OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18011846
	) CDTFA Case ID: 796442
PRAXAIR, INC.	) CDTFA Acct. No. SRZ OHB 30-686171
	)
	) Date Issued: October 3, 2019
	)
	)

OPINION

Representing the Parties:

For Appellant:	Carley A. Roberts, Attorney Robert P. Merten III, Attorney
For Respondent:	Jarrett Noble, Attorney Scott Claremon, Attorney Kevin Hanks, Representative

A. KWEE, Administrative Law Judge: Pursuant to Revenue and Taxation Code section 6561, appellant Praxair Inc. (Praxair) timely appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA), on a petition for redetermination of a January 27, 2014, Notice of Determination (NOD). The NOD is for $7,759,222.48 in tax, plus accrued interest, for the period July 1, 2006, through December 31, 2009 (liability period).

Office of Tax Appeals (OTA) Administrative Law Judges Andrew J. Kwee, John O. Johnson, and Teresa A. Stanley heard this appeal on March 27, 2019, in Sacramento, California. At the conclusion of the oral hearing, the record was held open to allow the parties time to submit additional briefing on several items. By letter dated June 25, 2019, we notified the parties that the record was closed, and this matter was submitted for decision.

ISSUES

1. Whether CDTFA established a basis to increase Praxair's use tax liability, from the amount of its original determination, based on a new issue raised after the oral hearing.
2. Whether CDTFA stipulated to the third issue on appeal (sales versus use tax).
3. Whether Praxair is liable for sales or use tax in connection with certain design and engineering charges.
4. Whether Praxair established a basis for adjustment to the measure of miscellaneous disallowed claimed nontaxable sales.

FACTUAL FINDINGS

1. Praxair is an industrial gas company that produces, distributes, and sells gases worldwide.
2. Praxair has held a California seller's permit since 1989.
3. One of Praxair's methods for delivering gas to its customers is to construct production and delivery facilities on or adjacent to a customer's site and supply the product directly by pipeline.

The Tupman Air Separation Plant Sale Agreement (Occidental Contract)

4. On or about November 7, 2005, Praxair entered into the Occidental Contract with Occidental of Elk Hills, Inc. (Occidental).[1] The Occidental Contract was a construction contract, and Praxair was the construction contractor under the contract. Under the terms of the Occidental Contract, Praxair was responsible to construct a turn-key air separation plant for Occidental, which would produce liquid and gaseous nitrogen on Occidental's property in Tupman, California. Praxair was also responsible to design and provide all the equipment, material, supervision, and labor required to construct the air separation plant.
5. The amount Occidental was required to pay to Praxair (Contract Price) included two components: (I) the sale of "Equipment" for $11,400,000, and (II) a charge for

[1] The parties to the appeal stipulated the contract was entered into on or about November 7, 2005; however, it was not executed until November 23, 2005.

"Engineering" in the amount of $8,073,500.[2] The term Equipment was defined as the "equipment and materials to be provided by [Praxair] required for the construction of the" air separation plant. The term Engineering was defined as "the specifications, drawings, engineering, and services, including procurement, construction, labor, testing, etc., to be provided by [Praxair] required for the construction of the air separation plant."

6. With respect to the sale of Equipment, the Occidental Contract specified that the "Contract Price for Equipment represents the purchase of tangible personal property, which is subject to California state and/or local sales/use tax." Pursuant to the contract, Praxair separately invoiced and collected $826,500 in sales tax reimbursement from Occidental on the sale of Equipment and remitted this amount to the state. Praxair's treatment of the sale of Equipment for $11,400,000 as taxable is not at issue in this appeal.

7. With respect to Engineering, the Occidental Contract specified that the "Contract Price for Engineering [(i.e., $8,073,500)] represents a lump sum/turn key price. Contractor is the consumer of all materials, supplies, and equipment purchased by Contractor." Praxair treated the Engineering charge as nontaxable and did not separately invoice Occidental for any sales tax reimbursement on the Contract Price for Engineering. The parties dispute the application of tax to the Engineering charge in the Occidental Contract.

