OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	OTA Case No. 20116890
	CDTFA Case ID 776-106
USA HOIST COMPANY, INC.	

OPINION

Representing the Parties:

For Appellant:	Samantha K. Breslow, Attorney Jeffrey B. Svehla, Attorney
For Respondent:	Jarrett Noble, Attorney Cary Huxsoll, Attorney Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Corin Saxton, Attorney

A. WONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, USA Hoist Company, Inc. (appellant) appeals respondent California Department of Tax and Fee Administration's (CDTFA's) decision denying appellant's petition for redetermination of a Notice of Determination (NOD) dated December 18, 2018.[1] The NOD is for a tax liability of $280,658, plus applicable interest, for the period January 1, 2013, through March 31, 2016 (liability period).[2]

Office of Tax Appeals (OTA) Administrative Law Judges Andrew Wong, Suzanne B. Brown, and Josh Aldrich held an oral hearing for this matter in Cerritos, California, on March 12, 2024. At the conclusion of the hearing, the record was closed and the parties submitted this matter for an Opinion.

[1] The State Board of Equalization (BOE) formerly administered sales and use taxes. On July 1, 2017, BOE functions relevant to this case transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to events that occurred before July 1, 2017, "CDTFA" refers to BOE.

[2] CDTFA timely issued the NOD because appellant waived the otherwise applicable three-year statute of limitations and extended the NOD-issuance deadline to January 31, 2019. (See R&TC, §§ 6487(a), 6488.)

ISSUE

Whether appellant has shown that adjustments are warranted to the determined measure of tax.

FACTUAL FINDINGS

1. Hoists are temporary external elevators that are attached to the sides of buildings/structures, which are being constructed, demolished, or renovated. They transport people and materials up and down such buildings/structures. The hoists at issue are controlled by an operator whose role requires skilled labor and specialized training. The pool of available hoist operators is limited.
2. Appellant, an Illinois corporation, served as a subcontractor providing hoists to general contractors for construction projects in several states, including California.[3] For some construction projects, in addition to hoists, appellant provided hoist operators, who were appellant's employees. Due to union requirements, many of appellant's general contractor customers used appellant's union-member operators because they did not have access to another operator who was a member of the union.
3. During the liability period, appellant entered into 13 agreements to provide hoists. At issue here are subcontracts between appellant and its general contractor customers for the following five projects in the Los Angeles area:
    a. Wilshire Towers Renovation;
    b. 1801 Avenue of the Stars Demolition;
    c. Wilshire Grand Hotel Demolition;
    d. Masonic Temple Renovation; and
    e. Wilshire Grand Hotel Shoring/Excavation.
4. The subcontract documents for the Wilshire Towers Renovation, the 1801 Avenue of the Stars Demolition, and the Wilshire Grand Hotel Demolition projects included agreements entitled either "USA HOIST LEASE AGREEMENT" or "CONSTRUCTION HOIST INSTALLATION AND RENTAL AGREEMENT." These agreements are substantially similar. They provided for the "lease" of construction hoist equipment by appellant to a

[3] Appellant also sold elevators, but this aspect of its business is not at issue here.

general contractor (sometimes described as a "lessee") and included the following relevant provisions:

a. Hoist Operators: the general contractor was responsible for providing a hoist operator at its own expense during the period of the hoist's erection/installation, jumps, dismantling, service, and maintenance. Another provision stated that, apart from these times, the general contractor would employ at its own expense "competent personnel to operate the equipment" (i.e., the hoist).[4]

b. Maintenance and Repair of Hoist Equipment: for a monthly maintenance fee, appellant would be responsible for routine preventative maintenance of the hoist equipment as well as repairs necessitated by ordinary wear and tear; however, damage to the hoist equipment caused by anyone other than appellant was the responsibility of the general contractor.

c. Insurance for Hoist Equipment: the general contractor was responsible for insuring the hoist equipment against the risk of loss or damage from any cause.

d. Safety/Control of Hoist Equipment: the general contractor was responsible for operating and using the equipment in accordance with applicable standards and laws.

5. The subcontract agreement for the Masonic Temple Renovation project stated that appellant would provide, furnish, and install a "man lift" for a "rental period" of six months and included the following relevant provisions:

a. Hoist Operators: a hoist operator was specifically excluded from the subcontract agreement; at the general contractor's "sole option," appellant could provide a qualified operator for an hourly price.

b. Maintenance and Repair of Hoist Equipment: for a monthly fee, appellant would be responsible for monthly full service and preventative maintenance of the hoist equipment as well as service and repair requests.

6. The subcontract agreement for the Wilshire Grand Hotel Shoring/Excavation project provided for the "rental" of seven hoists by appellant to a general contractor, and included the following relevant provisions:

[4] Appellant's subcontracts for the Wilshire Towers Renovation and the 1801 Avenue of the Stars Demolition also had provisions that specifically excluded from appellant's scope of work a hoist operator.

a. Hoist Operators: appellant would provide a hoist operator during the erection, jumping, and dismantling of the hoist. However, the agreement was silent as to who would be responsible for providing hoist operators during the hoist "rental" period. According to an email exchange between appellant and the general contractor for this project, appellant communicated that it wanted to include in the agreement charges for hoist operators on a time and material basis per an attached rate sheet. The general contractor replied that it agreed to the labor rates in principle but with the caveat that the labor rates would have to be formally submitted to the owner of the project for approval at the time of billing.

b. Key Personnel: the general contractor must approve "key personnel" assigned to the project, and such personnel could not be removed without the general contractor's prior written approval. The contract did not define the term "key personnel."

c. Maintenance of Hoists: "All hoist maintenance, not repairs, shall be on overtime at [appellant's] expense." Further, appellant would "[a]ssume maintenance for hoist complexes that are operational six (6) days per week."

d. Repair of Hoists: appellant would be responsible for repairs.

