

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:) OTA Case No. 18042552
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KOCH SUPPLIES, INC.) Date Issued: April 4, 2019
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_____)

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Reed Schreiter, Representative
Joan Armenta-Roberts, Representative

For Respondent: Scott Claremon, Tax Counsel IV
Robert Tucker, Assistant Chief Counsel

N. DANG, Administrative Law Judge: On December 13, 2017, an oral hearing on this matter was previously held by our predecessor, the California State Board of Equalization (SBE). After considering the arguments presented by the parties on appeal, SBE decided by a majority vote to grant the \$18,854 disputed portion of appellant’s \$48,065 refund claim. By letter dated April 2, 2017, the California Department of Tax and Fee Administration (respondent) filed a petition for rehearing of this matter (Petition) with the Office of Tax Appeals (OTA).¹ Upon consideration of respondent’s Petition, we conclude that the grounds set forth therein do not constitute good cause for a new hearing.

The sole issue considered by SBE in this case was whether Koch Supplies, Inc.’s (appellant) sales of tangible personal property to Dole Fresh Vegetables’ (Dole’s) Soledad facility, qualify for the partial exemption from tax for farm machinery and equipment pursuant to Revenue and Taxation Code section 6356.5.² To qualify for the partial exemption, three

¹ As of January 1, 2018, OTA has jurisdiction over any appeal which has been heard by the SBE, and where the SBE either failed to issue a decision or the decision is not yet final before that date. (Cal. Code Regs., tit. 18, § 30832(a).)

² Unless otherwise specified, all further undesignated statutory “section” or “§” references are to the Revenue and Taxation Code.

requirements must be met: (1) the purchaser must be a qualified person (e.g., a farmer); (2) the property must qualify as farm equipment and machinery or parts thereof; and (3) the property must be primarily used in producing and harvesting agricultural products. (§ 6356.5(a); Cal. Code Regs., tit. 18, § 1533.1(a).) “Primarily” means used 50 percent or more of the time in producing and harvesting agricultural products. (Cal. Code Regs., tit. 18, § 1533.1(b)(4).) “Producing and harvesting agricultural products” means those activities described in Major Group 01,³ 02,⁴ and 07,⁵ of the United States Office of Management and Budget Standard Industrialized Classification (SIC) Manual,⁶ such as those involving the cultivation of land or the growing, raising, or gathering of livestock or crops, and other integrally related activities such as weeding, pest control, nut hulling and shelling, and fruit ripening. However, excluded from the definition of producing and harvesting agricultural products are those activities described or otherwise designated in Major Group 20 of the SIC Manual – Food and Kindred Products (i.e., manufacturing or processing foods and beverages for human consumption).⁷ (Cal. Code Regs., tit. 18, § 1533.1(b)(5).) Finally, producing and harvesting agricultural products also includes the washing of agricultural products, the inspection and grading of agricultural products or livestock, or the packaging of agricultural products for shipment, but not post-harvesting activities. (*Ibid.*)

³ Major Group 01 of the SIC Manual includes establishments engaged in the production of crops, plants, vines, trees (excluding forestry operations), the operation of sod farms, the production of mushrooms, bulbs, flower seeds, and vegetable seeds, and the growing of hydroponic crops. (Cal. Code Regs., tit. 18, § 1533.1(b)(5).)

⁴ Major Group 02 of the SIC Manual includes establishments engaged in the keeping, grazing, or feeding of livestock for the sale of livestock or livestock products (including serums), for livestock increase, or for value increase, and includes cattle, hogs, sheep, goats, poultry of all kinds, horses, rabbits, bees, pets, fish in captivity, fur-bearing animals in captivity, and other animal specialties. (Cal. Code Regs., tit. 18, § 1533.1(b)(5).)

⁵ Major Group 07 of the SIC Manual includes establishments engaged in performing soil preparation services, crop services, veterinary services, animal services, landscape and horticultural services, and farm labor and management services. (Cal. Code Regs., tit. 18, § 1533.1(b)(5).)