The Praxair Richmond Project Engineering and Construction Contract (Lurgi Contract)

8. On or about October 6, 2006, Praxair entered into the Lurgi Contract for the design, engineering, and construction of a turn-key Hydrogen Steam Methane Reformer plant (hydrogen plant) in Richmond, California. The Lurgi Contract was a construction contract for the hydrogen plant, and the parties to the contract were Praxair, Lurgi PSI, Inc. (Lurgi), and ARB, Inc. (ARB).

9. Under the terms of the Lurgi Contract, Praxair was identified as the "Owner," and Lurgi and ARB were collectively identified as "Contractor." Lurgi is a construction contractor. All work pursuant to the contract was to be performed "under the leadership of Lurgi."

[2] The contract required an upfront payment of $10 million for Equipment, with the balance of the Equipment charge ($1.4 million), plus the Engineering charge, not due until after conditional acceptance (completion) of the air separation plant. The parties do not dispute that conditional acceptance occurred during the liability period.

Lurgi had joint and several liability for the work performed under the Lurgi Contract, while ARB was liable only for its own scope of work.

10. Lurgi was responsible for installation of all machinery and equipment, and/or fixtures, at the hydrogen plant in Richmond, California.

11. The parties to the Lurgi Contract separately stated the total contract price of $212,867,000 into the following three categories: (I) Lurgi Equipment Price, $80,046,000; (II) Lurgi Engineering and Design Price, $38,578,000; and (III) ARB Price, $94,243,000.

12. With respect to item (I), the Equipment Price, the Lurgi Contract provides that this amount represents the purchase of tangible personal property, which is subject to California state and/or local sales/use tax. The contract also states that Praxair shall pay to Lurgi any sales or use taxes due to the State of California with respect to any equipment included in the Equipment Price, and Lurgi shall be responsible for remittance of such taxes to the appropriate taxing authority. Praxair ultimately paid Lurgi $83,352,084 for item (I) and remitted to Lurgi $7,166,091 in "California state and/or local sales/use tax"[3] for this item. The application of tax to item (I), which the parties treated as taxable, is not at issue in this appeal.

13. With respect to item (II), the Engineering and Design Price, Lurgi separately charged Praxair for design and engineering fees. Praxair paid Lurgi the separately stated contract price of $38,578,000. Praxair did not remit tax or tax reimbursement to the state or any other person on this amount. The parties dispute the application of tax to item (II), which Praxair treated as nontaxable.

14. Praxair paid Lurgi the ARB Price. Praxair did not remit tax or tax reimbursement to ARB, the state, or any other person in connection with item (III), the ARB Price. The application of tax to item (III), which the parties treated as nontaxable, was not at issue at the time of the audit.[4]

[3] This language is placed in quotation marks because it is addressed in greater detail under the stipulation 34 discussion, below.

[4] Via post-hearing briefing, CDTFA raised a new dispute with this item (discussed below).

Miscellaneous Items

National Beef Packing Company, LP (NBC)

15. During the liability period, NBC purchased compressed carbon dioxide (CO2) from Praxair without payment of tax or tax reimbursement to Praxair. Praxair, in turn, did not collect or report tax on the sale of the CO2 to NBC. Praxair did not obtain a resale certificate from NBC at the time of the sale.

16. According to a statement provided by NBC to Praxair, "(NBC) used dry ice in its manufacturing process at its [California] facility. . . . As the pressure is released, [compressed CO2] will transition into dry ice frost or snow, which is applied directly onto raw beef products as they are packaged for resale, for the purpose of reducing the temperature of the raw product."

Ralph's Grocery Company (Ralph's)

17. On June 2, 2000, prior to the liability period, Ralph's issued a blanket resale certificate to Praxair for the purchase of retail groceries and related items.

18. During the liability period, Ralph's purchased liquid oxygen from Praxair to be used in combination with CO2 to freeze raw meat products at the end of the manufacturing process. Ralph's resold the raw meat products.[5] Ralph's did not purchase any other items from Praxair.

19. Praxair's sales invoices for liquid oxygen were billed to the attention of Ralph's "Vernon Meat Plant" and shipped to Ralph's location in Vernon, California.