7. During the liability period, along with hoists, appellant provided ancillary property for various projects (including the five referenced above). At issue here are six types of ancillary property: (a) communication systems; (b) tie-in attachments; (c) grillage; (d) enclosures; (e) floor gates; and (f) jump-tower extensions.

a. Communication Systems: these included callboxes, which allowed the hoist operator to communicate with the base and floors of the building, and wires, which connected the callboxes and ran along the sides of the hoists from the different floors to the base.[5]

[5] As relevant here, appellant purchased and paid sales tax reimbursement for the following 10 communication-system-related items that appellant provided to its customers: (1) an $860.05 battery/signal connector; (2) a $1,302.14 relay cable; (3) an $11,384.46 comm unit/relay cable; (4) an $11,566.44 relay cable/comm unit; (5) an $874.16 relay cable; (6) a $177.36 two-way splitter cable; (7) a $711.34 relay cable; (8) a $489.74 signal capacitor; (9) a $676 EMI inline filter/split toroid; and (10) a $3,078 material communication unit.

Included on two invoices for the communication system items appellant purchased were "invoice balance" charges of $6.59 and $4.39. It is unclear to OTA what these charges were for. For this reason and because the amounts are minimal, OTA will not discuss these "invoice balance" charges further.

b. Tie-In Attachments: these are metal or steel anchors that attach the hoist tower to the building during construction and allow the cage of the hoists to be positioned at a maximum height.[6] With respect to the tie-in attachments at issue, appellant purchased the following three items: (1) a $2,359 tie-in bracket/landing; (2) a $2,917 tower bracket; and (3) $16,503.24 worth of material brackets/tie-ins/spacers. Appellant did not pay any taxes with respect to the first two purchases but did pay Illinois tax at a 7.23 percent rate with respect to the third purchase.[7]

c. Grillage: these are steel I-beams that appellant assembled on site with bolts. Grillage sat directly underneath the hoist tower during construction and spread the weight of the tower, hoist, and load, allowing the hoist to move more easily. As relevant here, there were no separate installation charges for grillage.

d. Floor Gates: these are metal or steel gates that lined the edges of the floors of buildings during construction and allowed the operator, individuals, and material to enter the hoist. As relevant here, there were separate installation charges for floor gates.

e. Enclosures: these are plywood or sheet metal walls on each side of a floor gate. They prevented falls from the building and protected persons or items near the edge of a floor from being struck by a hoist cage as it traveled up and down the side of a building/structure. As relevant here, there were no separate installation charges for enclosures.

f. Jump-Tower Extensions (i.e., "Tower Extensions (Jumps)" per some agreements): these are metal or steel scaffolding that increased the height of the hoist. "Jumping" is the action of adding tower sections to the existing hoist, allowing the hoist to reach additional floors of the building as it was being constructed.[8]

[6] For example, if the building slants are not flush with the travel of the hoist, additional installation is required using the tie-in attachments.

[7] At the time of appellant's third purchase (May 9, 2013), the California sales tax rate was 7.50 percent (excluding district taxes). (See https://www.cdtfa.ca.gov/taxes-and-fees/sales-use-tax-rates-history.htm.)

[8] During the oral hearing, appellant compared the action of "jumping" or adding tower sections to stacking LEGO bricks.

8. For the liability period, appellant reported total sales of $11,985,097 and taxable sales of $1,703,593, claiming deductions of $10,254,761 for nontaxable sales of labor, as well as for tax included in gross receipts of $26,743.
9. Upon audit, appellant provided its sales journal, invoices, and agreements for the liability period. In total, CDTFA reviewed 13 agreements whose projects lasted from two to 27 months.
10. Using appellant's sales journal and invoices, CDTFA identified charges totaling $8,576,183 for "leases" of hoist systems provided during the liability period. CDTFA found that while appellant generally provided an operator, most of the "rental" agreements either specifically excluded the operator from appellant's scope of work or stated that appellant's customers would be responsible for providing their own operators. CDTFA thus concluded that appellant's operators were optional, and that the agreements constituted taxable leases rather than nontaxable service contracts.
11. CDTFA also treated appellant's provision of the ancillary property as taxable leases of tangible personal property that were part of, or related to, appellant's hoist rentals.
12. After making allowances for nontaxable delivery, installation of the hoist and related parts (including communication systems, floor gates, and enclosures),[9] and optional maintenance charges, CDTFA identified taxable hoist rental charges of $4,037,185. Based on a comparison of audited taxable hoist rental charges of $4,037,185 to reported taxable sales of $1,703,593, CDTFA computed a deficiency measure of $2,333,592 for unreported taxable leases of hoists.[10]
13. On December 17, 2018, based on its audit findings, CDTFA issued the NOD to appellant.
14. Appellant filed a timely petition for redetermination disputing the deficiency measure for unreported taxable leases of hoists.

