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APPEARANCES:

Panel Lead: Hon. JOSHUA LAMBERT

Panel Members: Hon. JEFF ANGEJA
Hon. LINDA CHENG

For the Appellant: EDDIE ALAMO
MANUEL ALMEIDA

For the Respondent: STATE OF CALIFORNIA
DEPARTMENT OF TAX AND
FEE ADMINISTRATION
By: JARRETT NOBEL
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LISA RENATI

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I N D E X

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E X H I B I T S

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CLOSING STATEMENT

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Mr. Nobel	20

1 Los Angeles, California; Wednesday, September 18, 2019

2 10:48 a.m.

3

4 ADMINISTRATIVE LAW JUDGE LAMBERT: Let's go on
5 the record then and get started.

6 We're now on the record in the Office of Tax
7 Appeals oral hearing for the appeal of Martinez Steel
8 Corporation, Case Number 18073411. We're in Los Angeles,
9 California. The date is Wednesday, September 18th, 2019,
10 and the time is approximately 10:48 a.m.

11 My name is Josh Lambert, and I'm the
12 Administrative Law Judge for this hearing. And my fellow
13 co-panelists today are Linda Cheng and Jeff Angeja.

14 Appellants, could you please identify yourselves
15 for the record.

16 MR. ALMEIDA: Manuel Almeida, representative.

17 MR. ALAMO: Eddie Alamo, Martinez Steel.

18 ADMINISTRATIVE LAW JUDGE LAMBERT: CDTFA?

19 MR. NOBLE: I'm Jarrett Nobel with CDTFA.

20 MS. SILVA: Monica Silva, CDTFA.

21 MS. RENATI: And Lisa Renati with CDTFA.

22 ADMINISTRATIVE LAW JUDGE LAMBERT: Thank you.

23 This appeal involves one issue which we agreed
24 upon at the prehearing conference: Whether an adjustment
25 to underreported ex-tax purchases of steel materials

1 subject to use tax is warranted. We also agreed during
2 our prehearing conference to admit evidence, Appellant's
3 Exhibits 1 through 4 and CDTFA's Exhibits A through C, and
4 neither party had any objections to the admission of those
5 exhibits. Is that still correct?

6 MR. ALMEIDA: Yes.

7 ADMINISTRATIVE LAW JUDGE LAMBERT: Thank you.

8 And I hereby admit these exhibits into evidence.

9 (Appellant's Exhibits 1-4 were received
10 in evidence by the Administrative Law Judge.)

11 (Department's Exhibits A-C were received in
12 evidence by the Administrative Law Judge.)

13 ADMINISTRATIVE LAW JUDGE LAMBERT: Also we agreed
14 previously that there would be no witnesses testifying.
15 Is that still correct?

16 MR. ALMEIDA: Correct.

17 ADMINISTRATIVE LAW JUDGE LAMBERT: Thank you.

18 We discussed that first, Appellant would have 15
19 minutes to talk and give their presentation and the CDTFA
20 and judges will be allowed to ask questions. Then CDTFA
21 will make its presentation not to exceed 15 minutes, and
22 Appellant and the judges will then be allowed to ask
23 questions if they wish. After that, the parties can give
24 closing remarks not to exceed five minutes.

25 So Appellants, you now have the opportunity to

1 explain your position, and you have 15 minutes. Thanks.

2 MR. ALMEIDA: Thank you.

3

4 OPENING STATEMENT

5 MR. ALMEIDA: Martinez Steel is a company that
6 sells steel products, and they are also a contractor.
7 This audit runs through, I believe, the 2nd quarter of
8 2015. And the one issue that we had with the audit had to
9 do with the timing of when tax should be paid on the ex --
10 tax purchases of materials.

11 During the audit, it was determined by the
12 CDTFA -- well, at the time Board of Equalization auditor
13 that there should be tax paid to the vendors, based on the
14 fact that Martinez Steel was not in the business of
15 selling tangible personal property. Therefore, they could
16 not issue a resale certificate to its vendors. Obviously,
17 we disagreed with that over a period of time.