Solar Turbines, Inc. (STI)

20. During 1995, Praxair installed a hydrogen gas (H2) manifold system (equipment) at a location owned by its customer: STI. The equipment was incorporated into and a part of a specific type of semi-trailer (referred to by Praxair as a "tube trailer"). A more detailed description of the equipment or trailer is not contained in the record (referred to hereinafter, collectively, as the trailer).[6]

[5] During the course of the audit, Ralph's issued a signed statement to Praxair dated August 5, 2015, stating that the liquid oxygen was purchased for resale and was resold in the form of tangible personal property.

[6] Praxair contends that it owned the equipment, and CDTFA responded that Praxair failed to explain why a customer would pay to upgrade Praxair's equipment. We make no finding on who owned the equipment.

21. During the liability period, STI contacted Praxair about updating the trailer to increase the flow of H2 and raise the pressure in the system. The modification required Praxair to make certain upgrades to the trailer. Praxair's records describe this transaction as "Hydrogen Manifold Modification," and the work details provide: "System Upgrade. They [(i.e., the customer)] have a new use coming on for the H2 tube bank (2 each 12 paks) [*sic*] where they will require a flow of 26,000 . . . "

22. Praxair upgraded the trailer from April 25, 2007, through May 23, 2007.

23. On July 27, 2007, Praxair invoiced STI $45,000.00, plus $0.00 in sales tax, for the upgrade. The invoice referenced purchase order "HD0603098," which is not a part of the record. Praxair provided a document titled "Service Work Order Cost [¶] Praxair Business Confidential," indicating that it cost Praxair $54,933 to perform the upgrade (including the cost of hiring subcontractors). Praxair's material cost was $28,483. Neither Praxair nor STI paid or reported sales or use tax to the state on this transaction. Praxair did, however, pay sales tax reimbursement to one of its vendors at the time of purchasing parts for the upgrade.

The Audit of Praxair

24. During January 2010, CDTFA[7] began an audit of Praxair for the liability period. On audit, CDTFA determined that the engineering and design charges from the Lurgi Contract, and the Occidental Contract, were taxable in their entirety. In addition, CDTFA disallowed the claimed nontaxable sales to NBC, Ralph's, and STI, in their entirety.

25. On January 27, 2014, CDTFA issued a Notice of Determination (NOD) to Praxair in the amount of $7,759,222.48 in tax, plus accrued interest, for the liability period.

26. The NOD was based on an audit which determined a deficiency measure of $93,117,787, consisting of nine audit items. As relevant, the audit items included: Audit Item 1, ex- tax fixed asset purchases for $1,000 to less than $50,000, based on a statistical sample, measured by $1,762,245; Audit Item 2, ex-tax fixed asset purchases for $50,000 or more, on an actual basis, measured by $40,477,450; Audit Item 6, disallowed claimed

[7] The underlying audit was handled by CDTFA's predecessor, the State Board of Equalization (board). On July 1, 2017, CDTFA took over certain functions of the board, including administration of the Sales and Use Tax Law. References to CDTFA's actions performed prior to the transfer of authority refer to actions of the board.

nontaxable sales per a statistical sample of sales from $100 to $4,999, measured by $17,282,528 (identified by CDTFA as Stratum 1); Audit Item 7, disallowed claimed nontaxable sales per a statistical sample of sales from $5,000 to $74,999, on an actual basis, measured by $10,385,287 (identified by CDTFA as Stratum 2); and Audit Item 8, disallowed claimed nontaxable sales for $75,000 or more, on an actual basis, measured by $15,836,802.

27. On February 21, 2014, Praxair timely petitioned the NOD.

28. In March 2014, CDTFA initiated a re-audit of Praxair for the liability period.

29. On March 29, 2016, CDTFA issued a Report of Field Audit: Re-audit (Re-audit Report) to Praxair for $5,185,585.52 in tax, plus accrued interest. The Re-audit Report proposes to redetermine the NOD to a deficiency measure of $60,632,156, consisting of the same nine audit items as the original audit. The measure of Audit Item 1 did not change. Audit Item 2 was reduced from $40,477,450 to $39,840,886, a reduction of $636,564; Audit Item 6 was reduced from $17,282,528 to $6,430,776, a reduction of $10,851,752; Audit Item 7 was reduced from $10,385,287 to $2,344,885, a reduction of $8,040,402; and Audit Item 8 was reduced from $15,836,802 to $8,134,889, a reduction of $7,701,913.

