally, by our comments.

U--- S--- W---, Inc. ("USW"), a Delaware corporation, proposed to enter into a construction contract with W--- P--- XXXX-X ("Partnership"), a Massachusetts limited partnership about to be formed. The general partner of Partnership will be a 100% owned subsidiary of USW. The limited partners will be individuals, many but not all of whom will be California residents. Not all of the limited partnership interests will have been sold at the time the contract is entered into.

The contract will call for the construction by USW for the Partnership of a Windplant on land located in Altamont Pass in Alameda County. The Windplant will be composed of approximately 100 interconnected windmills will generate electricity that will be sold to Pacific Gas & Electric Company. Each windmill will be composed of three major components: a windmill head (composed of a three-bladed rotor, axle, gear box, microprocessor control unit and electricity generator); a steel tower upon which the windmill head will sit; and transmission lines which connect the generator to an electricity collection station owned by USW to facilitate sales of the electricity to Pacific Gas & Electric Company. Enclosed as Exhibits A and B are diagrams of a windmill head and a complete windmill. Enclosed as Exhibit C is a draft of the construction contract agreement.

The windmill head will be partially assembled by USW at its facilities in Massachusetts and will be transported to the site by USW. The tower and lines will be constructed at the site by

subcontractors of USW with materials purchased in California from unrelated parties. The final assembly of windmill heads will take place at the site and will be installed on the towers by the subcontractors.

The land upon which the Windplant will be constructed is owned by an unrelated third party who has granted USW a renewable ten-year right to place windmills on his land. USW will in turn grant the Partnership a coextensive right to keep the Windplant on the land.

The Partnership will pay USW a lump-sum price of \$8,500,000 upon completion of the construction contract, composed of \$6,000,000 cash and a \$2,500,000 ten-year, nonrecourse promissory note. There is no established market for USW windmills and USW does not maintain a price list for windmill heads.

Based upon the foregoing we request the following rulings:

1. Sales or use tax liability will be imposed with respect to the acquisition by subcontractors of USW of the tangible personal property used in the construction of the towers and lines, measured by the cost of such property. However, no sales or use tax liability will be imposed with respect to the acquisition by USW or the Partnership of the tower and line portions of the Windplant. Property used in the constructions of the tower and line portions of the Windplant are property classified as "materials" used in a construction contract pursuant to Regulation 1521 (Construction Contractors).
2. Sales or use tax liability will not be imposed with respect to the acquisition by USW of the tangible property used in the assembly of the windmill head. The rotors, axle, gear box, microprocessor control unit and electricity generator, together with any encapsulating devices or materials, will be regarded collectively as a "fixture" under Regulation 1521 (Construction Contractors) and USW will be the retailer of the windmill head. Sales or use tax liability will be imposed with respect to the acquisition by the Partnership of the windmill head portion of the Windplant, measured by the following:
  - (1) Cost of materials, including such items as freight-in and import duties;
  - (2) Direct labor, including fringe benefits and payroll taxes;
  - (3) Specific factor/costs attributable to the windmill head;
  - (4) Any manufacturer's excise tax;
  - (5) Prorata share of all overhead attributable to the windmill head, including overhead attributable to manufacturing, selling, contracting, and administration

- (6) Reasonable profit from the manufacture and sale of the windmill head which shall be deemed to be 5 percent of the sum of the preceding factors; and
  - (7) Transportation costs from Massachusetts to the construction site. (See Regulation 1521.)
3. Sales or use tax liability will not be imposed with respect to the attachment of the windmill heads to the towers by the subcontractors of USW.

In our view, your "ruling" 1 correctly states the application of the Sales and Use Tax Law. The components utilized in constructing the towers on site as well as the powerlines will be treated as "materials" and tax will be due from the subcontractors who furnish and install these items based on cost (Reg. [b] [2] [A]1).

We agree, generally with your "ruling" 2 but further comments are necessary. While we would consider the windmill head and its components as "fixtures," it should be stated that your suggested method of measuring the tax is acceptable only if, in fact, the sales price cannot be determined based on sales to other contractors or based on amounts stated in price lists, bid sheets or other records of USW. Also, assuming your suggested method of computing the tax is the method used, "ruling" 2, item (6), should read: "Reasonable profit from the manufacture and sale of the windmill head which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors. Finally, it should be pointed out that jobsite fabrication, labor and its prorated share of manufacturing overhead must be included in the sale price of the fixture. As indicated in Regulation 1521, such labor includes pre-attachment assembly labor.

"Ruling" 3 correctly states the application of the Sales and Use Tax Law.

We hope this has answers your questions. If it has not or if further assistance is required, please contact us.

Very truly yours,

Les Sorensen  
Tax Counsel

LS:po