[9] CDTFA also identified nontaxable charges for "engineering" on the basis that these charges related to installation.

[10] In addition to the deficiency measure of $2,333,592 for unreported taxable leases of hoists, CDTFA's audit also identified the following four audit items: (1) a tax paid purchases resold credit of $6,569; (2) a credit of $3,300 based on the difference between recorded sales tax reimbursement and reported sales tax; (3) a deficiency measure of $778,000 for unreported taxable sales of elevators; and (4) a deficiency measure of $54,223 for unreported purchases subject to use tax. Only the deficiency measure of $2,333,592 for unreported taxable leases of hoists is in dispute.

15. On October 1, 2020, CDTFA issued a decision denying the petition. In its decision, CDTFA concluded that appellant's rental charges for the communication systems were taxable because appellant did not lease the communication systems in substantially the same form as acquired. Specifically, CDTFA found that appellant had cut the wires connecting the callboxes to configure the communication systems to its customers' needs. Further, CDTFA found that the communication systems increased the functional capabilities of the hoists by allowing them to be used at higher levels.
16. This timely appeal followed.

DISCUSSION

California imposes on all retailers a sales tax measured by the retailer's gross receipts from the retail sale of tangible personal property sold in this state, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.)

It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)1).) If CDTFA is not satisfied with the tax returns or the amount of tax required to be paid to the state by any person, or if any person fails to make a return, then CDTFA may determine or estimate the amount required to be paid on the basis of any information within its possession or that may come into its possession. (R&TC, §§ 6481, 6511.)

Hoists + Operator: Taxable Lease of Equipment or Non-Taxable Service Agreement?

For purposes of the Sales and Use Tax Law, a taxable "sale" or "purchase" in this state generally includes any lease of tangible personal property in any manner or by any means whatsoever, for consideration. (R&TC, §§ 6006(e), 6010(e).) The tax applicable to leases is a use tax upon the lessee's use of the property in this state as measured by the rentals payable, and the lessor is required to collect the use tax from the lessee and pay it to the state. (Cal. Code Regs., tit. 18, § 1660(c)(1).) Where there is no lease, the grantor of the privilege to use the property (i.e., the owner of the property) consumes it and tax applies to the sale of the property to him or her, measured by the purchase price. (Cal. Code Regs., tit. 18 § 1660(e)(4).)

A "lease" is a granting of temporary possession of tangible personal property by a lessor to a lessee for a consideration. (R&TC, §§ 6006.1, 6006.3.) A "lease" includes a rental, hire, and license (R&TC, § 6006.3), as well as "a contract under which a person secures for a consideration the temporary use of tangible personal property" that "is operated by, or under the direction and control of, the person or his or her employees" (Cal. Code Regs., tit. 18, § 1660(a)(1)). Unless otherwise exempt, a lease of tangible personal property is a continuing sale and purchase for the duration of the lease. (R&TC, §§ 6006.1, 6010.1; Cal. Code Regs., tit. 18, § 1660(b)(1).)

The chief characteristic of a lease is the transfer of possession and control over the leased property to the lessee. (*Entremont v. Whitsell* (1939) 13 Cal.2d 290, 295 (*Entremont*).) If possession and control are not transferred, then the transaction is not a lease. (*Ibid*.) In the *Entremont* case, an individual named Entremont, pursuant to a contract, provided three dump trucks, with drivers, to the State Department of Public Works (department) for the transportation of materials for the repair of highways. (*Id*. at 292-293.) The *Entremont* court determined that the contract was not a lease of equipment to the department but a service contract because, according to the contract, possession and control of the trucks and their drivers did not pass from Entremont to the department. (*Id.* at 295.) In reaching this conclusion, the court relied on contractual provisions indicating that the department did not have the power to select and discharge the drivers—a factor of "some importance" in ascertaining who controlled them. (*Ibid*.) The court also found that other provisions of the contract indicated that the department did not exercise exclusive control over the drivers and that possession of the trucks and control of the drivers remained with Entremont. Such provisions required Entremont to maintain and repair the trucks at his expense; to supply all oil, gas, and other materials necessary for the trucks' operation; and to carry compensation insurance on the drivers. (*Ibid*.) The contract also expressly provided that the drivers were Entremont's employees. (*Ibid*.) Finally, per the contract, Entremont assumed all responsibility for damage or injury to other persons or property because of the operation of the trucks. (*Ibid*.) The court found that this last provision "strongly implied" that Entremont did not confer exclusive control of the trucks on the department. (*Ibid*.)

Here, there are five subcontracts at issue. The subcontracts for the Wilshire Towers Renovation, the 1801 Avenue of the Stars Demolition, and the Wilshire Grand Hotel Demolition projects framed themselves as leases/rentals of hoists and placed the responsibility for the hoists'

maintenance/repair, insurance, and safe operation on appellant's general contractor customers, not on appellant. Critically, these agreements also stated that the general contractors were responsible for providing their own hoist operators at their own expense, indicating that the general contractors had the power to select and discharge the hoist operators and, thus, could exercise ultimate control over them and the hoists. Together, these contractual provisions strongly indicate that, with respect to these three projects, appellant conferred exclusive control of the hoists on its general contractor customers. Thus, OTA concludes that these three subcontracts were taxable leases.