30. On October 9, 2017, CDTFA issued its Decision & Recommendation (D&R) on Praxair's petition, recommending that the NOD be redetermined in accordance with the Re-audit Report. This timely appeal followed.

31. On appeal, Praxair disputes the following items: the $38,578,000 Engineering and Design Price from the Lurgi Contract;[8] a portion ($7,527,273) of Audit Item 8, which was established on an actual basis, and pertaining to the treatment of the Occidental Contract;[9] disallowed claimed nontaxable sales to NBC ($5,504.19) and Ralph's ($817),

[8] It is not clear if the entire $38,578,000 was included in the audit. CDTFA contends, in footnote 9 of its D&R, that the audit picked up $38,227,482 for the Engineering and Design Price as follows: $123,250 included in Audit Item 1, plus $38,104,232 included in Audit Item 2. The D&R erroneously referred to Strata 1 and 2 (disallowed sales), which we understand to be a typo and a reference to Audit Items 1 and 2 (disallowed purchases). As relevant, the only audit item in excess of $38 million is Audit Item 2. Considering the available evidence in the record, it is unclear why a portion of a charge for over $38 million was picked up in a sampling of purchases under $50,000, or how the $38 million charge was broken down and invoiced.

[9] Although the charge was for $8,073,500, CDTFA only treated $7,527,273 of this amount as taxable. CDTFA mistakenly treated the remainder, $546,227, as excess sales tax reimbursement collected from Occidental.

included in Audit Item 6 (Stratum 1); and a disallowed claimed nontaxable sale to STI ($45,000), included in Audit Item 7 (Stratum 2).

32. At the oral hearing, Praxair requested that OTA take official notice of certain information contained on the California Secretary of State (SOS)'s website regarding unclaimed property attributed to Lurgi. CDTFA has no objections to OTA taking official notice of this information. We take official notice that: (1) Toyota MDL Qualified Settlement Fund, KCC Claims Administration, notified the SOS that it has under $100 in funds that appear to belong to "Lurgi Inc," reported as of October 19, 2018, with a last contact date of April 20, 2015, and a reported address in Richmond, California, for "Lurgi Inc"; and

(2) Metlife Inc. Demutualization (CA) notified the SOS that it has funds valued at approximately $8.40 that appear to belong to "Lurgi Corp," and a reported address in Belmont, California, for "Lurgi Corp."

33. At the oral hearing, CDTFA conceded that a reduction to the taxable measure is warranted for tax-paid purchases resold to STI.[10] In a post-hearing submission, CDTFA clarified the amount of its concession: $15,249 in measure (which further reduces Audit Item 7 from $2,344,885 to $2,329,636).

34. After the oral hearing, in a brief dated May 24, 2019, CDTFA conceded that 50 percent of the $38,227,460[11] engineering and design charge from the Lurgi Contract is nontaxable. CDTFA maintains that 100 percent of Praxair's $8,073,500 charge to Occidental for engineering is taxable to the extent picked up in the audit: $7,527,273.

DISCUSSION

I. Preliminary matter involving stipulations 33 and 34.

On March 21, 2019, which was prior to the oral hearing, the parties submitted a document titled "Joint Stipulation of Facts" (stipulation). Both parties signed the stipulation. On Friday, March 22, 2019, Praxair submitted new evidence, marked for identification as

[10] CDTFA previously disputed whether purchase invoices showing that Praxair paid sales tax reimbursement to its vendor are relevant to the transaction between Praxair and STI. CDTFA now concedes an allowance for tax-paid purchases resold. As such, we understand CDTFA no longer disputes the purchase invoices.

[11] In its post-hearing brief, dated May 24, 2019, CDTFA contends the amount picked up in audit was $38,227,460. Previously, CDTFA contended that it was $38,227,482 (see footnote 8). As relevant, there is insufficient evidence in the record to verify the actual amount picked up in the audit (if different). For ease of analysis, we will refer to the Engineering and Design Price of $38,578,500, as set forth in the Lurgi Contract.

