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BEFORE THE INTERPRETATION AND APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For A Prior Determination of Tax Liability of . . .	)	D E T E R M I N A T I O N No. 88-342 Registration No. . . .

[1] **RULE 130:** RETAIL SALES TAX -- INCLUSION -- REALTY -- PERSONALTY -- DISTINCTION. The Department follows the common law rules for determining whether an item is realty or personalty. Lipsett Steel, Inc. v. King County, 67 Wn.2d 650, 409 P.2d 475 (1965). The three key factors are (1) actual annexation, (2) application to use or purpose, and (3) intention to make a permanent part of the realty.

[2] **RULE 130:** RETAIL SALES TAX -- INCLUSION -- REALTY -- PERSONALTY -- INTENTION. The most important factor is the intention of the parties. In this case, the lessor made improvements to real property owned by the lessee. The lease agreement provided that the improvements are to be removed at the expiration or termination of the lease and that the improvements are at all times to be considered personal property. Held: the intention of the parties was not to make the improvements a permanent part of the real estate.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

NATURE OF ACTION:

The taxpayer requested a ruling on whether the retail sales tax applied to the lease of a potato storage facility. The

facility was permanently affixed to real property owned by the lessee.

FACTS AND ISSUES:

Mastrodonato, A.L.J. -- . . . (taxpayer) has requested that the Department of Revenue issue an opinion as to whether or not payments received by it in connection with the lease of a potato storage facility (the "facility") will be subject to retail sales tax as rental for the lease of personal property. The taxpayer's request was made pursuant to WAC 458-20-100(18) and this Determination responds to that request. The following represents the facts pertinent to the issue presented and a brief statement as to the taxpayer's views concerning the application of the law.

The taxpayer is a Washington corporation and has its primary place of business in . . . County, Washington. Its principal business involves the sale of grain and other agricultural products.

In July 1987, the taxpayer was approached by [A] and [B], d/b/a [C] (lessee), to provide financing for the construction of a potato storage facility to be located upon real property owned by [A] and [B], d/b/a [C]. The facility would also be used by [C] for the storage of potatoes and other crops.

The taxpayer agreed to finance and construct the facility on property owned by [C] on the understanding that [C] would lease the facility from [taxpayer] for a minimum of seven years.

Under the lease agreement, the lessee has the right at the expiration of the term of the lease to purchase the facility for cash at a price equal to the fair market value of the facility. The facility itself is a storage building of frame construction on concrete foundation. Notwithstanding the apparent permanency of the structure, the following paragraphs appear in the Lease Agreement:

> 9. Surrender: Upon the expiration or earlier termination of any Lease term without renewal, the Lessee will surrender the Facility in good condition except for normal wear and tear. The Facility must be returned within five (5) days of the expiration of the term, in the following manner as may be specified by Lessor:

(a) By dismantling and arranging for the removal of the Facility at the Lessee's sole cost and expense, to such location as Lessor shall specify within . . . County, Washington; or

(b) By leasing to the Lessor the real property upon which the Facility is situated and the immediate acreage for which the same is used, based upon the fair rental value of said property as determined by the appraiser as designated in Section 22 hereof for the remaining useful life of the Facility, not be exceed fifteen years.

. . .

20. PERSONAL PROPERTY: The Facility is, and shall at all times be and remain, personal property notwithstanding that the Facility, or a part thereof, may now be, or hereafter become, in any manner affixed or attached to, or imbedded in, or permanently resting upon, real property, or attached in any manner to what is permanent as by means of cement, plaster, nails, bolts, screws or otherwise.

A copy of the lease agreement between [C] and [taxpayer] was provided to the Department for its review and is incorporated herein by this reference.

The taxpayer advised the principal contractor, subcontractors, and material suppliers involved in the construction of the facility that the materials were for lease and/or resale and, accordingly, that the taxpayer should not be required to pay retail sales tax on materials supplied by the material suppliers or work supplied by the contractor and subcontractors.

However, the general contractor sought an informal opinion from the Mount Vernon office of the Department of Revenue. A local auditor of the Department advised the general contractor that it should be collecting the retail sales tax on the contract amount and that it was his opinion after reviewing the lease agreement that the facility constituted real property as opposed to tangible personal property, and therefore any amounts as rental for the facility by [taxpayer] should be exempt from the application of the retail sales tax and/or use tax. The analysis of the local Department of Revenue auditor was apparently based on the fact that the

facility would be affixed to the real estate owned by [C] and would therefore constitute real property in the hands of [C].

The taxpayer is willing to accept the analysis of the local auditor to the effect that rentals received under the lease agreement between the taxpayer and [C] represent real estate rentals and, accordingly, are exempt from retail sales tax. However, the taxpayer is concerned that the Department of Revenue may, upon subsequent audit or examination, take a position inconsistent with the informal opinion offered by the local auditor and assert that payments received under the lease are subject to a retail sales tax or use tax. The taxpayer is further concerned that, if this were to occur after the period for filing a claim for refund has expired, the taxpayer and the contractors and material suppliers to whom it paid retail sales tax would be without the right to make a claim for refund of the retail sales tax paid.

Therefore, the taxpayer now seeks a formal ruling from the Department of Revenue on the issue of whether the facility in question is real or personal property.

DISCUSSION:

At the onset, we note the taxpayer is correct in its understanding that if the facility is real property, the lease payments would not be subject to retail sales tax. See RCW 82.04.050(2)(e); see also, RCW 82.04.390 for an exemption from the business and occupation (B&O) tax for the "gross proceeds derived from the sale [or lease] of real estate." In any event, our analysis of this transaction is set forth in detail below.