The subcontract agreement for the Masonic Temple Renovation project also framed itself as an agreement for the "rental" of a "man lift," and specifically excluded an operator from the agreement's scope. This agreement went on to provide the general contractor with the sole option to have appellant provide a qualified operator for an hourly price. Together, these contractual terms indicate that the general contractor alone had the power to select an operator, which in turn supports a finding that appellant conferred exclusive possession and control of the "man lift" to its general contractor customer. Thus, OTA concludes that this subcontract was also a taxable lease.

The subcontract agreement for the Wilshire Grand Hotel Shoring/Excavation project also framed itself as an agreement for the "rental" of seven hoists, but it is silent as to who would be responsible for providing an operator during the rental period. Instead, appellant and its general contractor customer agreed in principle via email to charges for hoist operators on a time and material basis per a separate rate sheet with the caveat that these labor rates must be formally submitted to the project's owner for approval at the time of billing. The fact that terms for the provision of hoist operators were neither originally included nor apparently formally incorporated into the hoist agreement suggests to OTA that this agreement could not have been a service agreement but must have been a lease for equipment. Moreover, the hoist agreement contained a provision that the general contractor must approve appellant's "key personnel" assigned to the project, and such personnel could not be removed without the general contractor's prior written approval. Although the agreement does not define "key personnel," a hoist operator—as a unionized position requiring skilled labor and specialized training—would likely qualify. Thus, this provision also suggests that the general contractor (not appellant) reserved for itself the power to select and discharge hoist operators, even if appellant provided

them. This in turn suggests that possession and control of the hoists passed to the general contractor, and that this agreement is also a taxable lease of equipment.

For the reasons stated, OTA finds that the five subcontracts at issue were taxable leases.

On appeal, appellant asserts that its hoists were not under the direction and control of appellant's general contractor customers because appellant provided operators who actually retained full control over the hoists, thus turning what might otherwise be a taxable lease into a nontaxable service agreement. Appellant argues that its operators were effectively mandatory because its customers are not typically signatories to the California Operating Engineers Union (Union), which severely limits their ability to hire a Union hoist operator and necessitates a subcontract with a Union signatory, such as appellant. In support of this argument, appellant provides affidavits from the general contractors for the 1801 Avenue of the Stars Demolition and the Masonic Temple Renovation projects, declaring that they utilized appellant's operators because they did not have access to a certified or qualified union operator.[11] Furthermore, appellant argues that CDTFA erroneously treated all of appellant's operators as optional simply because an operator was not provided for in every contract, and appellant argues that there is no legal support for this position and that the practical application of such an approach is untenable.

Additionally, appellant argues that even if its operators were optional, this is not dispositive in determining whether its contracts were for the rendition of services or the rental of tangible personal property. Appellant notes that California Code of Regulations, title 18, (Regulation) section 1660(a)(1) does not distinguish between mandatory and optional operators, and appellant argues that there is no support for this distinction other than Sales and Use Tax Annotation 330.2465 (8/5/1993).[12] In support of this argument, appellant cites to *Entremont* and *Service Tank Lines v. Johnson* (1943) Cal.App.2d 67 (*Service Tank Lines*). Appellant argues that, in these cases, the courts did not focus on whether the operator was mandatory, but instead analyzed whether possession and control was transferred. Appellant also cites to a 1960 California Attorney General Opinion (59 Ops.Cal.Atty.Gen. 151), arguing that this opinion

[11] In the affidavits, the general contractors averred that appellant did not transfer possession and control of the hoists to them.

[12] Annotations are not binding authority and do not have the force or effect of law. (Cal. Code Regs., tit. 18, § 35101(a)(1); *Appeal of Martinez Steel Corporation*, 2020-OTA-074P.) However, OTA may give some consideration to annotations and will independently determine the appropriate weight to afford an annotation. (*Yamaha Corp. of America v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 15; *Appeal of Martinez Steel Corporation*, *supra*.)

analyzed the tax treatment of equipment furnished with an operator and emphasized possession and control without regard to whether the operator was mandatory. Lastly, appellant cites to *Culligan Water Conditioning v. State Bd. of Equalization* (1976) 17 Cal.3d 86 (*Culligan*) and *Bar Master Inc. v. State Bd. of Equalization* (1976) 65 Cal.App.3d 408 (*Bar Master*) for the proposition that a lease exists when the hiree exercises dominion and control in a practical sense.

Here, appellant's operators were optional because appellant did not contractually require its general contractor customers to use its hoist operators. Although it may have been impractical or difficult for appellant's customers to obtain a hoist operator independent of appellant, contractually appellant's customers were free to rent appellant's equipment without appellant's hoist operator. With respect to appellant's argument that CDTFA erroneously treated all of appellant's operators as optional simply because an operator was not provided in every subcontract, OTA reviewed the documentation appellant provided for the five transactions in dispute and found no evidence showing that, per the five agreements at issue, the operators provided were mandatory. Therefore, OTA finds this argument lacks merit.

