Cite as Det. No. 10-0183, 36 WTD 201 (2017)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Correction of Assessment of	)	D E T E R M I N A T I O N
	)	No. 10-0183
. . .	)	Registration No. . . .

RULE 102; RCW 82.45.032: REAL ESTATE EXCISE TAX – FIXTURES – TEST. The department follows the common law rules for determining whether an item is a fixture of the realty or tangible personal property. 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. Department of Revenue v. Boeing Co., 85 Wn.2d 663, 667(1975).

RCW 82.45.032: REAL ESTATE EXCISE TAX – FIXTURES – INTENT. The intent of the Taxpayer is the most important of the three factors. In this case, there was no evidence of intent to permanently annex the equipment to the real property when it was installed, which coupled with evidence that the equipment was designed to be reconfigurable and movable was characterized as personal property in documents and depreciated as personal property, was sufficient support characterization as personal property. The fact that the equipment was characterized as a fixture on the property tax roles and was in place for a considerable time period was not sufficient to counter the evidence of intent to treat the equipment as personal property.

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.

Kreger, A.L.J. – A Taxpayer protests the assessment of Real Estate Excise Tax (REET) on saw mill equipment sold in conjunction with the sale of real property. It asserts that the equipment was tangible personal property not subject to REET. We conclude that this equipment is tangible personal property rather than fixtures subject to REET and, accordingly, grant the Taxpayer's petition and remand to the Special Programs Division to adjust the assessment.[1]

[1] Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

ISSUE

Does sawmill equipment sold by the Taxpayer in conjunction with the sale of real property qualify as a fixture subject to REET under RCW 82.45.032(1)?[2]

FINDINGS OF FACT

[Taxpayer] is a Washington partnership that on September 6, 2006, together with other entities under common or related ownership ([Entity A],[3] [Entity B],[4] and [Entity C][5]), entered into an asset purchase agreement with [Lumber Company][6]

The asset purchase agreement called for the transfer of real property and equipment owned by the Taxpayer, in addition to equipment owned by the other sellers, to[Lumber Company] for a total purchase price of $ . . . . The agreement allocated $ . . . to the real property sold by the Taxpayer.[7] While the Taxpayer sold both real property and equipment, the majority of the sale, both in value and in quantity, was equipment owned by the lessee of the property, [Entity A]. The Taxpayer subsequently filed a REET affidavit for the sale and deducted the value of all equipment sold by all of the sellers as personal property not subject to REET. Review of the affidavit subsequently resulted in the issuance of an assessment to the Taxpayer for additional REET on the value of the equipment that the Special Programs Division of the Department of Revenue characterized as fixtures subject to REET. The Taxpayer timely filed an appeal contesting the assessment.

The real property (building) sold is a large concrete pad with supporting joints installed into it, onto which the equipment can be secured (either through bolts or welding or a combination of both). Schedule 1.6 of the asset purchase agreement allocates $ . . . of the total purchase price to the building. The concrete pad is covered by a metal frame and metal walls and roofing. The exterior of the building can be removed and dismantled as necessary to allow for access and removal or relocation of the equipment. The Taxpayer's general partner [General Partner] has extensive experience in the forest products industry particular in saw mill and chip mill industry. He designed significant components of the equipment at issue. [General Partner] testified that in response to a downturn in the market for sawn logs at the end of the 1970's and early 1980's, his business activities turned towards chip fabrication primarily for the paper industry. In an effort to address the cyclical nature of the markets for sawn logs and wood chips, [General Partner] wanted to develop more adaptable equipment so he would be able to more easily convert and

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[2] The Taxpayer also asserted that REET was improperly assessed on equipment owned by parties other than the seller of the real property. Since we conclude that the equipment at issue does not qualify as a fixture and is not subject to REET, it is not necessary to address the Taxpayer's assertion that REET was improperly assessed on equipment that was neither owned nor sold by the Taxpayer.

[3] [Entity A] sold equipment and intangible assets, such as customer contracts and trade names. The equipment sold by [Entity A] was valued at $ . . . .

[4] [Entity B] sold one piece of mill equipment valued at $ . . . .

