

**OFFICE OF TAX APPEALS
STATE OF CALIFORNIA**

In the Matter of the Appeal of:) OTA Case No. 18103892
OWENS-BROCKWAY GLASS) CDTFA Case ID: 1008862
CONTAINER, INC.) CDTFA Acct No. 30-675832
)
) Date Issued: April 29, 2019
)

OPINION

Representing the Parties:

For Appellant:	Jeffrey R. Monsman, Attorney
For Respondent:	Mengjun He, Tax Counsel III

J. ANGEJA, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6901, Owens-Brockway Glass Container, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying a portion of appellant’s claim for refund for the period January 1, 2013, through August 31, 2016, in the amount of \$203,608.19.

Appellant waived its right to an oral hearing, and therefore the matter is being decided based on the written record.

ISSUE

Whether appellant has established that its use of non-depreciated molds is partially exempt from tax as tangible personal property used in the manufacturing process pursuant to R&TC section 6377.1.

¹ Sales taxes were formerly administered by the State Board of Equalization. In 2017, functions of the board relevant to this case were transferred to the California Department of Tax and Fee Administration (CDTFA). (Gov. Code § 15570.22; 2017 Stats. 2017, ch. 16, § 5.) The term “CDTFA” shall refer to both, depending on the context and timing. When referring to acts or events that occurred before July 1, 2017, “CDTFA” shall refer to the board; and when referring to acts or events that occurred on or after July 1, 2017, “CDTFA” shall refer to CDTFA.

FACTUAL FINDINGS

1. Appellant, a corporation based in Perrysburg, Ohio, manufactures and sells glass container products. Appellant holds a seller's permit with an effective start date of April 1, 1987, and appellant maintains facilities in Los Angeles, Oakland, Tracy, and Fairfield, California.
2. Appellant uses molds in its glass bottle manufacturing process.
3. The useful life for the molds is generally 2.5 years,² but for federal income tax purposes, appellant elected to classify the cost of the molds as an expense in the period in which the cost was incurred, via the "de minimis safe harbor election" pursuant to 26 Code of Federal Regulations part 1.263(a)-(1)(f), rather than depreciate the molds over their 2.5-year useful life.
4. On May 5, 2017, appellant submitted a claim for refund for the period January 1, 2013, through August 31, 2016, for \$1,089,529.20 tax reported in error.³
5. In response to appellant's claim for refund, CDTFA issued a September 12, 2017 Report of Field Audit and a September 12, 2017 Field Billing Order, which identified tax credits of \$435,398.20 and \$325,367.34, respectively. However, CDTFA denied appellant's refund request of \$203,608.19 for use tax paid on appellant's use of undepreciated molds.⁴
6. CDTFA issued a Decision in this matter, in which CDTFA sustained the audit report and field billing order on the basis that the useful life requirement of R&TC section 6377.1 was not met due to appellant's election, under the de minimis safe harbor rule, to deduct the molds as an expense. This timely appeal followed.

² Pursuant to Internal Revenue Service Revenue Procedure 87-56, the class life for asset class 32.11, "Manufacture of Glass Products – Special Tools" (which includes molds in its definition) is 2.5 years. Pursuant to California Code of Regulations, title 18, section 24349(a)(1), California conforms to the federal useful lives of property.

³ Appellant's claim for refund included tax accrued (i.e., reported) in error for nontaxable services, exempt food, raw material, exempt packaging, clerical errors, and use tax paid on tangible personal property used in the manufacturing process.

⁴ According to the Decision, CDTFA denied \$221,387.32 of appellant's claim for refund, and this denied amount consists of alleged clerical errors or calculation adjustments, as well as use tax paid by appellant on its use of non-depreciated molds. Appellant states in its opening brief that it does not dispute CDTFA's denial of refund amounts relating to calculation adjustments, but does dispute CDTFA's denial of \$203,608.19 related to the non-depreciated molds.