As for appellant's argument that subcontracts for hoists with optional operators should be considered service contracts, it is undisputed that, in instances where appellant's customers provided their own operator, the transactions would be leases. Yet, regardless of whether appellant's customers provided their own operator or chose to hire appellant's operator, the amount of control appellant's customers had over the operator would be the same, which is why an optional operator is deemed to maintain control of the property for the lessee rather than the lessor.

Moreover, the *Entremont* court cites to Civil Code sections 1925 and 1955 for the proposition that the "chief characteristic of a renting or a leasing is the giving up of possession to the hirer, so that the hirer and not the owner uses and controls the rented property." (*Entremont, supra*, 13 Cal.2d 291, 295.) And, in assessing whether there was "possession and control," the court noted the importance of the hirer's power to select and discharge the operator. (*Ibid*.) Given that the power to select and discharge an operator is a fundamental aspect of all contracts where the provision of an operator is optional, OTA finds that CDTFA's longstanding position—that the provision of an *optional* operator constitutes a lease—to be consistent with *Entremont*.

As for appellant's reliance on *Service Tank Lines*, OTA finds the facts of that case are distinguishable because, unlike the agreements at issue here, the alleged leases at issue in *Service*

Tank Lines were preceded by a contract for services, and the court based its holding on its finding that "the leases made no substantial change in the way in which the parties conducted their business with each other." (*Service Tank Lines, supra*, 61 Cal.App.2d 67, 69.) With respect to appellant's reliance on *Culligan* and *Bar Master*, OTA does not find these cases instructive here because these cases do not involve operators provided pursuant to a lease of tangible personal property. Regarding appellant's reliance on the 1960 California Attorney General Opinion, OTA notes that this opinion is not controlling authority, and, moreover, the portion of the opinion that appellant relies on indicates that the right to hire and fire the operator is significant in determining whether the requisite control exists, which further supports CDTFA's position in this appeal.

Based on the foregoing, OTA finds that the five subcontracts at issue constitute taxable leases, not nontaxable service agreements.

Communication Systems and Tie-In Attachments: Leased in Substantially the Same Form?

A lease of tangible personal property is not a continuing sale and purchase, and therefore is not subject to tax, if the lessor leases the property in substantially the same form as acquired and the lessor paid sales tax reimbursement or use tax measured by the purchase price of the property. (R&TC, §§ 6006(g)(5), 6010(e)(5); Cal. Code Regs., tit. 18, § 1660(b)(1)(E).) If a lessor of property leased in the same form as acquired did not pay sales tax reimbursement or use tax to its vendor when it purchased the tangible personal property and the lessor does not want to pay use tax measured by its rental charges, the lessor must timely report and pay tax measured by the full purchase price with its return for the period during which the property is first placed into rental service. (Cal. Code Regs., tit. 18, § 1660(c)(2).) If the lessor does not make a timely election to pay tax on the purchase price, the lessor may not retroactively do so. (See *Action Trailer Sales, Inc. v. State Bd. of Equalization* (1975) 54 Cal.App.3d 125, 131-132.)

A lessor who leases property in substantially the same form as acquired and who has paid a retail sales or use tax, or reimbursement therefor, imposed with respect to that property by any other state prior to leasing the property in this state, may credit the payment against any use tax imposed by this state because of the lease. (Cal. Code Regs., tit. 18, § 1660(c)(8).) However, to be entitled to the credit the lessor must make a timely election to measure any tax liability for the property by its purchase price, unless the out-of-state tax equals or exceeds the tax imposed by this state. (*Ibid*.) If the out-of-state tax equals or exceeds the tax imposed by this state, the lessor

will be deemed to have made a timely election and the rental receipts will not be subject to tax provided the property is leased in substantially the same form as acquired. (*Ibid*.) If a timely election is not made, no credit will be allowed because the tax due will be a use tax measured by rental receipts and imposed directly against the lessee, a person other than the one who paid the out-of-state tax or tax reimbursement. (*Ibid*.)

Here, CDTFA treated appellant's provision of the communication systems and tie-in attachments as taxable leases of tangible personal property that were part of appellant's hoist rentals. Regarding the communication systems specifically, CDTFA concluded that appellant had cut the wires connecting the callboxes based on appellant's need to configure the communication systems to its customers' needs. CDTFA further found that the communication systems increased the functional capabilities of the hoists by allowing them to be used at higher levels. For these reasons, CDTFA concluded that appellant did not lease the communications systems in substantially the same form as acquired, which rendered appellant's rental charges for the communication systems taxable.

On appeal, appellant generally argues that it made tax-paid purchases of the communication systems, which it leased in substantially the same form as acquired; thus, the leases of the communication systems are not subject to tax.

Although it is undisputed that appellant purchased the communication systems at issue tax paid, CDTFA asserts that appellant did not lease them in substantially the same form as acquired. In support, CDTFA cites to Sales and Use Tax Annotation 330.4165 (12/8/80), which states that large spools of insulated copper cable are not leased in the same form as acquired when cut into various standard lengths with adaptors and connectors added to them so that the cable can be attached to power distribution boxes and electrical equipment. Therefore, CDTFA asserts that a substantial change in form occurred when appellant configured (i.e., cut) the wires for the communication systems.[13]

[13] CDTFA also cites to Sales and Use Tax Annotation 330.4120 (9/22/66) for the proposition that there is a substantial change in form when an attachment increases the functional capabilities of the leased property, and CDTFA asserts that the communication systems and tie-in attachments increased the functional capabilities of the hoists because the communication systems and tie-in attachments allowed the hoists to be used at higher levels. However, Sales and Use Tax Annotation 330.4120 states that the addition of a side shifter to a leased fork-lift truck, which significantly increased the truck's capabilities, constituted a substantial change in form of the property being leased (i.e., the fork-lift truck). Because the leased item at issue in this annotation is the fork-lift truck, the analysis concerns the change in form to the fork-lift, not the attachment to it, and therefore, contrary to CDTFA's position, this annotation does not stand for the proposition that property substantially changes in form simply because it is attached to another piece of property whose capabilities have changed as result of the attachment.