Exhibit 26. Later that same day, CDTFA requested a postponement of the oral hearing (scheduled for March 27, 2019), in order to consider Exhibit 26. Praxair objected to postponement on the basis of inconvenience to its witnesses, who were flying in from the east coast and scheduled to arrive in Sacramento shortly. OTA sustained the objection on March 25, 2019, but in that same order OTA permitted the parties to request time to submit additional briefing after the oral hearing. At the oral hearing OTA granted CDTFA 60 days to submit additional briefing on matters pertaining to Exhibit 26. As relevant here, in a post-hearing submission dated May 24, 2019, CDTFA raised a new issue and also requested permission to withdraw from two stipulations.

OTA has not established any rules for the withdrawal from stipulations, however, we conclude that withdrawal may be permitted upon a showing of good cause. Good cause generally means a showing of fraud, mutual mistake of fact, duress or undue influence. (See Civ. Code, §§ 1689, 1691; see also *Carmichael v. Industrial Acc. Commission* (1965) 234 Cal.App.2d 311.)

II. Issue 1: Whether CDTFA established a basis for additional use tax liability (the stipulation 33 issue).

Praxair paid ARB $38,578,000 in connection with the ARB Price, and neither party paid or reported sales or use tax on this amount. The parties stipulated that: "At audit, [CDTFA] determined that Praxair did not incur any sales or use tax for the 'ARB Price' portion of the Lurgi Contract" (stipulation 33). CDTFA now contends that ARB performed taxable jobsite fabrication labor, which is subject to use tax. As such, CDTFA requests permission to withdraw from stipulation 33 on the basis that, due to its additional review conducted after the oral hearing, CDTFA now believes Praxair is liable for use tax in connection with the ARB Price. Here, the facts stipulated to by the parties was a statement of CDTFA's findings at the time of the *audit*. Prior to the oral hearing, and during the oral hearing, neither party contended that Praxair was liable for use tax for the ARB Price, and all parties involved, including OTA, understood this to be a non-issue. Additionally, an amount for use tax on the ARB Price was not noticed in the NOD subject to this appeal, or briefed by either party until CDTFA's post-hearing submission. Thus, we conclude that both parties were not mistaken as to the facts stipulated in stipulation 33. To the contrary, all the evidence indicates that both parties understand stipulation 33 to be a factually correct statement: at the time of the *audit*, CDTFA did not realize Praxair may have a

use tax liability in connection with the ARB price. Therefore, we find that CDTFA failed to establish good cause to withdraw from stipulation 33.

We acknowledge that, per its post-hearing submission, CDTFA has now changed its position with respect to the ARB Price. In summary, CDTFA is now raising a new issue after the hearing, and that new issue is whether Praxair is liable for any use tax in connection with the ARB Price. The law provides, in pertinent part, that CDTFA may increase the amount of the NOD before it becomes final if a claim for the increase is asserted by CDTFA *at or before the hearing*.[12] (Rev. & Tax. Code, § 6563(a).) CDTFA's NOD did not assert any liability in connection with the ARB price, and CDTFA did not assert a claim for increase *at or before the oral hearing*. It is now too late for CDTFA to assert a claim for increase *after* the oral hearing. Therefore, we conclude that CDTFA cannot increase the amount of taxes as originally noticed in the NOD subject to this appeal because CDTFA failed to timely assert an increase at or before the oral hearing as required by Revenue and Taxation Code section 6563(a). Nevertheless, we must still address CDTFA's new issue to the extent that an offset is allowable on account of reductions to the liability for the other (timely noticed) issues on appeal. (See Rev. & Tax. Code, § 6483.)

Generally, for income tax matters, when the Franchise Tax Board (FTB) introduces a "new matter" that alters the original deficiency asserted against the taxpayer, such as increasing the amount of the deficiency, or which requires the presentation of different evidence, the burden of proof shifts to FTB. (*Appeal of Mendelsohn* (85-SBE-141) 1985 WL 15923 [citing *Achiro v. Commissioner* (1981) 77 T.C. 881].) The rationale for shifting the burden of proof under such circumstances originates with Rule 142 of the United States Tax Court Rules of Practice, which provides, in pertinent part, that the burden of proof is on the respondent in respect to any new matter or increases in the deficiency.[13]

Similar to the Internal Revenue Code (as it pertains to new matters asserted by the Internal Revenue Service), the Administration of Franchise and Income Tax Laws (part 10.2 of division 2 of the Revenue and Taxation Code) and the Sales and Use Tax Law (part 1 of division 2 of the Revenue and Taxation Code) do not specifically set forth the application of the

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burden of proof

[12] There are additional requirements, including an 8- or 3-year statute of limitations on making such a claim, which runs from the date of the NOD, or the date tax records requested by CDTFA were first made available, whichever is later. (Rev. & Tax. Code, § 6563(a).)

