

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Consolidated Appeals of:) OTA Case Nos. 18011893, 18012032, 18012033,
) 18011999, 18012031
CALIFORNIA WOOD RECYCLING, INC;) CDTFA Case IDs: 864715, 994320, 994322,
SILVAS OIL COMPANY, INC; AND) 985236, 994314
QUINN COMPANY) CDTFA Acct. Nos. 099-785648, 015-684155,
) 097-799366
)
) Date Issued: September 23, 2019

OPINION

Representing the Parties:

For Appellant: Bill Camarillo, President
Jim Fier, CPA

For Respondent: Lisa Renati, Supervising Tax Auditor III
Mengin He, Tax Counsel III
Scott Claremon, Tax Counsel IV

J. ANGEJA, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, California Wood Recycling, Inc., et al. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA) ¹ denying appellant’s claim for refund of \$234,092.05 for the period January 1, 2009 through December 31, 2011.

Office of Tax Appeals (OTA) Administrative Law Judges Linda C. Cheng, Douglas Bramhall, and Jeffrey G. Angeja held an oral hearing for this matter in Los Angeles, California, on February 22, 2019. At the conclusion of the hearing, the record was held open to allow the parties to submit additional briefing to address the amount of the refund claim. The parties provided additional briefing, the record was closed on July 8, 2019, and this matter was submitted for opinion.

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 CDTFA. (Gov. Code, § 15570.22.) 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.

ISSUE

Whether appellant has established that its use of certain equipment and diesel fuel qualifies for the partial farming exemption pursuant to R&TC sections 6356.5 and 6357.1.

FACTUAL FINDINGS

1. Appellant is a wholesaler and retailer of soil amendments (i.e., mulch), which it manufactures from green waste and plant materials. During the claim periods, appellant entered into lease agreements with farmers for the use of the farmers' lands so that appellant could receive green waste and plant materials from waste disposal companies on that land. Appellant then converted the waste into usable mulch, which was subsequently spread onto the farmers' agricultural lands or sold to others.
2. Appellant's August 1, 2009 lease with the Limoneira Company (Limoneira) is representative of appellant's leases at issue during the claim period.
3. In the Limoneira lease, in exchange for a five-year lease for appellant to use Limoneira's property to set up a mulch facility and to receive green waste and plant material, appellant agreed to pay rent to Limoneira in the amount of 10 percent of the tipping fees that appellant received (i.e., the amount that appellant received from green waste disposal companies in exchange for accepting the disposal companies' green waste). In addition, appellant agreed to provide Limoneira the mulch that appellant produced at appellant's mulch facility on Limoneira's property. Appellant was also required to stage² the mulch on the property at locations directed by Limoneira.
4. After entering into the lease agreements, appellant and Limoneira obtained the necessary permit with the county in which the land was located, thus enabling appellant to legally receive the green waste.
5. After receiving the green waste, appellant performed the recycling, processing, and conversion of the green waste into usable mulch, which was then used in most cases on the farmers' lands for the purpose of cultivating and harvesting food products for human consumption.

² According to the parties, staging consists of using loaders and trucks with trailers to transport the mulch from the location at which it is produced to specific points on farm land where the mulch is unloaded for subsequent spreading onto the farmland.

6. Approximately 85 percent of the soil amendments were used on the farmers' lands on which it had been produced, while the remainder was sold to others.
7. The equipment at issue herein consists of trommel screens³ and related parts, shredding and grinding equipment and related parts, loaders and trailers, and trucks.
8. Appellant filed a timely claim for refund of the use tax and diesel fuel tax appellant paid in connection with its purchase and use of the equipment used to perform the recycling, processing, and conversion of the green waste into usable mulch, compost, or other soil amendment products. CDTFA denied the claim for refund. This timely appeal followed.

DISCUSSION

California imposes a sales tax on a retailer's retail sales in this state of tangible personal property, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) When sales tax does not apply, use tax applies to the storage, use, or other consumption in this state, measured by the sales price, unless that use is specifically exempted or excluded by statute. (R&TC, §§ 6201, 6401.)