[5] [Entity C] is the sole shareholder of [Entity A].

[6] While distinct entities, the sellers of the property and equipment are predominantly owned by related parties; [General Partner], the general and managing partner of the Taxpayer, and his sons and brother.

[7] The value allocated to the equipment sold by the Taxpayer was $ . . . .

adapt his business to existing market conditions.[8] The property and equipment at issue in this appeal was developed based on [General Partner's] prior experience in contracts with the Forest Service where he developed mobile equipment that could be transported down forest service roads. The facility initially operated primarily as a chip mill. Due to subsequent changes in market conditions and demand in the mid 1990's, manufacture of sawn logs was subsequently added and expanded.

The equipment at issue falls into three categories identified on appeal as Mill #1, Mill #2, and Mill #3. The Mill #2 equipment is comprised of [multiple] components, which reside on trailers. Based on the additional information and documentation provided by the Taxpayer on appeal, the Special Programs Division has acknowledged that the Mill #2 equipment is not subject to classification as a fixture and accordingly not subject to REET. This leaves the Mill #1 and Mill #3 equipment in dispute (contested equipment). [General Partner] testified that all of the mill equipment at issue was specifically designed to be mobile and capable of being re-located and reconfigured within the facility.[9] The equipment pieces are sufficiently large and heavy that moving them requires mechanical assistance and some pieces require a crane to move them. The equipment sold was assembled and acquired over time. Components included both new and used equipment purchased from other mills. The Taxpayer modified, adjusted and customized equipment to maximize productivity and flexibility. The Taxpayer has depreciated the property at issue as personal property for federal tax purposes.

The contested equipment includes:

- Mill #1 equipment consists of machinery that turns whole logs and log scraps into wood chips, including a de-barker, metal detector, chipper, screens, bins, and grinding equipment. These components are connected by a series of conveyor belts located inside and outside of the building. Approximately one-third of the Mill #1 equipment sits in the building with the remaining equipment being located outside of the building.

- Mill #3 equipment is focused on the production of lumber rather than woodchips. This equipment includes a "slash deck" that cuts logs into appropriate lengths for further processing, conveyor belts, log sorters, and automatic saws that cut the lumber. Debris and scraps from the lumber production equipment are then used for woodchip manufacture. The majority of the Mill #3 equipment is located in the building, but an edger and log sorting equipment are situated outside in the sawmill yard.

The Taxpayer acknowledges that it was an error to deduct the value of all equipment sold as its personal property on the REET affidavit because it did not own and, accordingly, was not the seller of all of the equipment. However, the Taxpayer explains that this error was attributable to

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[8] The markets for logs and chips are counter cyclical – as the market for logs declines, more wood is directed to whole log chips, when the lumber market rises chip manufacture from mill residue rather than whole logs rises.

[9] The Taxpayer also notes that after the sale, the purchaser discontinued using part of the mill #3 equipment, specifically, the wood miser components, which were designed to salvage and saw board lumber from logs that would otherwise be chipped. The removal of this specific equipment both altered the configuration of the remaining equipment and changed how logs are processed. The Taxpayer offers this information as an example of the flexibility capacity for customization that was part of the design of both the facility and equipment.

the single purchase contract between all of the parties and the total price for the transaction being derived from that contract.

In support of its characterization of the contested equipment as fixtures, the Special Programs Division notes the following: the significant size and weight of the equipment; that the equipment was wired to the electrical service in place; that the equipment was located at the site for a significant period of time; and that the equipment was sold attached to the real property. Supplemental briefing dated January 7, 2009. Special Programs also emphasizes that the property tax records valued the equipment as part of the real property. *Id.*

The Taxpayer has provided a copy of the initial lease agreement between Taxpayer and [Entity A], dated April 18, 1989, under which Taxpayer leases the real property at issue to [Entity A] for a term of five years for a monthly rental payment. A September 5, 1997, addendum to that lease amends the lease to a term of ten years and provides for the construction of a building deferring rent payments until July 15, 1998, and modifies the lease payment.