⁶ The SIC system is used to classify businesses by the type of economic activity conducted and is intended to cover the entire field of economic activities. (*Morningstar Co. v. SBE* (2004) 9 Cal.Rptr.3d 600, 604.) “SIC codes classify businesses in major groups by a two-digit SIC Code, industry groups by a three-digit SIC code, or industries by a four-digit SIC code, depending on the level of detail most appropriate.” (*Ibid.*) The SIC Manual is available for viewing online at: < https://www.osha.gov/pls/imis/sic_manual.html>.

⁷ Major Group 20 of the SIC Manual includes establishments manufacturing or processing foods and beverages for human consumption, and certain related products, such as manufactured ice, chewing gum, vegetable and animal fats and oils, and prepared feeds for animals and fowls.

Dole's Soledad facility is a receiver of raw vegetables, 11 percent which are grown by Dole and 89 percent are purchased from third-party growers.⁸ This facility used the tangible personal property purchased from appellant, namely beard guards, latex gloves, dust masks, and knives, in its operations, which included cutting, trimming, washing, mixing, and packaging vegetables into ready to sell bags for market. Twenty-five percent of these bags consisted of single vegetable items (e.g., a bag of iceberg lettuce), 60 percent consisted of different mixtures of lettuce and other vegetables, and 15 percent consisted of different mixtures of lettuce, vegetables, and a "master pack" containing items such as salad dressing, croutons, and nuts.

Presumably due to the transition of SBE's adjudicative authority to OTA on January 1, 2018, which occurred shortly after the oral hearing in this matter on December 13, 2017, SBE did not issue a written opinion explaining its decision. However, the hearing transcript shows that prior to reaching its decision, SBE heard arguments from the parties relating to the application of section 6356.5, Regulation 1533.1, and the SIC Manual to the facts of this case.⁹ Appellant primarily argued that the cutting, mixing, and bagging of raw vegetables is an activity described within SIC Code 0723 of Major Group 07, which are "[e]stablishments primarily engaged in performing services on crops, subsequent to their harvest, with the intent of preparing them for market or further processing."

Respondent, however, argued that this activity was better described by SIC Code 2099 of Major Group 20, which pertains to "establishments primarily engaged in manufacturing prepared foods and miscellaneous food specialties, not elsewhere classified." Specifically, respondent argued that the cutting, mixing, and bagging of vegetables carried out by Dole's Soledad facility are post-harvesting activities that are not ultimately required to prepare vegetables individually for market. Respondent further argued that this facility used the tangible personal property purchased from appellant primarily to manufacture prepared foods, namely salads, which is a non-exempt activity expressly covered by SIC code 2099.

⁸ Appellant claims although it purchased most of the vegetables from others, it still harvested those vegetables using its own equipment, bearing the cost of harvesting and the risk of loss of the crop.

⁹ The transcript is available on SBE's website at: <http://www.boe.ca.gov/app/transcripts.aspx?year=2017>.

SBE also considered a legal opinion letter issued by respondent dated March 9, 2017, which agreed with appellant's position.¹⁰ While respondent repudiated this letter at the hearing, it conceded that the letter underwent the proper review and approval process prior to issuance. Ultimately, based on a finding that cut and mixed raw vegetables were not prepared food products (i.e., salads), SBE granted appellant's petition for redetermination.

There is no dispute that appellant meets requirements 1 and 2 for the partial exemption; however, in its Petition, respondent argues that a rehearing is warranted because SBE's determination that the cutting, mixing, and bagging of vegetables (that is, the preparation of mixed vegetable bags which constitute 60 percent of Dole's activities at its Soledad facility) is a producing and harvesting activity within the meaning of the Sales and Use Tax Law, is contrary to law. Thus, respondent concludes that it was clearly erroneous for SBE to find that requirement 3 was met.