18 We were able to demonstrate -- and as it shows in
19 the exhibits, particularly 1 and 2 that we provided --
20 there was over a million-and-a-half-dollars in sales,
21 over-the-counter, of steel products. At that time, I'm
22 not necessarily sure that during the audit, the auditor
23 did his due diligence in trying to determine whether there
24 was, in fact, sales.

25 One thing that was noted during the appeals

1 process was that the auditor kept on referring to sales --
2 retail sales. Ultimately, Martinez Steel not only makes
3 retail sales of steel product, but they also make sales of
4 resale. Which, you know, to a certain extent, I think it
5 was a little bit more difficult to try to identify during
6 the process of the audit. Because at the end of the day,
7 it was not an issue as it related to the audit. In other
8 words, there were no question of sales for resale during
9 the audit.

10 So we went in and we, basically, demonstrated by
11 going through and doing an analysis from day one. And the
12 permit was actually secured, I believe, in August of 2010.
13 And over that period of time, Martinez Steel established
14 the methodology and, basically, the business model that
15 they would have, which was we're going to be selling steel
16 product. We're going to issue resale certificates to our
17 vendors.

18 And to the extent that we use any of those
19 products in a lump sum contract, we will accrue and pay
20 use tax as we withdraw from inventory, which they did.
21 And ultimately, the issue in the audit was not whether
22 they paid use tax on those products or not, it's when the
23 use tax was paid.

24 And the CDTFA at that time made a decision
25 that -- or the Board of Equalization made a decision that

1 well, you know what? They're not in the business of
2 selling tangible personal property. Therefore, they
3 should not be allowed to issue a resale certificate to
4 their vendors, and therefore, they're going to owe tax on
5 the remaining inventory.

6 Of course we disagreed with this decision. And,
7 ultimately, we went to the appeals conference and once
8 again, presented our exhibits and our position. And,
9 clearly, there's no statutory authority that says that you
10 are required to pay the tax. The only thing that we were
11 able to find within the statutes, annotations, and rulings
12 is that, ultimately, if you're in a business of selling
13 tangible personal property, you can issue resale
14 certificates.

15 There's no specific amount of transactions that
16 are required to have a resale certificate issued to the
17 vendors. All it says is that if you're in the business of
18 selling tangible personal property, you can issue that.
19 The Department's position at that time and why we're here
20 today, is well, there isn't a significant amount of
21 over-the-counter sells. And, again, they use the term
22 retail. We don't believe retail alone is the term that
23 needs to be used.

24 But, again, when you have over a
25 million-and-a-half-dollars, I think 1.6 million-plus to be

1 precise, in over-the-counter sales, and you're asking the
2 taxpayer to basically pull all the resale certificates
3 from its vendors, and say, now we're going to pay tax.
4 And now we're going to take a credit or we're going to
5 file a claim for refund on every return thereafter, simply
6 on the basis that you pay tax to the vendor and now
7 issue -- you're basically making sales for resale.

8 Yeah. Easy to do a tax paid purchase resold
9 credit if you actually collect sufficient tax to cover
10 what you paid the vendor. But at the end of the day,
11 you're going to be filing a claim for refunds. And,
12 ultimately, that was one of our contentions. Okay. So if
13 we have to pay the tax at the end of the audit period,
14 don't we have to file claims for refund for every quarter
15 thereafter until all that inventory has been used up or
16 withdrawn from inventory?

17 So not only do we believe it's not -- there's no
18 statutory authority as long as the tax has been paid. We
19 believe the Department should be comfortable with that and
20 should have accepted our position. Having said that,
21 we're here today. And, obviously, we would need,
22 obviously, as far as a decision ultimately being made, if
23 there's tax owed in this particular audit, then now we
24 have to get refunds for all the other periods when we --
25 inventory was withdrawn and the use tax was ultimately

1 paid.

2 So in a nutshell that's really the issue.
3 There's another issue related to use tax within the audit,
4 items that were purchased from out of state. We have no
5 contention with that. And that is something that taxpayer
6 is comfortable with. But the timing issue, there's plenty
7 of adaptations. If you look at Exhibit 4, there's plenty
8 of adaptations and rulings that clearly demonstrate that
9 it's more subjective than anything else.