[13] See < https://www.ustaxcourt.gov/rules/Rules.pdf >

with respect to new matters asserted by FTB or CDTFA. As the law does not specify the application of the burden of proof to a new matter, a rule regarding that burden must be adopted by the reviewing authority, as the Tax Court did in Rule 142.

With respect to Franchise and Income Tax appeals, the board did adopt such a rule. In deciding *Appeal of Mendelsohn, supra,* the board concluded that principles of fairness adopted by the United States Tax Court, and applicable federal caselaw, shall apply to new matters asserted by FTB in appeals before the board because actions taken by FTB were appealable to an external body (i.e., the board) prior to filing suit in superior court. The board did not opine on the burden of proof for new matters asserted in Sales and Use Tax appeals, because actions of the board on such matters were not appealable to an external body, prior to filing suit in superior court. (See Rev. & Tax. Code, §§ 6564, 6933.) In other words, as both the agency responsible for administering the Sales and Use Tax Law and the agency deciding the appeal, the board acted as the final administrative authority reviewing Sales and Use Tax matters prior to filing suit in superior court. In contrast, FTB did not act as the final authority reviewing Franchise and Income Tax matters as those matters could be appealed to the board prior to filing suit in superior court. (See Rev. & Tax. Code, §§ 19324(a), 19045(a), 19382.)

With the passage of the Taxpayer Transparency and Fairness Act of 2017 (Assembly Bill 102, Stats. 2017, Ch. 16.), CDTFA became, on and after July 1, 2017, successor to the board with respect to administering the Sales and Use Tax Law. (Gov. Code, § 15570.22.) Additionally, effective January 1, 2018, actions by CDTFA on a petition or claim for refund became appealable to OTA. (Gov. Code, § 15672; Rev. & Tax. Code, § 20(b).) CDTFA and FTB are now similarly situated in that actions by either tax agency on a petition or claim for refund are appealable to OTA, prior to filing suit in superior court for refund of tax. OTA has not specifically set forth in its Rules for Tax Appeals, the application of the burden of proof with respect to new matters raised by a tax agency in an appeal before OTA. Nevertheless, OTA adopted California Code of Regulations, title 18, § (Regulation or Reg.) 30504, which provides that precedential opinions of the board adopted prior to January 1, 2018, are precedential in appeals before OTA. As did the board, we also do not believe it would be fair to place the burden on the taxpayer to establish error in circumstances where the tax agency shows up on the day of the oral hearing, or, as in this case, in briefing filed after the oral hearing, asserting an increase to the liability on a previously conceded matter. Considering that CDTFA and FTB are

now similarly situated with respect to appeals before OTA, we conclude that the board's decision in *Appeal of Mendelsohn, supra,* applies equally to appeals from both FTB and CDTFA. As such, we find that when CDTFA introduces a new matter, the burden of proof shifts to CDTFA with respect to that new matter.

Here, CDTFA alleged a new source and basis for an additional tax liability, on an amount that the parties had stipulated was not at issue during the audit. Specifically, CDTFA contends:

> [E]xhibit 26 indicates that ARB assembled or fabricated fixtures and machinery and equipment furnished by Lurgi. Any labor ARB performed on [such property] prior to attachment to real property would be taxable as jobsite fabrication labor and part of the retail selling price of the property, and [Praxair] would be liable for use tax on those amounts.

Based on its new argument that Praxair owes use tax on a portion of the ARB Price, CDTFA essentially requests that it be allowed to recoup Praxair's use tax liability for the ARB Price by increasing the taxable allocation in the Lurgi Contract (discussed further under the Lurgi Contract, below). Specifically, CDTFA asserts that 40 percent of the Engineering and Design Price is taxable. Nevertheless, after allowing CDTFA an offset to recoup use taxes on the ARB Price, CDTFA now asserts that OTA should regard 50 percent of the Engineering and Design Price as taxable.