Good cause for a new hearing may be shown where there was insufficient evidence to justify the decision or the decision is contrary to law, such that the substantial rights of the complaining party is materially affected. (*Appeal of Sjofinar Masri Do*, 2018-OTA-002P, Mar. 22, 2018; *Appeal of Wilson Development, Inc.*, 94-SBE-007, Oct. 5, 1994.)¹¹ The question of whether the decision is contrary to law is not one which involves a weighing of the evidence, but instead, requires a finding that the decision is "unsupported by any substantial evidence"; that is, the record would justify a directed verdict against the prevailing party. (*Sanchez-Corea v. Bank of America* (1985) 38 Cal.3d 892, 906.) This requires a review of the decision in a manner most favorable to the prevailing party, and an indulging of all legitimate and reasonable inferences to uphold the decision if possible. (*Id.* at p. 907.)

In considering respondent's Petition, we strongly emphasize that it is not our duty to determine whether we would have come to a different conclusion than SBE.¹² Instead, we consider only whether SBE's decision was contrary to law. The primary obstacle for respondent in demonstrating that SBE's decision is contrary to law is that there is no legal authority that

¹⁰ The letter is addressed to Bud Antle, Inc., which appellant asserts is a wholly owned subsidiary of Dole, and that the Soledad facility is "carried on Bud Antle's GL," which we presume to mean its general ledger.


¹¹ OTA's precedential opinions are viewable on OTA's website: <<https://ota.ca.gov/opinions/>>. SBE's precedential opinions are viewable on SBE's website: <<http://www.boe.ca.gov/legal/legalopcont.htm>>.

¹² Had this appeal come before us, we may very well have reached a different result.


conclusively establishes that the cutting, mixing, and bagging of raw vegetables is a post-harvesting activity within the context of the Sales and Use Tax Law, nor is there any clear boundary delineating “crop services” from “manufacturing prepared foods” as it applies to those activities. Rather, the activity described within SIC Code 0723, “performing services on crops, subsequent to their harvest, with the intent of preparing them for market or further processing,” is so broadly written, that when viewed *in a manner most favorable to appellant*, we think could reasonably include the cutting, mixing, and bagging of raw vegetables. And we doubt respondent would have issued a legal opinion letter reaching a similar conclusion had this position been entirely unreasonable. Lastly, we note that this activity is not patently inconsistent with the illustrative examples provided in SIC Code 0723, such as bean cleaning, corn shelling, nut hulling, or grain grinding, because like these examples, the final product underwent only minimal processing and remains essentially in its raw state.

Regarding the term “salad” as provided within SIC code 2099, we are not persuaded that this term is applicable to the mixed raw vegetables at issue here. The many illustrative examples given in SIC code 2099, such as butter, baking powder, gelatin, popcorn, fried and uncooked noodles, and peanut butter, are all items that have been highly processed and are far removed from their raw state. While the term “salad” is also included in that list, that term is not specifically defined within, nor, as the hearing record demonstrates, is there any commonly accepted definition of salad that might apply here. However, given that the examples provided in SIC code 2099 include only highly processed food items, the term “salad” as used here could reasonably refer to salads which contain additional processed food items (e.g., salad dressing, cheese, cooked meats, or croutons), and not the mixed raw vegetables sold by appellant. Therefore, the inclusion of salads in SIC Code 2099, does not conclusively demonstrate that SBE’s decision was contrary to law.

Based on the foregoing, we find that respondent has not shown that SBE’s decision was contrary to law. Accordingly, respondent’s Petition is hereby denied.

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Nguyen Dang
Administrative Law Judge

I concur:

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Daniel K. Cho
Administrative Law Judge

DISSENT

KWEE, A., Administrative Law Judge, dissenting:

I respectfully dissent. The issue is whether the decision of the State Board of Equalization (board) was contrary to law or there was insufficient evidence to justify the decision, which is a basis for granting a rehearing. (Cal. Code Regs., tit. 18, § 30820(d) [replaced by section 30604(d), effective 1/3/19].) Resolution of this petition for rehearing involves a legal, and not a factual, issue. The law is clear that the post-harvesting activities for which the property was used do not meet the statutory requirements for the partial exemption from use tax. As such, the purchaser used the property primarily in a nonqualifying manner. Nevertheless, the board granted the refund. Therefore, the board's decision is contrary to law.