10 And the reality is that contractors out there,
11 they do both. And if they have over-the-counter sales,
12 they should have the ability to issue resale certificates,
13 particularly if it makes it easier for them to comply, and
14 the state winds up getting all their sales and/or use tax
15 associated with those purchases.

16 So that's -- in a nutshell, that's our position,
17 and, you know, we feel very strongly that if the tax has
18 been paid, you know, the decision should be rendered for
19 the taxpayer.

20 ADMINISTRATIVE LAW JUDGE LAMBERT: Thank you,
21 Mr. Almeida.

22 MR. ALMEIDA: Thank you.

23 ADMINISTRATIVE LAW JUDGE LAMBERT: CDTFA, you
24 have 15 minutes to make your presentation.

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OPENING STATEMENT

MR. NOBLE: In this appeal, there's no dispute that the Appellant is a construction contractor that furnished and installed steel rebar in California under lump sum construction contracts. In addition, Appellant also makes sales of steel without installation, either at retail or sales for resale to other retailers.

During the liability period, Appellant purchased \$18,374,604 worth of steel without paying tax, either by issuing resale certificates to its vendors or purchasing the property from out of state. During the liability period, Appellant reported a taxable measure of \$15,534,190 representing \$15,516,800 of steel consumed in the performance of construction contracts. And according to documents provided by Appellant, it sold, either at retail or in sales for retail, \$17,320 of steel.

The deficiency measure established during the audit of \$2.8 million represents the difference between the taxable measure Appellant reported on its sales and use tax returns and the steel it purchased without paying tax.

Under regulation 1521(b)(2)(a)(1), construction contractors are consumers of materials they furnish and install in the performance of a construction contract. And either sales or use tax applies to the contractor's

1 purchases of materials. Furthermore, a construction
2 contractor may not purchase materials for resale, unless
3 they are also in the business of selling materials.

4 Pursuant to Regulation 1668(g), when a retailer
5 improperly issues a resale certificate for property that
6 is not intended to be resold, the tax becomes due at the
7 time of purchase.

8 In addition, Department's Audit Manual, Section
9 1206.10 provides that when a construction contractor
10 purchases material for consumption without paying tax, the
11 tax becomes due at the time of purchase, not at the point
12 of which materials are withdrawn from inventory for use by
13 the contractor.

14 According to Sales and Use Tax Annotations
15 190.0161 and 190.0208, a construction contractor may issue
16 a resale certificate when purchasing materials in fungible
17 lots, some of which will be resold, and some of which will
18 be consumed under the performance of construction
19 contracts, but only when a significant portion of the
20 material is intended to be and actually resold. If at the
21 time of purchase the contractor knows that certain
22 materials will be consumed in the performance of a
23 construction contract, the contractor may not issue a
24 resale certificate with respect to those materials, and
25 the sale is subject to tax.

1 Essentially, even when a contractor also sells
2 materials, it can only make an entire purchase of
3 materials without paying tax when it intends to resell
4 most of the materials, and it does not know what amount
5 will be consumed.

6 As applied to this appeal, the evidence
7 establishes that Appellant had retail sales of \$17,320,
8 whereas, Appellant consumed steel totaling \$15,516,000.
9 This means that Appellant resold less than 1 percent of
10 the total materials that withdrew from its resale
11 inventory during the liability period.

12 That Appellant only resold less than 1 percent of
13 the steel it purchased during the liability period,
14 strongly indicates that Appellant did not intend to resell
15 a significant portion of the steel it purchased.
16 Furthermore, according to schedule 12A-1 of the audit work
17 papers, the Department's Exhibit C, Appellant purchased
18 approximately \$9.8 million of steel in 2014 and reported a
19 taxable measure of approximately \$5.5 million.

20 However, according to Appellant's Exhibit 1, it
21 recorded retail sales of steel of only \$2,978 during the
22 same quarter. Appellant could not have reasonably
23 intended to resell a significant portion of over \$9
24 million in steel purchases based on these amounts.
25 Instead, the evidence establishes that Appellant purchased

1 the materials for its own consumption.