In response, appellant argues that although it configured the wires of the communication systems for each lessee, CDTFA incorrectly assumed that appellant cut the wires to do so. At the oral hearing before OTA, appellant's CEO testified that appellant hung callboxes on the hoist enclosure near the floor gate on each floor of a building, and each callbox was connected to the one above and below it with a coaxial-type wire running along the hoist. Appellant's CEO further testified that appellant did not cut the wires to adjust their lengths to account for floors of varying heights but would bundle and tie up excess wire with a zip-tie when attaching them to the callboxes. Additionally, appellant's CEO testified that cutting or splicing the wires would destroy or degrade them, and appellant did not modify the callboxes. Thus, appellant argued that it leased the communication systems in substantially the same form as acquired.

Here, OTA finds appellant's witness credible and that, more likely than not, appellant did not cut or alter the wires but merely adjusted their length by tying up excess wire with zip-ties. Thus, OTA finds that appellant leased the communication systems at issue, which primarily consisted of callboxes and wires, in substantially the same form as acquired. Accordingly, OTA concludes that, to the extent that appellant paid sales tax reimbursement or use tax when it purchased the communication system items at issue, then their rental streams are not subject to tax.

Regarding the tie-in attachments, appellant argues that it made tax-paid purchases of the tie-in attachments, which it leased in substantially the same form as acquired; thus, the leases of the tie-in attachments are not subject to tax.

In response, CDTFA contends that appellant did not lease the tie-in attachments in substantially the same form as acquired. In support, CDTFA cites Sales and Use Tax Annotation 330.3900 (2/17/67; 5/2/94), which states, in part, that a substantial increase in the value of the leased property alone is enough to show that the property is not leased in the same form as acquired.[14] CDTFA argues that a substantial change in form occurred because the tie-in attachments increased the value of the hoist and the tie-in attachments themselves.

[14] Sales and Use Tax Annotation 330.3900 also states that other situations exist where there is a change in the form of the leased property, but little increase in value; in such instances, if the change in form between what the lessor acquired and what the lessor leased is such that the property is not leased in substantially the same form as acquired, then the minimal change in the value of the property is irrelevant. This additional aspect of the annotation is not relevant to the tie-in attachments at issue because CDTFA is arguing that the value of the tie-in attachments increased substantially.

Regarding CDTFA's argument, the most relevant rental property at issue in Sales and Use Tax Annotation 330.3900 were growing plants, which are distinguishable from the tie-in attachments at issue. A back-up memorandum to the annotation states, "Where the property involves plants which continue to grow, whether the value of the leased property is substantially in excess of the purchase price is a helpful tool in determining if the property is leased in substantially the same form as acquired." This is not the case here because the tie-in attachments at issue are inorganic objects that do not physically grow.[15] Further, OTA's review of the record finds no other basis for CDTFA's finding that appellant leased the tie-in attachments in a form that differed from when appellant acquired them. In other words, OTA finds that appellant leased the tie-in attachments in substantially the same form as acquired.

However, appellant purchased the tie-in attachments either ex-tax or with an out-of-state tax rate *lower* than the rate imposed by this state (7.23 percent for Illinois versus 7.50 percent for California in 2013)[16] but did not make a timely election to pay tax on the purchase price of its tie-in attachments. Accordingly, for the tie-in attachments appellant purchased ex-tax, use tax is due on appellant's rental receipts for them. (See Cal. Code Regs., tit. 18, § 1660(c)(2).) For the tie-in attachments appellant purchased with an out-of-state tax rate lower than California's, use tax is also due on the tie-in attachments' rental receipts. (See Cal. Code Regs., tit. 18, § 1660(c)(8).) Appellant, as lessor, is responsible for collecting such taxes from its lessees. (See Cal. Code Regs., tit., 18, § 1660(c)(1).)

To summarize, OTA finds that use tax is due from appellant on the rental receipts from appellant's tie-in attachments that it purchased ex-tax or with an Illinois rate lower than California's, but not on its rental receipts for its communication systems, which appellant leased in substantially the same form as acquired.

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[15] As noted in footnote 14, *ante*, page 14, there is an additional aspect to Sales and Use Tax Annotation 330.3900, which concerned another type of property besides plants: beverage dispensing equipment. In the back-up memorandum, CDTFA concluded that it did not have sufficient information to determine whether a taxpayer was leasing the beverage dispensing equipment in substantially the same form as acquired and suggested further investigation into whether the physical form—not the value—of the beverage dispensing equipment differed from when the equipment was purchased to when the equipment was leased. Again, this additional aspect of the annotation is not relevant to the tie-in attachments at issue because CDTFA's argument is that the value of the tie-in attachments substantially increased.