The appeal before the board involved the application of the Sales and Use Tax Law to purchases of beard guards, latex gloves, dust masks, and knives by Dole Fresh Vegetables (DFV). To qualify for the partial exemption, the transaction must meet three elements: (1) purchase by a qualified person, (2) of qualified property, and (3) the purchaser must use the property primarily in a qualifying manner. (Rev. & Tax. Code, § 6356.5; Cal. Code Regs, tit. 18, § 1533.1.) The California Department of Tax and Fee Administration (CDTFA) concedes that the first two elements are met. On appeal, the only dispute is whether the property was primarily used in a qualifying manner.

The legal standard for element three

Section 6356.5 requires qualifying use for each item purchased. As a matter of law, a separate analysis is statutorily required for each item purchased. (Rev. & Tax. Code, § 6356.5.) Thus, the legal standard for element three is based on the actual use of the property.

The majority opinion correctly states that DFV's general business operations include cutting, mixing, washing, and bagging vegetables. It is similarly undisputed that DFV produces bags of cut, washed, and mixed vegetables. The majority goes on to base its decision in this petition on an analysis of whether cutting, mixing, washing, and bagging vegetables is a qualifying use of the property. Nevertheless, the general business operations of the purchaser are only relevant to determining element one: whether the purchaser is a qualified person. CDTFA concedes element one. With respect to element three, the disputed issue, the fact that DFV washes or bags vegetables in its general business operations is not relevant because the property

at issue was primarily used to trim, mix, and cut vegetables. Thus, DFV's general operations are overbroad for purposes of determining the actual use of each respective item at issue: beard guards, latex gloves, dust masks, and knives.

Here, DFV's general business operations included "bagging vegetables," which could be covered by SIC Code 0723, depending on whether the bagging is performed in connection with harvesting or post harvesting activities. Nevertheless, the specific property at issue could not have been primarily used for purposes of "bagging" vegetables. For example, there is no circumstance where knives would be used to bag vegetables. Instead, DFV primarily used the knives to trim and cut the vegetables. This activity is not described under any qualifying SIC Code.¹ Like the knives, the other disputed property (gloves, beard guards, dust masks (hereinafter protective gear) was also property primarily used in the "trim line"; where the vegetables are handled by workers for purposes of cutting and trimming, prior to bagging and sealing. Thus, it is a misapplication of the statute to apply DFV's general business operations, as opposed to the actual use of the property, in determining the primary use of the property at issue. While DFV did, in fact, wash and bag vegetables and purchase property for use in washing and bagging vegetables, those transactions are not at issue in this petition or the underlying appeal because CDTFA granted appellant's refund claim with respect to such transactions.² In summary, the fact that DFV washed and bagged freshly cut vegetables at its facility is not legally relevant to the actual use of the types of items at issue on appeal, knives and protective gear, which were primarily used for cutting and trimming. Therefore, I believe an incorrect standard was applied in denying the petition for rehearing.

Application of element three

The test for element three is whether the purchaser primarily used the knives and protective gear for producing and harvesting agricultural products. (Cal. Code Regs., tit. 18,

¹ For purposes of section 6356.5, this means the Standard Industrial Classification (SIC) Manual published by the Office of Management and Budget, 1987 Edition.

² As relevant, the board issued written advice to a subsidiary of appellant, Bud Antle, Inc., on March 9, 2017, concluding that the transactions described therein qualify for the partial exemption. In the letter, the board quotes appellant, and notes that the scope of the written advice is limited to washing and bagging equipment:

"You state that the equipment and machinery at issue is used for 'washing of agricultural products . . . [and] the purchase of packaging of agricultural products for shipment' under [Regulation 1533.1(b)(5).] You ask whether this purchase and use of equipment qualifies for the partial exemption for farm equipment and machinery."