The Taxpayer has also provided a separate equipment lease agreement dated September 5, 1997, between the Taxpayer and [Entity A] for log mill equipment. That lease agreement specified that the equipment remains the property of the lessor and specifies that the lessee shall have no right to purchase the equipment at the conclusion of the lease. Paragraph 3. Paragraph 4 of the lease provides that the equipment "shall at all times remain personal property regardless of the manner affixed to the realty." The equipment lease is for a term of ten years for a monthly payment, and that payment is designated as including personal property taxes due on the equipment. Paragraph 7. There is an addendum to the lease modifying the lease payments as of July 1, 1998.

ANALYSIS

Pursuant to Chapter 82.45 RCW, the [REET] applies to the sale of real estate. The seller of the real property is responsible for filing the required REET affidavit and for paying REET.[10]

RCW 82.45.010(1) defines sale to include "conveyance, grant, assignment, quitclaim, or transfer of the ownership of or title to real property, including standing timber, or any estate or interest therein for a valuable consideration."

The term "real property" is defined for REET purposes, as follows, in RCW 82.45.032(1):

> "Real estate" or "real property" means any interest, estate, or beneficial interest in land or anything affixed to land, including the ownership interest or beneficial interest in any entity which itself owns land or anything affixed to land. The term includes used mobile homes, used floating homes, and improvements constructed upon leased land.

See also WAC 458-61A-102 (definitions).

[10] If a portion of the selling price is attributable to tangible personal property, the personal property transferred is subject to use tax under Chapter 82.12 RCW. The purchaser is responsible for paying the use tax. If the sale of property is the sale of real property and subject to REET, the purchaser does not owe use tax upon its use. *See* Det. No. 89-055, 7 WTD 151 (1989).

The term "affixed" connotes the common law concept of "fixture," and RCW 82.45.032(1) intends by its use, to classify as real property for REET purposes, anything that would be a fixture at common law if affixed to land by the land owner. Generally, "[g]oods are fixtures when they become so related to the particular real estate that an interest in them arises under real estate law." *Black's Law Dictionary* 638 (6th ed. 1990). "The word 'fixture' usually means something a possessor of land has added that *cannot* be removed, in other words, a thing that has become part of the land by accession." 17 Wash. Prac., Real Estate Sec. 6.141 (2nd Ed. 2007)(Emphasis in original.). "Fixture" necessarily implies something having possible existence apart from realty, but which may, by annexation, be assimilated into realty. *Gaspee Cab v. McGovern*, 51 R.I. 247, 153 A. 870 (1931).

In Det. No. 00-122, 20 WTD 461 (2001), we discussed the three-part common law test articulated by Washington Courts for determining whether an item is a fixture or personal property as follows:

> According to the common law, whether an item is a fixture or personal property turns upon the application of three general tests, all of which must be satisfied:
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> > (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.
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> [*Dep't of Revenue v. Boeing Co.*, 85 Wn.2d 663, 667, 538 P.2d 505 (1975)]; (other citations omitted).
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> . . .
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> The first prong, annexation, is often considered in light of the actual relationship of the object to the realty--whether the article is "in use as an essential part" of the overall use of the property. *See Courtright Cattle Co. v. Dolsen Co.*, 94 Wn.2d 645, 675, 619 P.2d 344 (1980); 5 R. Powell & P. Rohan, *Real Property* § 660, at 96.4 (1984 & Supp. 1985). . . .
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> Intention is the most important of the three factors and is determined
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> > 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 is made. The test is objective rather than subjective intent.

This analysis and the primary importance of intent have been consistently applied by the courts and by the Department. [*Union Elevator & Warehouse Co. Inc. v. Dep't of Transp.*, 144 Wn. App. 593, 603, 183 P.3d 1097 (2008)]; *see also Lipsett Steel Products, Inc. v. King County*, 67 Wn.2d 650, 409 P.2d 475 (1965); *Glen Park Assoc. v. Dep't of Revenue*, 119 Wn. App. 481, 487, 82 P.3d 664 (2003); *Det. No. 88-342*, 6 WTD 361 (1988); *Det. No. 89-541*, 8 WTD 439 (1989).