[16] See footnote 7, *ante*, page 5.

Enclosures and Grillage: True Object

Generally, tax does not apply to the sale of intangible personal property or to the provision of services. (R&TC, §§ 6006, 6007, 6051.)

"Gross receipts" mean the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers, valued in money, without any deduction for the cost of the materials used, labor or service cost, interest paid, losses, or any other expense. (R&TC, § 6012(a)(2).) The total amount of the sale or lease or rental price includes any services that are part of the sale. (R&TC, § 6012(b)(1).) However, "gross receipts" do not include the price received for labor or services used in installing or applying the property sold. (R&TC, § 6012(c)(3).)

"Sales price" means the total amount for which tangible personal property is sold or leased or rented, as the case may be, including the cost of labor or services, as well as any services that are a part of the sale. (R&TC, § 6011(a)(2), (b)(1).) However, "sales price" does not include the amount charged for installing or applying the property sold. (R&TC, § 6011(c)(3).)

The term "tangible personal property" means personal property that may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses. (R&TC, § 6016.) Services means the performance of labor for the benefit of another. (*Dell, Inc. v. Superior Court*, (2008) 159 Cal.App.4th 911, 923 (*Dell, Inc.*).)

A "bundled transaction" occurs when the transfer of tangible personal property and the provision of services are inseparably bundled together or inextricably intertwined in a single transaction. (R&TC, §§ 6006, 6012; *Dell, Inc.*, *supra*, at pp. 923-924.) A bundled transaction is either a taxable sale or a nontaxable service transaction in its entirety. (*Ibid*.) Regulation section 1501 establishes the true object test to determine whether a bundled transaction involves either a taxable sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a nontaxable service. (Cal. Code Regs., tit. 18, § 1501.) Under the true object test, it must be determined whether the real object sought by the buyer is the service per se or property produced by the service. (*Ibid*.) If the true object of the contract is the service per se, the transaction is not taxable even though some tangible personal property is transferred. (*Ibid*.) If the transaction is regarded as a sale of tangible personal property, tax

applies to the gross receipts from the furnishing thereof, without any deduction for any work, labor, skill, thought, time spent, or other expense of producing the property. (*Ibid*.)

Aside from bundled transactions, California courts have also recognized "mixed transactions." Mixed transactions are transactions in which goods and services are sold together yet are readily separable, and each is a significant object of the transaction (i.e., not incidental to the other). (*Dell, Inc.*, *supra*, at p. 925.) If the provision of services and the transfer of tangible personal property are distinct and readily separable, tax will only apply to the tangible personal property. (R&TC, §§ 6006, 6012; *Dell, Inc.*, *supra*, at p. 925.)

In sum, there are three categories of transactions involving the transfer of tangible personal property and services: (1) bundled transactions where the real object of the transaction is the purchase of tangible property and services are incidental (all taxable); (2) bundled transactions where the real object is the purchase of services and the property is incidental (all nontaxable); and (3) mixed transactions where the real object is both services and property and the two elements are distinct, identifiable, and readily separable (only tangible personal property taxable). (See *Dell, Inc.*, *supra*, at p. 926.)

In its audit, CDTFA treated appellant's provision of the tie-in attachments, grillage, floor gates, and enclosures as taxable leases of tangible personal property that were part of appellant's hoist rentals.

In its appeals briefs, appellant argued that its provision of tie-in attachments, grillage, floor gates, and enclosures were not taxable because these were bundled transactions whose true objects were nontaxable installation labor, as evidenced by the significant cost of the labor in comparison to the value of the items. At the oral hearing, appellant narrowed the focus of its argument to grillage and enclosures only, acknowledging that there were separate installation labor charges for floor gates (thus, the floor gate charges must have related to the rental transaction alone, not a bundled transaction that included installation).[17] Although appellant did not separately list charges for installation labor for grillage and enclosures, appellant asserts that the charges for these items cannot represent mere property, which it contends are little more than assembled metal or steel.[18]

[17] OTA has already addressed tie-in attachments above.

[18] Appellant states that the contracts and invoices provided demonstrate that charges range from $10,470 to $85,000 for grillage and $2,200 to $25,000 for enclosures.

Installation charges generally are not taxable but, here, appellant apparently did not separately state installation labor charges for grillage and enclosures, claiming that the charges for them mainly related to installation. However, during the audit, CDTFA provided an allowance for installation labor charges with respect to the hoists and related parts, including specifically enclosures and presumably grillage. Appellant has not argued that this allowance for installation should be increased. Although appellant downplays grillage and enclosures as simply assembled metal or steel, to OTA, their function and intended purposes appear to serve important roles in multi-story building projects: grillage managed, distributed, and balanced the weight of a hoist and various loads over a foundation; and enclosures provided fall protection and contributed to the general safety of personnel. Grillage and enclosures serve these functions on building projects lasting between two and 27 months, which are not insignificant periods of time. Considering their importance to multi-month/year projects, OTA finds that appellant's charges of $10,470 to $85,000 for grillage and $2,200 to $25,000 for enclosures were for the rental of those items and were not bundled with installation labor. OTA further finds that appellant's contention that the true object of these charges was installation labor lacking in merit; these charges were for the property being rented. For the reasons stated, OTA concludes that appellant's charges for grillage and enclosures are taxable rental charges.