In response, Praxair contends that CDTFA is making speculative conclusions about the ARB Price, which are unsupported by the evidence, and this is not an appropriate basis to justify inflating Praxair's liability for the Lurgi Contract. Aside from citing to Praxair Exhibit 26, CDTFA provided no new evidence in support of its new contention that additional use taxes are owed by Praxair on a portion of the ARB Price. CDTFA does not offer any audit papers or support for us to reasonably ascertain an actual use tax amount or taxable measure for the allegedly taxable portion of the ARB Price. Exhibit 26 is a Consortium Agreement between Lurgi and ARB, and Praxair is not a signatory to this agreement. This document lists an estimated "total construction" cost of $93,868,000 for ARB, which is close to the ARB Price of $94,243,000. This amount is broken down into total man-hours for four different areas (structural, civil, pipe, mechanical). There is no basis to ascertain or reasonably estimate a cost for fixtures, or machinery and equipment, furnished and installed by ARB, if any (or, for that matter, to establish that any such amounts were not already included in the Equipment price). (See Reg. 1521(b)(2) [specifying the application of tax to fixtures, and machinery and

equipment, furnished and installed by a construction contractor].) At this late stage in the appeals process, and considering the lack of supporting evidence or rational basis on which we can make an adjustment, we conclude that CDTFA failed to meet its burden to establish any additional use tax liability owed by Praxair in connection with the ARB price. As such, we find that no offset would be allowable for this issue based on the evidence available.

III. Issue 2: Whether CDTFA stipulated to one of the issues on appeal (the stipulation 34 issue).

At a pre-hearing conference held on March 12, 2019, the parties agreed that certain facts were not disputed and the parties agreed to work together to prepare a joint summary of the undisputed facts for this appeal. Also, on a separate matter of discussion, and as evidenced by OTA's Minutes and Orders of Pre-Hearing Conference, dated March 13, 2019, the parties were placed on notice during the pre-hearing conference that an issue that OTA would consider in deciding this appeal was whether "the applicable tax for the Lurgi contract [is] sales or use tax." OTA specifically requested that the parties be prepared to brief this issue during the oral hearing. Shortly thereafter, on March 21, 2019, the parties stipulated to 62 items, including that: "Praxair paid Lurgi $83,352,084 for purchases of tangible personal property related to the 'Lurgi Equipment Price' and remitted to Lurgi $7,166,091 in sales tax reimbursement for such purchases" (stipulation 34).

At the oral hearing, Praxair raised a new issue and contended that OTA must reduce Praxair's liability for the Lurgi Contract from $38,578,000 to $0, because CDTFA stipulated that the applicable tax for the Lurgi Contract was a sales tax imposed on Lurgi, not Praxair. (See Rev. & Tax. Code, § 6051 [imposing sales tax on the retailer].) In support, Praxair referred OTA to stipulation 34. The implicit assumption here is that if the Lurgi Equipment Price was a sales tax transaction, then the Lurgi Engineering and Design price must also be a sales tax transaction. CDTFA objected and requested permission to withdraw from this stipulation. OTA held the record open to allow additional briefing on this matter. In its post-hearing submission, CDTFA contends that it inadvertently accepted that language, which was drafted by counsel for Praxair, and that this is contrary to CDTFA's stated position at all relevant times during the audit and during this appeal before OTA. CDTFA's position had been that the applicable tax is a use tax but, prior to the oral hearing, it had not provided a basis for that conclusion.

In its post-hearing response to CDTFA's submission, Praxair contends that a stipulation is binding on a party if it is within the authority of the party's attorney, even if the attorney was mistaken in his or her judgment. Additionally, Praxair contends that it "should be able to rely on stipulations from [CDTFA] regarding whether or not sales tax reimbursement was submitted" because CDTFA is responsible for administering this tax.

As a preliminary matter, we note that the subject of stipulation 34 (the application of tax to the Lurgi Equipment Price) is not an issue in this appeal. With respect to the disputed issue, the parties correctly stipulated that:

> The disagreement on appeal is whether the Lurgi [ ] Engineering and Design Price of $38,578,000 paid by Praxair to Lurgi is subject to California sales or use tax. [CDTFA] contends that it is, while Praxair contends it is not.