§ 1533.1(a.) California Code of Regulations, title 18, section (Regulation) 1533.1 provides, in pertinent part:

“Producing and harvesting agricultural products” means those activities described in Major Groups 01, 02 and 07 of the SIC Manual. . . . Except as otherwise provided under Major Groups 01, 02 or 07 of the SIC Manual, producing and harvesting activities do not include post harvesting activities nor those activities described or otherwise designated in Major Group 20 – Food and Kindred Products of the SIC Manual.

(Cal. Code Regs., tit. 18, § 1533.1(b)(5).) Qualifying activities, those described under SIC Code 0723, include “packaging fresh or farm dried fruits and vegetables” and “sorting, grading, and packing of fruits and vegetables.” SIC Code 0723 further limits qualifying activities to those performed while preparing crops “for market or for further processing.” The SIC Code explains that qualifying activities described in Major Group 07 are those performed “for others on a contract or fee basis.” Nonqualifying activities are those which are not described under Major Groups 01 (agricultural production crops), 02 (agriculture production livestock and animal specialties), or 07 (agriculture services). Thus, for example, one nonqualifying activity is described under SIC Major Group 20, “manufacturing prepared foods and miscellaneous food specialties,” including “Salads, fresh or refrigerated.” (SIC Code 2099.) This is one activity which occurs during “further processing.” In summary, the law, which incorporates by reference the SIC Manual, draws a line between harvesting and related activities (gathering crops and preparing them for market), and manufacturing activities (blending and cutting the crops to make a salad, or any other post-harvest processing activity).

The line for qualifying activities ends with packaging harvested agricultural products for shipment to “market” (i.e., for sale) or for shipment to another facility for “further processing.” (SIC Code 0723.) Any additional activity, including further processing, is a post-harvesting activity. Post-harvesting activities, such as manufacturing a salad (here, the further processing of crops sold to or shipped to DFV’s facility) do not qualify. Qualifying activities are limited to those specifically described in Major Groups 01, 02 or 07 of the SIC Manual. (Cal. Code Regs., tit. 18, § 1533.1(b)(5).) Here, DFV used the knives and protective gear to trim and cut vegetables, which DFV ultimately sold as salads, salad kits, and salad blends, both with and without salad dressing and croutons. Further, 89 percent of the cutting and trimming pertained to crops that were shipped to DFV’s facility for further processing from third party locations. The activity of performing “further processing” on these crops is a nonqualifying activity which is

described under SIC Code 2099, under Major Group 20, of the SIC Manual. More importantly, preparing salads is not an activity described under Major Groups 01, 02, or 07, which is the legal requirement to qualify. Finally, for the above reasons, even if any of the property was incidentally used while bagging and packaging freshly cut and trimmed vegetables, such packaging would have occurred in connection with a post-harvest activity, and as such would be a nonqualifying use of the property.

The majority opinion finds that the activity of “performing services on crops” in SIC Code 0723 is so broad, that it could reasonably include cutting, mixing, washing, and bagging vegetables. This conclusion is based on a comparison between qualifying activities described in SIC Code 0723, with nonqualifying activities described in SIC Code 2099. Specifically, the majority believes that DFV’s general business operations are more similar to qualifying activities described in SIC Code 0723, than they are to nonqualifying activities described in SIC Code 2099. Based on this comparison, the majority asserts a standard for what types of activities should or should not qualify. This reasoning is misplaced. The law requires that, to qualify, the activity at issue be “described in Major Groups 01, 02 and 07.” (Cal. Code Regs., tit. 18, § 1533.1(b)(5).) Any activity which is not described under one of those three Major Groups is a nonqualifying activity. SIC Code 0723 describes many qualifying activities and the specific activities of trimming, cutting, or blending vegetables are not described in SIC Code 0723, nor any other qualifying SIC code. Further, SIC Code 2099 is one of hundreds of nonqualifying SIC Codes, just as SIC Code 0723 is one of dozens of qualifying SIC Codes. Thus, any comparison of SIC Code 2099 to 0723 as a basis for establishing a legal standard for what types of activities generally should or should not qualify is wholly unrepresentative and unpersuasive.