"Evidence of intent is gathered from the surrounding circumstances at the time of installation." *Glen Park* 119 Wn. App. at 490-91. "The intent of the parties ís to be inferred, when not

determined by an express agreement, from the nature of the article affixed, the relation and situation to the freehold of the party making the annexation, the manner of the annexation and the purpose for which it is made." *Stain v. Green*, 25 Wn2d.692, 699, 172 P.2d 216 (1946).

In this case, the equipment is physically bolted to the concrete pad that is the floor of the building. While the equipment can be moved, it is physically attached to metal joints secured in the concrete foundation by bolts or welding, or a combination of both. Thus, there is a physical connection of the equipment to the real property.

In addition to being physically connected to the concrete foundation, the equipment is also essential to the operation of the building as a saw or chip mill. The Taxpayer, however, notes the flexibility and adaptability of the equipment, which was designed so as to be reconfigured and adjusted to address the counter cyclical demand for saw lumber and wood chips. Furthermore, the Taxpayer emphasizes that the building is not limited to use as either a chip or saw mill, but suitable for myriad industrial, manufacturing, or storage uses. In this case, the Taxpayer testified that the equipment was specifically designed so the production can be reconfigured and adjusted to address changing market demand. When the demand for lumber is down, production can be shifted to chip manufacture and vice-versa. The floor bolts, onto which the equipment is attached, are set at a standard consistent spacing to enable reconfiguration. The Taxpayer also notes that these bolts could be sawn off at the base, leaving a flat concrete slab, which would render the building suitable for an even broader array of activities.

The Taxpayer also notes that the equipment could be used at another site – all the design requires is a consistent elevation. On this point, the Taxpayer testified that it is common in other saw and paper mills to have varying layers of flooring and foundations of different mass, but that this equipment was designed to used on consistent floor surface and supports. Over the course of operating the facility, the Taxpayer has sold and replaced particular components, and the Taxpayer also notes that the purchaser of the property has also changed the configuration of equipment and discontinued using one of the pieces of mill equipment it purchased.

The Taxpayer asserts that at the point of installation it intended this equipment to remain personal property. As evidence of this intent, the Taxpayer notes the design and mobility of the equipment discussed above, that it has depreciated the equipment as personal property on its federal income tax returns, and that its lease of the equipment also characterizes it as personal property. Paragraph 4 of the Taxpayer's lease with [Entity A] provides that the equipment "shall at all times remain personal property regardless of the manner affixed to the realty."

The Taxpayer acknowledges that the county classified the equipment as real property. We concur with Special Programs that the county assessor's treatment of property provides evidence of intent to characterize the equipment as part of the real property, which the Taxpayer acquiesced to and perpetuated. Special Programs appropriately . . . relied on this information as objective evidence of the character of the equipment at issue. However, in this case, [we must evaluate all of the evidence available, and] the additional evidence [provided], such as the lease agreements and additional detail about the design and mobility of the equipment, . . . [that] supports [the Taxpayer's] intent that the equipment be personal property.

Washington Courts have characterized comparable equipment as personal property. In C*hase v. Tacoma Box Co.* 11 Wash. 377, 379, 39 P. 639 (1895), the Court characterized equipment used in a box factory that was attached to the building "by means of iron legs, and are fastened to the floor, or to blocks set upon the floor, of said building, by screws or nails or bolts, for the purpose solely of steadying said machinery and apparatus when in use" as personal property In *E.C. Neufelder v. Third Street and Suburban Railway*, 23 Wash 470, 472-273, 63 P. 197 (1900), saw mill equipment, which was removed prior to a mortgage foreclosure sale, was also classified as personal property. In that case, the court again emphasized that the equipment was attached to the building or to timbers that were bolted to the building framework "for the purpose of steadying it while in use" and that the equipment could be "removed from the premises without any material damage." *Accord Cherry and Parkes v. Arthur,* 5 Wash 787, 788, 32 P. 744 (1893) (Saw mill planer bolted to the floor classified as personal property.).

