STATE BOARD OF EQUALIZATION
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January 3, 1991

Mr. T--- H---
D--- & T---
XXXX --- Boulevard
--- ---, California XXXXX-XXXX

RE: Q--- L--- P---, Inc.
SR -- XX-XXXXXX

Dear Mr. H---:

This is in response to your letter dated December 4, 1990 regarding whether certain items of machinery qualify as real estate under Regulation 1596(c).

Your client, Q--- L--- P---, Inc., operates a manufacturing plant. Q--- leased the building and owned the subject pieces of machinery. Q--- sold its assets. If the machinery qualifies as real estate, no sales tax will apply to that sale. If the machinery constitutes tangible personal property, sales tax will apply to Q---'s sale of that property.

You argue that under Regulation 1596(c) machinery and equipment permanently attached to real property are also regarded as real property unless the lease agreement for the real property specifically provides that the lessee has the right to remove the items. This is not entirely accurate. Actually, subdivision (c) states that the transfer in place of machinery and equipment owned by a lessee of land or buildings to which those items are affixed is 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. Civil Code section 1019 provides that a tenant may remove anything affixed to the leased premises for the purposes of trade or manufacture if the removal can be effected without injury to the premises, unless the thing has, by the manner in which it is affixed, become an integral part of the premises.

You state that Q--- is forbidden by the lease from removing machinery and equipment if that removal will result in damage to the building. Actually, paragraph 7.5(d) provides that Q---'s machinery and equipment, other than that which is affixed to the premises so that it cannot be removed without material damage to the premises, shall remain the property of Q--- and may be removed by Q--- subject to the provision of paragraph 7.2. Paragraph 7.5(a) provides that the lessor may require Q--- to remove any improvements at the end of the lease term, including machinery and

equipment, and restore the premises to their prior condition. Paragraph 7.2 provides that Q--- shall repair any damage to the premise occasioned by its installation or removal of Q---'s trade fixtures, furnishings and equipment.

Under the provisions of the lease, the lessor may require Q--- to remove any machinery and equipment Q--- installed. Q--- has the right to remove any such machinery and equipment, even if the lessor does not elect to require Q--- to do so, provided it repairs any damage done in removing that property.

One of the items in question is a cartsch treating tower which comprises four main components: the treating tower, a rooftop combustion pollution control system, three resin mixing tanks, and four resin storage tanks. You note that the tower is three stories tall and was installed in a two story building by removing the roof. A corrugated steel enclosure was added to enclose the hole in the roof. Under the lease provisions, it is clear that the lessor may require Q--- to remove that tower and replace the roof. Even if Q--- were to remove the tower and replace the steel enclosure, it appears that Q--- would be able to do this without further damage to the roof. In order for this machinery and equipment to be regarded as part of the real estate, you must establish that it is not possible to remove that machinery and equipment without material damage to the real estate. Since almost anything can be repaired, this is a very heavy burden. Further, under the lease you have provided, the lessor has reserved the right to require Q--- to remove the subject property, notwithstanding any damage that removal may cause and then repair the damage.

The tower and some of the other items in question apparently are interconnected by plumbing and electrical wiring. A pollution control unit is mounted on the roof. The other items are permanently attached to the floor. You conclude that based upon the size and connections of these items to the building, that they meet the requirements of being permanently affixed to real property and qualify for the exemption from sales tax (that is, you believe that they are no longer regarded as personal property). However, as noted above, attachment to real estate is not sufficient. In effect, what is required for items otherwise regarded as machinery and equipment to be regarded as real estate is that ownership of those items is transferred to the owner of the underlying real estate. That is, if the lessee may not remove the machinery and equipment at the end of the lease term and must leave those items for the lessor, the lessor effectively owns those items. In this case, it appears ownership was not transferred to the lessor under the terms of the lease.

Since the subject items are not regarded as real estate under subdivision (c) of Regulation 1596 we must refer to the general rules of Regulation 1521. Most of the items that you list are regarded as fixtures or machinery and equipment under appendices B and C of Regulation 1521. We note that the treating tower might be composed of items regarded as materials and it may be regarded as part of the real estate notwithstanding any right of Q--- to remove it. For example, if the tower were solely comprised of sheet metal, the tower itself might be regarded as materials when it is attached to real property. (See Regulation 1521, appendix A.) However, you state that the tower is a piece of machinery for treating laminates, and based on this description it appears that we must regard the tower as machinery.

If you have further questions, feel free to write again. If you wish to discuss this particular issue further, we strongly recommend that you send detailed photographs of the items in question individually and in the context of the entire plant.

Sincerely,

David H. Levine
Senior Tax Counsel

DHL:cs