R&TC section 6356.5(a) partially exempts from the sales and use tax, the sale and storage, use, or other consumption of farm equipment and machinery, purchased for use by a "qualified person" to be used primarily⁴ in producing and harvesting agricultural products. (See also Cal. Code Regs., tit. 18, § 1533.1(a).) California Code of Regulations, title 18, section (Regulation) 1533.1, interprets and implements the exemption, and provides that "producing and harvesting agricultural products" means those activities described in Major Groups 01, 02 and 07 of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition (SIC Manual). (Cal. Code Regs., tit. 18, § 1533.1(b)(5).) Major Group 01 includes establishments engaged in the production of crops, plants, vines, and trees (excluding forestry operations). This major group also includes establishments engaged in

³ Trommel screens are used in crushing and separating compost materials for the production of mulch.

⁴ "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).) However, if the particular equipment involved is a vehicle, such as a tractor, Regulation 1533.1 requires that the vehicle be used exclusively in the conduct of agricultural operations. (See Cal. Code Regs., tit. 18, § 1533.1(b)(1)(B).)

the operation of sod farms; in the production of mushrooms, bulbs, flower seeds, and vegetable seeds; and in the growing of hydroponic crops. Major Group 02 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. Livestock, as specified in Major Group 02, includes cattle, hogs, sheep, goats, and poultry of all kinds; also included are animal specialties, such as horses, rabbits, bees, pets, fish in captivity, and fur-bearing animals in captivity. Major Group 07 includes establishments engaged in performing soil preparation services, crop services, veterinary services, animal services, landscape and horticultural services, and farm labor and management services. Producing and harvesting agricultural products involves the cultivation of land or the growing, raising, or gathering of the commodities described in Codes 0111 to 0291 of the SIC Manual and integral activities thereto described in Code 0711 to 0783 of the SIC Manual. (Cal. Code Regs., tit. 18, § 1533.1(b)(5).)

A “qualified person” means a person engaged in a line of business described in Codes 0111 to 0291 of the SIC Manual. (Cal. Code Regs., tit. 18, § 1533.1(b)(6).) A “qualified person” also includes any person conducting activities, as defined in Regulation 1533.1(b)(3), that uses qualified property to assist a person engaged in a line of business described in the regulation in producing and harvesting agricultural products owned by the qualified person. (Cal. Code Regs., tit. 18, § 1533.1(b)(6).) A person that assists a qualified person is defined as “a person employed by a qualified person, or engaged on a contract or fee basis to perform activities described in Major Group 7⁵ of the [SIC Manual] which include soil preparation services ... that uses farm equipment and machinery in assisting a qualified person.” (Cal. Code Regs., tit. 18, § 1533.1(b)(3).) According to SIC Code 0711, “soil preparation services” includes establishments primarily engaged in land breaking, plowing, chemical treatment of soil for crops, fertilizer application for crops, lime spreading for crops, seed bed preparation, weed control of crops (before planting), and other services for improving the soil for crop planting. A person that assists a qualified person must provide physical aid or assistance in the actual producing and harvesting of agricultural products owned by the qualified person and not merely provide aid in administrative, managerial, or marketing activities. (*Ibid.*)

⁵ Major Group Code 07 lists those business establishments that provide agricultural services, including those that provide soil preparation services, fertilizer application services, lime spreading services, plowing services, seed bed preparation services, soil chemical treatment services, soil testing services, and weed control services. (See SIC Code 0711, et seq., found at <https://www.naics.com/standard-industrial-code-divisions/?code=07>.)

R&TC section 6357.1 provides that the gross receipts from the sale of, and the storage, use, or other consumption in this state of “diesel fuel” used in “farming activities” are partially exempt from sales and use tax. (See also Cal. Code Regs., tit. 18, § 1533.2(a).) For purposes of the exemption, “farming activities” means a trade or business involving the cultivation of land or the raising or harvesting of any agricultural or horticultural commodity that may be legally sold to or offered for sale to others, including, as relevant here, the trade or business of operating a nursery or sod farm or the raising or harvesting of trees bearing fruit or nuts, or of other crops (e.g., grains, vegetables, or cotton). (Cal. Code Regs., tit. 18, § 1533.2(b)(1).)

A taxpayer bears the burden of proving entitlement to an exemption or exclusion. (*Honeywell, Inc. v. State Bd of Equalization* (1982) 128 Cal.App.3d 739, 744-745.) The applicable burden of proof is by a preponderance of the evidence. That is, a taxpayer must establish by documentation or other evidence that the circumstances they assert are more likely than not to be correct.