More recently, the Court has affirmed this analysis in U*nion Elevator & Warehouse v. State,* 144 Wn. App. 593, 183 P.3d 1097 (2008). In that case, the court concluded that equipment attached to and integral to the functioning of a grain elevator, and which had been classified as realty for tax purposes, was nevertheless not a fixture. The court emphasized that this equipment could be moved "without damaging the grain elevator." *Id*. at 606. The equipment at issue in *Union Elevator,* was considered integral to the operation of the grain elevator, had been in place for an extended period of time and was treated as realty for appraisal and tax purposes, but was held to be personal property by the court.

Special Programs emphasized that the size and weight of the equipment and its electrical connection support characterizing it as a fixture. The Taxpayer disagrees, noting that the size and weight of the mill equipment at issue in the cases discussed immediately above were also of significant size and weight as were the jigs at issue in *Boeing.* As to the issue of the equipment requiring particular electrical connections, the Taxpayer notes that this is a common requirement for large pieces of equipment and that Special Programs cites no authority relying on electrical connection as a factor supporting characterization as a fixture.

The case law supports the Taxpayer's assertion that equipment of substantial size, weight, and connection may still be tangible personal property rather than a fixture. In *Boeing*, the jigs at issue weighed between 20 to 103 tons and were bolted to a specially designed floor. *Boeing,* 85 Wn 2d. at 664. The *Chase*, *Neufelder,* and *Union Elevator* cases discussed above also involved large equipment bolted into place with particular electrical connections. The court has also held that large steel scrap sheets installed in pilings with a reinforced concrete base, capable of exerting 880 tons of pressure, were not permanently affixed to the realty and accordingly denied a refund of personal property taxes. *Lipsett Steel*, 67 Wn.2d at 651. Indeed, in the *Lipsett* case the court specifically noted the immense size and weight of the equipment but, nevertheless, concluded that "despite great expense and difficulty, the shear could have been removed." *Id.* at 653. The equipment at issue here is also of significant size and weight, but also can be readily moved and reconfigured within the building or removed completely without damage to the building.

On the most important factor of intent, the Taxpayer's intent that the equipment be personal property when it was installed is supported by: (1) the design of the equipment to be

reconfigurable; (2) the ability to remove the equipment; (3) a lease that expressly characterizes the Taxpayer's equipment as personal property "regardless of the manner affixed;" (4) for the equipment owned by [Entity A] the absence of any provision in its lease with Taxpayer that the equipment would revert to the owner of the building/property at the conclusion of the lease; and (5) the depreciation of the equipment as personal property. Thus, while the equipment was affixed to steel joints in the floor, in light of the case law discussed above it could be moved without damage, and its treatment as personal property support the Taxpayer's assertion that there was no intent to permanently affix the equipment to the building. The contrary evidence of intent to affix the equipment to the property is: (1) the fact that the property was treated as real property on the property tax roles; and (2) that it was in place for a considerable period of time.

In this case, the Taxpayer's equipment is also contractually defined as personal property. As previously noted, paragraph 4 of the equipment lease provides that the equipment "shall at all times remain personal property regardless of the manner affixed to the realty." By actually leasing equipment to [Entity A], the parties contractually characterize the equipment as personal property, and also, generally indicate that the equipment was considered distinct and separate from the building. Furthermore, the Taxpayer's lease agreement with [Entity A] for the real property and building does not provide any indication by [Entity A] to relinquish title or permanently affix the equipment to the building. *See SSG Corporation v. Cunningham,* 74 Wn.App. 708, 711, 875 P.2d 16 (1994) (Intention of parties governs whether building constructed on leasehold is personal property of builder. "[E]vidence of an intent to retain ownership of the chattel is evidence of an intent not to make a permanent accession to the freehold."). Thus, as to the majority of the equipment at issue the presumption under the lease is that this property retained its characterization as personal property of the tenant [Entity A].

We conclude that the weight of the objective evidence shows no intent by the owners to permanently annex the equipment it owned to the real property when it was installed. Accordingly, we conclude that evidence available does not support characterizing the equipment as a fixture. REET was due on the true and fair value of the real property conveyed, which in the case included land and buildings, but not the mill equipment. The Taxpayer's petition is granted and we remand this matter to the Special Programs Division for adjustment of the assessment.

DECISION AND DISPOSITION

The Taxpayer's petition is granted.

Dated this 10th day of June 2010.