Nevertheless, the fact that an activity is, in fact, described under nonqualifying SIC Code would serve to further reinforce a conclusion that the activity is a nonqualifying activity. Major Group 20 of the SIC Code explains that manufacturing includes “the blending of materials.” Within this group, SIC Code 2099 specifically includes as a nonqualifying activity, making: “salads, fresh or refrigerated.” Other nonqualifying manufacturing activities include “freezing fruits, fruit juices, and vegetables,” including the quick (flash) freezing of these products. (SIC Code 2037.) Thus, first, the standard applied by the majority (referring to manufacturing as making those items which are “highly processed and are far removed from their raw state”) is

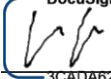
inconsistent with the SIC Code. Second, the activity at issue, blending vegetables to make a salad, is an activity specifically described under nonqualifying SIC Code 2099.

Finally, even the taxpayer reports itself as being an establishment engaged in performing nonqualifying activities described in SIC Code 2099.³ As indicated above, the only issue on appeal is whether the taxpayer primarily used the property in “producing and harvesting agricultural products.” Qualifying activities are limited to those described in Major Groups 01, 02, and 07. (Cal. Code Regs., tit. 18, § 1533.1(b)(4).) Major Group 07, including SIC Code 0723, only applies to activities performed “for others on a contract or fee basis.” Regulation 1533, subdivision (b)(4), the definition of “producing and harvesting agricultural products,” contains an illustrative example of this limitation in SIC Code 0723. When a third-party works with a farmer on a contract basis to use machinery and equipment to dry the farmer’s crops, the transaction qualifies for the partial exemption because the third party is performing an activity described in SIC Code 0723. (Cal. Code Regs., tit. 18, § 1533.1(b)(4), example B.) On the other hand, when a third-party purchases crops from a farmer and uses the machinery and equipment to dry crops, the transaction does not qualify because the third party owns the crops and, as such, is not performing an activity described in SIC Code 0723. (Cal. Code Regs., tit. 18, § 1533.1(b)(4), example C.) By its own admission, DFV owns the crops and is not performing its activities for a third party on a contract or fee basis. Thus, the board’s decision is contrary to law and DFV’s activities do not qualify under SIC Code 0723.

In conclusion, the partial exemption is inapplicable because DFV primarily used the property for non-qualifying purposes: trimming, blending, and cutting salad vegetables that were primarily shipped to DFV for further processing from third party locations. The board was required to follow Regulation 1533.1. (See *Newco Leasing, Inc. et al. v. State Bd. of Equalization* (1983) 143 Cal.App.3d 120, 124.) Therefore, the board’s decision is contrary to law, which is a basis for granting a rehearing. A basis for a rehearing is material if it is likely to produce a different result. (See *Santillan v. Roman Catholic Bishop of Fresno* (2012) 202 Cal.App.4th 708; *Hill v. San Jose Family Housing Partners, LLC* (2011) 198 Cal.App.4th 764; *Trovato v. Beckman Coulter, Inc.* (2011) 192 Cal.App.4th 319.) Here, the board’s decision was contrary to law and resulted in the claim being granted instead of denied. Therefore, the board’s

³ CDTFA provided evidence that DFV registered its business with the SIC Code business database and classified itself under SIC Code 2099; manufacturing prepared foods, including salads.

error is material and a rehearing is warranted. (*Appeal of Wilson Development, Inc.*,
94-SBE-007, Oct. 5, 1994.)

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Andrew J. Kwee
Administrative Law Judge