Jump-Tower Extensions

In its audit, CDTFA determined that appellant's provision of the jump-tower extensions constituted taxable leases of tangible personal property that were related to appellant's hoist rentals.

On appeal, appellant argues that charges for "jump tower labor" (a term derived from CDTFA's audit working papers but does not appear in the agreements at issue) actually constituted nontaxable installation labor rather than taxable fabrication labor. Appellant argues that it does not fabricate the jump-tower extensions prior to attaching them to the building and that the jump towers are manufactured and assembled by a third party prior to reaching the jobsite.

At the oral hearing, appellant revised its argument, contending that, generally, a third-party "can" provide jump-tower extensions but, even if appellant itself fabricated them, it did so in Illinois, not in California. Appellant further argues that taxable fabrication labor requires that a third party provide the material being fabricated, but appellant's general contractor customers

did not do so here. Appellant's CEO testified that charges for "jump tower labor" were only for installation and not for any of the physical jump-tower extensions or tower pieces furnished. He further acknowledged that appellant manufactured "a lot" of the jump-tower extensions but not all of them. On the difference between the initial installation of the hoist on the one hand and "jump tower labor" (or jumping) on the other, appellant's CEO testified that they were almost identical except that the initial hoist installation took place on the ground while jumping occurred 200 or 300 feet in the air.

In response, CDTFA contends that a taxable rental or sale of jump-tower extensions includes fabrication in the guise of engineering and assembly labor performed off-site prior to installation, which in this case changed the form of the property acquired by appellant. Additionally, CDTFA disagrees with appellant's assertion that only fabrication labor is taxable when the materials are furnished by a customer, reiterating that taxable fabrication includes any operation resulting in the creation or production of tangible personal property. Finally, CDTFA disagrees with appellant's CEO's assertion that "jump-tower labor" charges were solely for installation labor and the related implication that appellant provided the physical jump-tower extensions or tower sections free of charge.

Unless otherwise exempt, a lease of tangible personal property is a continuing sale and purchase for the duration of the lease. (R&TC, §§ 6006.1, 6010.1; Cal. Code Regs., tit. 18, § 1660(b)(1).) "Sale" means and includes the producing or fabricating of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing or fabricating. (R&TC, § 6006(b).) "Purchase" means and includes the producing or fabricating of tangible personal property—when performed outside of California—for a consideration for consumers who furnish either directly or indirectly the materials used in the producing or fabricating. (R&TC, § 6010(b).)

Producing or fabricating includes any operation which results in the creation or production of tangible personal property or which is a step in a process or series of operations resulting in the creation or production of tangible personal property. (Cal. Code Regs., tit. 18, § 1526(b).) Tax applies to charges for producing or fabricating tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing or fabricating. (Cal. Code Regs., tit. 18, § 1526(a).)

Here, although appellant's CEO testified that the "jump tower labor" charges were only for installation services and not related to any of the physical jump-tower extensions or tower pieces furnished, OTA finds that this position is not supported by the evidence.[19] The rental/lease agreements at issue provide for a limited number of tower extensions to the existing hoist, essentially granting temporary possession of these tower extensions or additional tower pieces to appellant's general contractor customers for the balance of the contract terms. OTA finds that some portion, possibly most, of the charges CDTFA labeled as "jump tower labor" are actually taxable rental/lease charges for the lessee's temporary possession of tangible personal property for the balance of the contract term.

Further, OTA finds that the balance of those charges is for fabrication labor, not installation. Per the contract, the charges at issue are for extending the existing hoist tower by adding tower pieces, which OTA finds more akin to fabricating taller hoists rather than installing additional tower pieces. The existing hoists have already been installed and the agreements have included nontaxable installation charges for this labor. Accordingly, OTA concludes that the separate charges for tower extensions are actually for some combination of fabrication and the rental of these tower extensions.

Regarding appellant's contention that the tower extensions were fabricated in Illinois, OTA finds that the fabrication labor here is not of the tower extensions in Illinois but of taller hoists at the various Los Angeles area project sites. Regarding appellant's contention that a third party must provide the material being fabricated, the relevant authorities indicate that the material may be provided "indirectly," which includes direct payment by appellant's customer for the material being fabricated. Therefore, OTA finds that appellant has not shown that charges for jump tower labor constitute nontaxable installation charges.

[19] In general, businesses like appellant's, which provide both tangible personal property (e.g., hoists, jump-tower extensions, tower pieces, hoist components, etc.) and nontaxable services (e.g., installation) together in mixed transactions, are expected to establish fair retail rental/selling prices for the tangible personal property. (See, e.g., Cal. Code Regs., tit. 18, § 1546(b)(1).)

HOLDING

Appellant has shown that adjustments are warranted to the determined measure of tax with respect to the communication systems at issue.

DISPOSITION

Delete the measure of tax with respect to the communication systems at issue. Otherwise, CDTFA's action is sustained.

DocuSigned by:
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Andrew Wong
Administrative Law Judge

We concur:

DocuSigned by:
Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

DocuSigned by:
Josh Aldrich
48745BB806914B4...
Josh Aldrich
Administrative Law Judge

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