2 Therefore, under Regulation 1668(g), Appellant's
3 purchases of steel with resale certificates without
4 payment of tax at the time of purchase were improper, and
5 Appellant is liable for use tax at the time it purchased
6 the steel. None of the authorities relied upon by the
7 Appellant provide that a retailer can purchase all
8 tangible personal property for resale without paying tax.
9 Rather, the authorities provide that you must intend to
10 resell a significant portion of a comingle lot of goods.

11 In addition, with respect to Appellant's
12 arguments regarding sales of steel prior to the liability
13 period, the journal entries Appellant provided as
14 Exhibit 2, only show Appellant's alleged over-the-counter
15 sales of steel, either sales for resale or retail sales.
16 The journal entries do not indicate the total amounts of
17 steel purchases during that time. Thus, there's no way to
18 determine whether significant portions of the steel
19 Appellant purchased were resold rather than consumed.

20 Furthermore, considering Appellant sold less than
21 1 percent of the material withdrew from inventory and
22 consumed the remainder, Appellant's sales prior to this
23 liability period still would not establish that it
24 intended to resell significant portions of the steel it
25 purchased during the period at issue.

1 Further, according to Appellant's Exhibit 1, the
2 bulk of its over-the-counter sales of steel, approximately
3 \$1.2 million occurred in the 4th quarter of 2011. And
4 according to Appellant's sales journal for that quarter,
5 attached as Exhibit 2, all the sales were coded the same
6 job number in the County of San Bernardino. This
7 indicates that the bulk of Appellant' over-the-counter
8 sales in prior periods was to the same customer and,
9 likely an outlier, and not a repeated pattern of
10 over-the-counter sales.

11 Likewise, Appellant's sales after the liability
12 period also do not establish that it intended to resell
13 significant portions of the steel it purchased during the
14 periods at issue. There's simply no evidence that
15 establishes that Appellant resold significant amounts of
16 steel. In fact, the evidence shows the opposite.
17 Appellant consumed a very significant amount of the steel
18 it purchased.

19 With respect to the invoices showing that
20 Appellant collected tax reimbursement from its retail
21 sales of steel after this liability period, and
22 Appellant's assertion that it reported use tax on steel it
23 consumed after the liability period, the claim for refund
24 is pending. That claim for refund is not part of this
25 appeal. However, any overpayment of tax that can be

1 verified during these periods would be applied.

2 Accordingly, there's no evidence or legal
3 authority to establish that the audited deficiency measure
4 is not valid, and this appeal should be denied.

5 ADMINISTRATIVE LAW JUDGE LAMBERT: Thank you.

6 Appellant, do you have any questions for CDTFA?

7 MR. ALMEIDA: Well, I think speculation on the
8 1.2 million that, you know, that was not accurate. Again,
9 during the audit period, all of these thing were addressed
10 with those particular periods. And, again, you have to
11 understand. When the taxpayer establishes a pattern of,
12 okay, here's what we're going to do, and we're going to
13 start, you know, at least trying to get some business any
14 which way we can, and he establishes it. Whether it's 1
15 customer or 10 customers, they're going to by steel. And
16 there's a worthwhile business decision to be made, and
17 that's going to happen.

18 So, again, with respect to that comment about the
19 outlier, the whole thing, it's -- that's purely
20 speculation and not factual. But at the end of the day,
21 there is no statutory authority that gives you a specific
22 amount that's significant. I mean, obviously, when you
23 establish a pattern with vendors, if you've been through
24 enough sales tax audits over the years and you see where
25 the resale certificates are being issued to vendors and,

1 ultimately, somebody is asked to pull those resale
2 certificates from the vendors and now start, basically,
3 paying tax, the compliance level of trying to fix that and
4 resolve that. Particularly, like I said, in a situation
5 where you're going to be filing claims for refunds for any
6 subsequent over-the-counter sales, which you pay tax on.