On appeal, appellant states that all of its activities at issue here occurred on farmland, and that all of its activities were integrated into one activity: to produce mulch that was to be applied to the farmland. Appellant asserts that if a farmer conducted the same activities that appellant performed, the farmer’s use of the equipment and fuel to perform those activities would qualify for the exemption. Appellant contends that since it performed the same activities, its use of the equipment and fuel should also qualify for the exemption. In addition, with respect to staging activities, appellant argues that because all of its activities occurred on the farmland, all of the areas appellant occupied qualified as staging areas because the mulch appellant created could have been applied where it was generated or on other locations within the farm. Thus, appellant contends that its purchase and use of the disputed equipment and fuel qualify for the partial exemptions.

Here, appellant was engaged in the line of business of receiving green waste and plant materials for recycling and producing mulch for sale to qualified persons (e.g., farmers) who were engaged in the line of business of producing and harvesting agricultural products. There is no evidence that those farmers employed or otherwise contracted with appellant to provide the farmers with physical assistance in the production and harvesting of their agricultural products. In fact, appellant’s sample lease agreement simply allowed appellant to use the farmer’s land to receive and process green waste, in exchange for rental payments (i.e., a percentage of the

tipping fees paid to appellant by the waste disposal companies + all the mulch or compost produced by appellant on the farmer's land, for the farmer's own use). Except as noted below in connection with staging activities, nowhere in these addenda did appellant agree to provide the farmers with soil preparation services (a qualifying service) or any other services to assist in the production and harvesting of the farmers' agricultural products. Appellant's provision of mulch to the farmers does not qualify as a soil preparation service simply because appellant produced the mulch on the farmers' land, just as appellant's provision of mulch would not qualify as a soil preparation service if appellant produced the mulch on its own land or purchased it from a vendor before providing it to the farmers. Accordingly, appellant was not a qualified person and cannot qualify for the exemption on this basis.

However, as relevant here, appellant may qualify as a "person who assists a qualified person" in soil preparation services. (Cal. Code Regs., tit. 18, § 1533.1(b)(3).) Specifically, the act of physically staging the mulch (i.e., transporting the mulch after appellant produces it, to the spot from which the farmers then spread the mulch throughout the fields), qualifies as soil preparation services as defined in SIC Code 0711 (e.g., fertilizer application for crops, lime spreading for crops, seed bed preparation, weed control of crops (before planting), and other services for improving the soil for crop planting). (Cal. Code Regs., tit. 18, § 1533.1(b)(3).) Therefore, to the extent that appellant physically engaged in staging activities, appellant would qualify as a person who assists a qualified person. (*Ibid.*) However, in order to qualify for the exemption for its equipment, appellant would need to establish that it used its equipment 50 percent or more of the time in such soil preparation services (Cal. Code Regs., tit. 18, § 1533.1(b)(4)), and that its vehicles were used exclusively in the conduct of such operations (Cal. Code Regs., tit 18, § 1533.1(b)(1)(B)).

In this case, appellant has not quantified the amount of time that it used its equipment in staging activities. Instead, appellant merely argues that because all of its activities occurred on the farmland, and because the mulch could have been applied where it was generated or on other locations within the farm, all of the areas appellant occupied constituted staging areas. But as explained above, appellant's production of the mulch is not a qualifying activity, only the staging activities are qualifying activities, and appellant has not submitted evidence to establish what percentage of the time its equipment and vehicles were engaged in that activity. Furthermore, most of the equipment appellant identified (i.e., trommel screens, shredders, and grinders) relates

to the production of the mulch, not the hauling of the mulch to staging locations. In other words, the trammel screens, shredders, and grinders, were not used in a qualifying activity. Appellant’s loaders were used in both the mulch-production process as well as the staging process; however, appellant has not submitted evidence sufficient to establish that the loaders were used primarily in the staging process. Likewise, appellant has not submitted evidence sufficient to establish that its vehicles were used exclusively in staging operations. Accordingly, we conclude that appellant has failed to meet its burden of proof that its equipment and vehicles are subject to partial farming exemption.

Regarding the diesel fuel purchases, for the reasons explained above we conclude that appellant’s production of mulch does not constitute a trade or business involving the cultivation of land, or the raising or harvesting of any agricultural or horticultural commodity that may be legally sold to or offered for sale to others, as required for the partial diesel fuel exemption to apply. (See Cal. Code Regs., tit. 18, § 1533.2, subd. (b)(l).) Therefore, we conclude that none of the disputed fuel purchases qualified for the partial exemption for diesel fuel used in farming activities.