[1] The Department of Revenue follows the general common law principals of law relating to the characterization of improvements or additions to real estate. Those principals are enunciated in Lipsett Steel Products, Inc. v. King County, 67 Wn.2d 650, 409 P.2d 475 (1965) and Department of Revenue v. Boeing Co., 85 Wn.2d 663, 538 P.2d 505 (1975). In these cases, the court quoted the rule in Foreman v. Columbia Theater Co., 20 Wn.2d 685, 695, 148 P.2d 951 (1944), which stated:

> The true criterion of a fixture is the united application of these requisites: (1) Actual annexation to the realty, or something appurtenant thereto; (2) application to the use or purpose to which that part of the realty with which it is

> connected is appropriated; and (3) the intention of the party making the annexation to make a permanent accession to the freehold.

In reviewing these factors, there is no question in our mind that the taxpayer has satisfied requirements (1) and (2) above. The potato storage facility has a concrete foundation and frame construction, and is actually affixed to the realty. Furthermore, the facility is used for potato and other crop storage, incident to a farming operation. However, according to the common law and case law development, whether an item is a personal property turns upon the application of the three general tests (quoted above), all of which must be satisfied. Western Ag Land Partners v. Department of Revenue, 43 Wn.App. 167 (1986).

[2] In ascertaining whether or not improvements to land have become, in legal contemplation, a part of the realty to which they are annexed, the intention of the parties may be the dominant factor or determinant. Lipsett Steel, supra, at page 652; Western Ag Land, Supra, at page 173. Intention is determined

> from the circumstances surrounding the annexation, including the nature of the article affixed, the annexor's situation in relation to the freehold, the manner of annexation, and the purpose for which it was made. The test is objective rather than subjective intent.

Liberty Lk. Sewer Dist. v. Liberty Lk. Utils. Co., 37 Wn.App. 809, 813, 683 P.2d 1117 (1984). Furthermore, it has been held that when a property owner attaches an article to the land, the owner is rebuttably presumed to have annexed it with the intention of enriching the freehold. Nearhoff v. Rucker, 156 Wash. 621, 628, 287 P.2d 658 (1930); Hall v. Dare, 142 Wash. 222, 227, 252 P. 926, 50 A.L.R. 635 (1927).

Nevertheless, the presumption that the item becomes realty is rebuttable. In this case, the lease agreement clearly indicates that the taxpayer, the lessor, was leasing tangible personal property to [C], the lessee, and that the property must be returned to the lessor at the expiration of the term of the lease. The lease agreement unequivocally provides that upon an expiration or earlier termination of the lease without renewal, the lessee is required to surrender the facility in good condition and return the facility within five days by dismantling and arranging for the removal of the facility at

lessee's cost and expense. Lease Agreement, paragraph 9, page 2. Furthermore, the agreement specifically provides that, at all times, the facility is personal property "notwithstanding that the Facility, or a part thereof, may now be, or hereafter become, in any manner affixed or attached to, or imbedded in, or permanently resting upon, real property, ..." Lease Agreement, paragraph 20, page 4.

There is no doubt that it may take great expense and difficulty in removing the facility, given the apparent permanency of the affixation of the facility to the land. Nevertheless, the parties have explicitly agreed that the facility is intended to be personal property. In applying the common law principals of law quoted above, it is apparent that the requisite intention to make the facility "a permanent accession to the freehold," Lipsett Steel, supra, is lacking. Hence, our conclusion is that the property involved is personalty, not realty, and therefore the retail sales tax applies to the lease payments made to the lessor by the lessee.

It is our understanding that the taxpayer was previously advised to pay sales tax to the contractor, subcontractors, and material suppliers. This advice was in error. Since the item in question is personal property for resale by lease thereof, the taxpayer was eligible to give, and should have given, resale certificates pursuant to WAC 458-20-102 (Rule 102), and should be collecting retail sales tax from the lessee (and paying Retailing B&O tax) on the lease payments.

To correct this error, the taxpayer should now give its contractors and suppliers resale certificates, and obtain refunds of the sales tax paid to those businesses. The taxpayer should also collect sales tax from the lessee effective from the inception of the Lease Agreement, and pay the business and occupation (B&O) tax under the Retailing classification on the gross proceeds from the lease of the facility.

This legal opinion may be relied upon for reporting purposes and as support of the reporting method in the event of an audit. This ruling is issued pursuant to WAC 458-20-100(18) and is based upon only the facts that were disclosed by the taxpayer. In this regard, the Department has no obligation to ascertain whether the taxpayer has revealed all of the relevant facts or whether the facts disclosed are actually true. This legal opinion shall bind this taxpayer and the Department upon these facts. However, it shall not be binding

if there are relevant facts which are in existence but have not been disclosed at the time this opinion was issued; if, subsequently, the disclosed facts are ultimately determined to be false; or if the facts as disclosed subsequently change and no new opinion has been issued which takes into consideration those changes. This opinion may be rescinded or revoked in the future, however, any such rescission or revocation shall not affect prior liability and shall have a prospective application only.

DECISION AND DISPOSITION:

In conclusion, it is the opinion of the Department of Revenue that the facility in question is personal property, and the taxpayer's tax liability should be reported in accordance with the instructions contained herein.

DATED this 26th day of August 1988.