DISCUSSION

There are no facts in dispute in this matter. The molds were purchased by a qualifying person (appellant) for use in a qualifying manner (manufacturing glass bottles) and the only issue remaining in dispute is the legal question of whether appellant's molds meet the useful life requirement of R&TC section 6377.1 despite appellant's election to expense the molds under the de minimis safe harbor rule.

R&TC section 6377.1 was enacted by AB 93, effective July 11, 2013, and operative July 1, 2014. As relevant here, that section provides a partial exemption from sales and use tax for the sale or use of qualified tangible personal property purchased for use by a qualified person to be used primarily in any stage of the manufacturing of tangible personal property. (R&TC, § 6377.1(a)(1).) Qualified tangible personal property includes machinery and equipment, including component parts and contrivances such as belts, shafts, moving parts, and operating structures. (R&TC, § 6377.1(b)(9)(A)(i).) Manufacturing aids may be considered machinery and equipment when purchased by a qualified person for use by that person in a manner qualifying for exemption. (Cal. Code Regs., tit. 18, § 1525.4 (b)(9)(A)(1).) Qualified tangible personal property shall not include consumables with a useful life of less than one year. (R&TC, § 6377.1(b)(9)(B)(i).)

As originally written, R&TC section 6377.1 set forth that "useful life" for tangible personal property that is treated as having a useful life of one or more years for state income or franchise tax purposes shall be deemed to have a useful life of one or more years for purposes of this section. (Former R&TC, § 6377.1(b)(10).) And, "useful life" for tangible personal property that is treated as having a useful life of less than one year for state income or franchise tax purposes shall be deemed to have a useful life of less than one year for purposes of this section. (*Ibid.*) However, R&TC section 6377.1 was amended by AB 398, effective July 25, 2017, which moved the language of subdivision (b)(10) to subdivision (b)(13)(A), and added the following to this subdivision: "For the purposes of this paragraph, tangible personal property that is deducted under Sections 17201 and 17255 or Section 24356 shall be deemed to have a useful life of one or more years." R&TC section 6377.1, subdivision (b)(13)(A), is retroactive to July 1, 2014, pursuant to subdivision (b)(13)(B).

Under R&TC sections 17201 and 17255 (for personal income tax purposes) and section 24356 (for corporate tax purposes), California conforms, with some modifications, to the federal

election to deduct as an expense the cost of qualifying property under Internal Revenue Code (IRC) section 179, rather than to recover such costs through depreciation deductions.

Under R&TC section 17201, subdivision (c) (for personal income tax purposes) and section 24422.3 (for corporate tax purposes), California conforms to the uniform capitalization rules of IRC section 263A and Treasury Regulation section 1.263(a)-1(f). Under Treasury Regulation section 1.263(a)-1(f), qualifying businesses with an applicable financial statement may deduct as expenses eligible property in the year of purchase if the amount paid does not exceed \$5,000 or if the useful life of the property is no more than a year (i.e., the de minimis safe harbor).

A taxpayer bears the burden of proving entitlement to an exemption or exclusion and must provide some credible evidence of that entitlement. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 443); *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal. App.3d 739, 744.) The applicable burden of proof is by a preponderance of the evidence. (Evid. Code, § 115; *Appeal of Estate of Gillespie*, 2018-OTA-052P, June 13, 2018, at p. 4, internal citation omitted.) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.)

On appeal, appellant notes that CDTFA acknowledged in its Decision that California recognizes the 2.5-year useful life of items like the molds at issue for income and franchise tax purposes, which appellant asserts is dispositive of the issue. Furthermore, appellant argues that because the requirements of the de minimis safe harbor election are disjunctive, and because appellant elected to expense the molds on the basis of their cost, appellant's use of the de minimis safe harbor election has no bearing on the molds' useful life.