HOLDING

Appellant failed to establish that it is entitled to the partial farming exemption.

DISPOSITION

CDTFA’s action in denying the claims for refund is sustained.

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Jeffrey G. Angeja
Administrative Law Judge

I concur:

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Linda Cheng
Administrative Law Judge

D. BRAMHALL, dissenting:

Before diving into details, I want to step back from the details (albeit ultimately determinative) and assess what factually is the basis for the dispute in this appeal. A partial sales tax exemption was enacted by the California Legislature, to subsidize farmers, and those who provide certain defined assistance to farmers, for the cost of farm machinery and equipment and parts. So, without dispute, a farmer who produces mulch from green waste and spreads it on his or her fields will qualify for the partial exemption of sales or use taxes paid on machinery and equipment used in those activities. So, it is not the equipment or machinery itself that is not qualified as farm equipment and machinery. According to the majority, it is the lack of physically spreading the mulch on fields (other than staging) after production that disqualifies most of the machinery and equipment cost documented as a basis for appellant's refund claim.

My disagreement with the majority opinion rests on differences in defining appellant's primary activity and the application of the physicality requirement. The majority concludes the primary activity is receiving green waste and plant materials for recycling and producing mulch which is provided to qualified persons.¹ Respondent argues appellant's primary business is receiving tipping fees from green waste suppliers. I view both of those activity descriptions as too limiting. Since appellant's permits require the application of the majority of the products produced with the waste to be spread on the land to which it is delivered, a fact omitted from the majority analysis, the receipt and processing of that waste were all part of the primary activity of appellant – primarily “providing other services for improving the soil.”² And this activity was defined by the Legislature as one that qualifies to be provided by a person who assists a qualified person. Additionally, while respondent concedes that if appellant physically spread the mulch on a farmer's crop area, the activity would qualify as soil preparation, it asserts that the lack of that physical activity precludes anything prior to staging to be considered a soil preparation service.

¹ Interestingly, the farmers to whom appellant is providing its services and delivering mulch, pay nothing directly to appellant for the mulch. Yet the majority concludes appellant's activity is primarily producing mulch without any recognition of a purpose for that production.

² See, SIC Manual Code 0711. I find it highly unlikely that any business would seek to collect green waste, just to do so, absent an ultimate potentially profitable goal. While the majority of appellant's revenues was derived from tipping fees, that is not the end of the story. With those fees, appellant invested in machinery and equipment, rented land and produced and delivered a product for use in the farming industry and specifically on the farmer's land on which appellant's physical production activity occurred. Accordingly, I conclude that appellant's primary activity was the provision of a service for improving the soil and that activity commenced with the receipt of raw materials and ended with distribution of mulch to a farmer – an activity squarely defined in SIC Manual Code 0711.

However, while SIC 0711 includes a description, “fertilizer application for crops” that implies a physical application, the section also describes “other services for improving the soil” and no physical application is stated or implied. And while Regulation 1533.1(b)(3) requires a person who assists a qualified person to “provide physical aid or assistance ...”, I view the collection and production activity as satisfying that physical aid requirement. Accordingly, I view appellant as a “person who assists a qualified person” with respect to all of its activity on a farm, and not just with respect to its activity undertaken to “stage” the mulch (finished product).³

Therefore, I also disagree with the majority analysis of what machinery and equipment and diesel fuel may or may not qualify for partial exemption. Since the focus of the majority opinion is on a limited scope of activity (staging), it is not possible to evaluate that aspect of the opinion had it agreed with this dissent. However, since respondent agreed at one point that if physical activity were present with regard to appellant’s services, and this dissent concludes it was present (in connection with the collection, production and staging or application processes) I would find, based on the documentation and credible testimony at the hearing, that appellant’s machinery and equipment qualifies for the partial sales and use tax exemption to the extent it documents tax actually paid on the items claimed.⁴

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Douglas Bramhall
Administrative Law Judge

³ The majority concludes the provision of mulch to farmers does not constitute soil preparation simply because appellant produced it on the farmer’s land, and justifies that conclusion by comparing it to a provider of mulch or fertilizer who manufactures elsewhere or who buys from a third party and delivers to a farm. However, I view that difference as exactly why appellant’s activity, and not comparison activity which generates revenues from sales, should qualify as a soil preparation service.

⁴ I agree with the majority opinion with respect to appellant’s claim for a partial exemption for diesel fuel.