

**STATE BOARD OF EQUALIZATION**

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November 4, 1986

Mr. D--- S. F---
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Dear Mr. F---:

Your letter of September 22, 1986 addressed to Mr. Gary Jugum of this office has been referred to me for a response. You write to us on behalf of your client, U---S--- W---, Inc. ("USW") requesting a legal opinion regarding the application of Sales and Use Tax Law to the lease of wind power facilities. The facts, as set forth in your letter, are as follows:

Facts: USW will be constructing wind power facilities for investors pursuant to construction contracts. Rights to the underlying realty will be passed along to the investors.

USW has acquired long-term wind rights, land use agreements on the underlying realty for the wind power facilities. These land use agreements, which are denominated easements, give USW the exclusive right to develop the commercial wind resources for time periods varying from thirty years to perpetuity and do not allow the landowners to develop the wind resources on the properties nor to undertake any activities which impair the value of the properties' wind resources. Although labeled easements, the documents

substantively describe long-term leases of the properties to USW for the development of all the wind resources on the properties.

At the time USW constructs a wind facility, USW assigns a portion of land use agreement to the owner of the particular wind facility for a time period equal to the expected useful life of the wind facility (as determined both at the time of construction and ten years from the date of completion). Under the terms of the assignment, the owner of the wind facility undertakes to perform all of the obligations of USW under the land use agreements to the extent the obligations relate to the owner's wind facility. The assignments are accomplished either through subleases, subeasements, partial assignments or license agreements, each of which gives the wind facility owner exclusive rights to the property to the extent of the boundaries of the wind facility, and non-exclusive access rights to the property.

The owners of a wind facility allow the use of the property by a lessee of the wind facility to the extent necessary to allow the lessee to operate its wind facility. The lessee may further assign, to any sublessee of the wind facility, full rights to the use of the property to generate wind resources.

Analysis

In the above described factual situation, USW enters into a construction contract with an investor or investment group to build a wind power facility. The wind power facility is constructed on property leased by USW and subleased to the investor or investment group. The owner of the wind power facility leased the wind power facility to a lessee and subleases the interest in real property to the lessee of the wind power facility. You request an opinion as to whether tax would be due and payable on the lease between the owner of the wind power facility and their lessee.

As stated in your letter, under a construction contract materials and fixtures are transformed into real property (Regulation 1521, Cal. Admin. Code, Title 18). Generally, construction contractors are considered to be consumers of materials which they furnish and install in the performance of a construction contract (Regulation 1521(b)(2)(A)(1)). Construction contractors are generally considered to be retailers of fixtures (Regulation 1521(b)(2)(B)(1)). As correctly stated in your letter a wind power facility contains no "machinery or equipment", as defined by Regulation 1521(a)(6). The components of the supporting tower are considered to be materials and the only fixture is the wind turbine head (Sales and Use Tax Annotation 190.1420 and Regulation 1521, Appendix B).

Under certain circumstances tangible personal property which becomes affixed to real property will be regarded as tangible personal property rather than real property. Revenue and Taxation Code Section 6016.3 provides as follows:

Leased fixtures. “Tangible personal property,” for the purpose of this part, includes any leased fixtures if the lessor has the right to remove the fixtures upon breach or termination of the lease, unless the lessor is also the lessor of the realty (emphasis added).

As stated above, construction contractors are generally retailers of fixtures and sales tax is due on the sale of the fixtures. Regulation 1521(b)(2)(B)(3) allows a construction contractor to accept a resale certificate in a situation in which the construction contractor installs a fixture for a person, other than the owner of the realty, who intends to lease the fixture in place as tangible personal property as provided in Section 6016.3 of the Revenue and Taxation Code.

The principle question for our review is whether the lease of the wind power facility constitutes a taxable lease of tangible personal property or a non-taxable lease of real property. The last sentence of Revenue and Taxation Code Section 6016.3 provides, in effect, that a lease of a fixture shall be regarded as a lease of real property if the lessor of the fixture is also the lessor of the realty. Under the given facts, in which the lessor of the fixture is also the “sublessor” of the realty, the question then becomes whether the term “lessor” may be interpreted to include “sublessor”.

We conclude that the correct interpretation of section 6016.3 defines “lessor” so as to include “sublessor”. The apparent intent of the statute is to tax as a lease of tangible personal property fixtures which are likely to be severed from the real property upon a default under the lease. The lease of an interest in real property, together with a lease of the fixture will more likely result in the fixture remaining attached to the realty in the event of a default. Hence, a lease of a fixture by a lessor who holds a mere leasehold interest in the real property may be treated the same as a lessor with a fee ownership in the realty, in that in both instances the fixture is less likely to be severed from the realty in the event of a default on the lease.

If we follow the interpretation that “lessor” is intended to include sublessors, then the lease of the fixture together with the sublease of the realty will be a lease of real property, which is excluded from sales and use tax. Sales tax, however, would be due and payable on the sale of the fixture by the construction contractor. The construction contractor would not be able to accept a resale certificate from his customer since the lease of the fixture would not constitute a lease of tangible personal property as provided in Section 6016.3 (Regulation 1521(b)(2)(B)(3)).

Following the above described interpretation of Revenue and Taxation Code Section 6016.3, sales tax would be due and payable by USW on the sale of the fixtures, the wind turbine heads. USW could not accept in good faith a resale certificate from their customer since pursuant to Revenue and Taxation Code Section 6016.3 the wind power facility does not constitute

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tangible personal property. It follows therefore that the lease of the wind power facility is not subject to sales or use tax.

If you have any questions concerning this matter, please contact us again.

Sincerely,

Teresa Armstrong
Legal Counsel

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