7 That's an absolute compliance nightmare, not only
8 for the taxpayer, but, you know, simply for the
9 Department. It has to, you know, go back and forth. And,
10 ultimately, you know, what they normally tend to say is,
11 hey, look. If you're going to continue to file claims for
12 refund, maybe you should change your billing methodology.

13 But, you know, at the end of the day, there's no
14 statutory authority that says that you have to have a
15 certain percentage. There's no particular amount in
16 place. And, again, if you look at the exhibits or the
17 adaptations of rulings in Exhibit 4, there's numerous,
18 numerous transactions or examples of rulings and
19 transactions where, you know, it happens where you have
20 resale certificates issued to these vendors.

21 You can't just all of a sudden pull resale
22 certificates and say, okay. Well, don't tax me on those.
23 And, again, there's fungible goods. I mean, Martinez
24 Steel maintain inventory, and to the extent that they
25 could sell that inventory over-the-counter, they would

1 certainly do so.

2 So, you know, otherwise we wouldn't be talking
3 about it. Otherwise, you know, they would be buying the
4 product and subsequently having it shipped directly to the
5 job site.

6 ADMINISTRATIVE LAW JUDGE LAMBERT: Okay. Thank
7 you.

8 MR. ALMEIDA: You're welcome.

9 ADMINISTRATIVE LAW JUDGE LAMBERT: Judges do you
10 have any questions for Appellant?

11 ADMINISTRATIVE LAW JUDGE ANGEJA: No questions.

12 ADMINISTRATIVE LAW JUDGE LAMBERT: CDTFA, do you
13 have any questions for Appellant?

14 MR. NOBLE: We don't have any questions. Thank
15 you.

16 ADMINISTRATIVE LAW JUDGE LAMBERT: Judges, any
17 more questions?

18 Appellant, do you want to give a final closing
19 remark?

20

21 CLOSING STATEMENT

22 MR. ALMEIDA: Yeah. You know, the bottom line,
23 at the end of the day, the tax has been paid. And it's
24 been paid long ago. Probably, if anything remains, it was
25 probably through the 4th quarter of 2015. And they will

1 continue to do, you know, as we've heard this morning.
2 They will continue to do things accordingly until there's
3 a written decision that requires them to change it
4 because, ultimately, they're paying the tax. If we have
5 an issue where they're not paying the tax or there's other
6 things associated with buying tangible personal property
7 from vendors and not paying, I can understand it.

8 But here we are four years later, and this tax
9 has been long gone. It's been paid. You know, we're
10 going to basically -- you know, this decision will
11 basically, potentially establish a whole different ball
12 game for them in trying to go back and, you know, comply
13 with having provide all these records to prove the refunds
14 and so on and so on. So hopefully, we don't have to do
15 that but --

16 ADMINISTRATIVE LAW JUDGE LAMBERT: Thank you.

17 MR. ALMEIDA: -- thank you.

18 ADMINISTRATIVE LAW JUDGE LAMBERT: CDTFA, do you
19 have a closing remark?

20

21 CLOSING STATEMENT

22 MR. NOBEL: Yeah. We would just reiterate that
23 in this case, Appellant's over-the-counter sales of steel
24 represented less than 1 percent of the materials it
25 purchased without paying tax. This very low percentage of

1 sales of steel indicates that Appellant did not intend to
2 resell a significant portion of the steel it purchased.
3 In other words, it really indicates that Appellant was not
4 in the business of selling steel.

5 Accordingly, the Appellant is liable for use tax
6 from the date of purchase, and this appeal should be
7 denied. Thank you.

8 ADMINISTRATIVE LAW JUDGE LAMBERT: Thank you.

9 I'm going to close the record and conclude the
10 hearing. So thanks to both parties for coming.

11 Following the hearing me and my co-panelists will
12 discuss the evidence and argument, and we will issue a
13 written opinion within 100 days. Thank you.

14 The hearing is now closed.

15 (Proceedings adjourned at 11:09 a.m.)

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HEARING REPORTER'S CERTIFICATE

I, Ernalyne M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 11th day of October, 2019.

ERNALYN M. ALONZO
HEARING REPORTER