Appellant contends that the partial exemption for tangible personal property used in the manufacturing process must coexist with the de minimis safe harbor election. Appellant asserts that R&TC section 6377.1 reflects the legislature's preference to partially exempt manufacturing equipment that has a useful life of one or more years, while the federal safe harbor reflects the IRS's preference to give a taxpayer the administrative flexibility to expense low cost items that otherwise would be capitalized throughout their useful life. Appellant asserts that in cases such as this, where tangible personal property costs less than \$5,000 and has a useful life greater than

one year, California Code of Regulations, title 18, section 24349, subdivision (l), incorporates the useful life for state income and franchise tax purposes and section 6377.1's exemption applies because the property has met the statutory requirement. Appellant states that, at the same time, Treasury Regulation section 1.263(a)-1(f), provides administrative relief via a cost accounting technique. Appellant asserts that the plain language of R&TC section 6377.1 does not mandate a taxpayer relinquish the safe harbor's administrative relief as a condition to claim the partial manufacturing exemption.

Lastly, appellant's opening brief addresses the fact that R&TC section 6377.1 deems property expensed under section 17201 and 17255 and section 24356 as having a useful life of at least a year but does not include in this list property expensed via the de minimis safe harbor election. In this regard, appellant argues that "[b]y adding sections 17201, 17255, and 24356, the Legislature expanded the scope of 6377.1's exemption in those specific cases. Including Regulation 24349(l) in the list would be redundant as the regulation operates solely to define useful lives for income or franchise tax purposes."

In order to qualify for the exemption, the law requires that the property at issue be depreciated over a useful life of one year or more (R&TC, § 6377.1(b)(9)(B)(i)), and the only statutory exception to that rule is when the property is expensed pursuant to IRC section 179 (R&TC section 6377.1, subd. (b)(13)(A).) We note that R&TC section 6377.1, subdivision (b)(13)(A), identifies a single instance in which a potentially depreciable asset that is deducted as an expense has a useful life of at least one year.⁵ The Legislature's identification of a single instance in which expensed assets meet the useful life requirement implies that the useful life requirement is not met in other instances where the asset is expensed. The legislative history of AB 398 is silent as to the Legislature's intent regarding subdivision (b)(13)(A), and we are therefore unwilling to interpret this omission as inadvertent, especially since tax exemptions are to be strictly construed against the taxpayer. (*Alpha Therapeutic Corp. v. Franchise Tax Board* (2000) 84 Cal.App.4th 1, 5). Moreover, our role is limited to the interpretation of statutes as they are written, and we have no power to rewrite statutes to make them conform to a presumed intention which is not expressed. (See *Seaboard Acceptance Corp. v Gray* (1931) 214 Cal. 361,

⁵ Although R&TC section 6377.1, subdivision (b)(13)(A), refers to R&TC sections 17201, 17255 and section 24356, these sections involve elections to expense assets under California's modifications of IRC section 179 for personal income tax purposes and for corporate tax purposes, respectively.

365.) Therefore, we decline to read R&TC section 6377.1, subdivision (b)(13)(A), so broadly as to include items expensed under the de minimis safe harbor election.

For the foregoing reasons, we find appellant has failed to prove that the partial exemption for tangible personal property used in the manufacturing process applies to appellant’s non-depreciated molds, and appellant has failed to show that it is entitled to an additional refund amount.

HOLDING

Appellant has not established that its use of non-depreciated molds is partially exempt from tax as tangible personal property used in the manufacturing process pursuant to R&TC section 6377.1.

DISPOSITION

CDTFA’s denial of appellant’s claim for refund over and above those amounts identified in the September 12, 2017 Report of Field Audit and a September 12, 2017 Field Billing Order is sustained.

DocuSigned by:
Jeff Angeja
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Jeffrey G. Angeja
Administrative Law Judge

We concur:

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Neil Robinson
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Neil Robinson
Administrative Law Judge

DocuSigned by:
Alberto Rosas
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Alberto T. Rosas
Administrative Law Judge