(Stipulation 36). Reading stipulations 34 and 36 in context, it does not appear either party honestly intended to stipulate to the issue on appeal. Additionally, it appears the parties are emphasizing terminology over context. The parties may refer to it as "sales tax," "use tax," "tax," "tax reimbursement," "sales tax reimbursement," "local tax," or whatever else they may so choose to reflect the addition of tax to the selling price. The character of the tax is dependent on the applicable taxing statutes. (See Rev. & Tax. Code, §§ 6051, 6201.) Thus, for sales and use tax purposes, the exact terminology used by the parties to a contract to identify the addition of tax will not change the nature of the tax from sales tax to use tax, or vice versa. Along those same lines, the payment of an amount identified as "sales tax" to a seller will not thereby, for example, convert a use tax transaction into a sales tax transaction if the seller does not have sufficient nexus with this state to obligate the seller to collect the sales tax.

In any event, both parties submitted the Lurgi Contract, which we admitted into the evidentiary record. The Lurgi Contract states, on this issue, that the "Equipment Price represents the purchase of tangible personal property, which is subject to California state and/or local sales/use tax . . . [Praxair] shall pay to Lurgi [ ] the same in addition to the Lurgi Equipment Price." In light of the inconsistencies surrounding stipulation 34, we hereby strike it for good cause. In its place, we adopt the language in the Lurgi Contract, and based thereon we make a factual finding that Praxair paid Lurgi "California state and/or local sales/use tax" on the Lurgi Equipment Price. Furthermore, because the parties agree that neither Lurgi nor Praxair owe any additional tax in connection with the Equipment Price, we do not address this matter any further.

IV. Issue 3: Whether Praxair is liable for sales or use tax in connection with certain design and engineering charges.

California imposes sales tax on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt or excluded from taxation by statute. (Rev. & Tax. Code, §§ 6012, 6051.) A sale includes any transfer of title or possession of tangible personal property for a consideration. (Rev. & Tax. Code, § 6006(a).) The measure of tax includes any services that are a part of the sale of tangible personal property. (Rev. & Tax. Code, § 6012(b)(1).) No special exemptions or adjustments are allowed on account of charges related to the sale of custom-designed property. (See *ibid*.) To the contrary, a contract to design, develop, and manufacture custom-made property is a sale of tangible personal property, and the measure of tax includes all charges related to research, design, and development activities. (Reg. 1501.1(b)(3).) No deduction from the measure of tax is allowed for labor or service cost, the cost of materials used, interest paid, losses, or any other expense. (Rev. & Tax. Code, § 6012(a)(2).) As an exception, the measure of tax does not include charges for installation labor. (Rev. & Tax. Code, § 6012(c)(3).)

In the context of a construction contract, Regulation 1521 further interprets and implements these statutory provisions, and the California courts have upheld the validity of this regulation. (See *Honeywell, Inc. v. State Board of Equalization* (1975) 48 Cal.App.3d 897.) For these purposes, Regulation 1521 classifies property furnished under a construction contract into three categories: materials, fixtures, and machinery and equipment. (Reg. 1521(a)(4)-(6).) As relevant here, a construction contractor is the consumer of materials, and retailer of fixtures, and machinery and equipment, which they furnish and install in the performance of a construction contract and tax applies to the construction contractor's gross receipts from such sales. (Reg. 1521(b)(2).) Where the construction contract is on a lump sum basis, the construction contractor is the manufacturer, and there is no readily ascertainable retail market price for the fixture or machinery and equipment, then the construction contractor's gross receipts (also referred to as cost price) may be determined based on price lists, bid sheets, or other records of the contractor. (Reg. 1521(b)(2)(B)-(C).)

When CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (Rev. &

Tax. Code, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (See *Schuman Aviation Co. Ltd. v. U.S.* (D. Hawaii 2011) 816 F.Supp.2d 941, 950; *Todd v. McColgan* (1949) 89 Cal.App.2d 509, 514; *Appeal of Myers* (2001-SBE-001) 2001 WL 37126924.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA's determination is warranted. (*Riley B's, Inc. v. State Bd. of Equalization* (1976) 61 Cal.App.3d 610, 616.) Unsupported assertions are not sufficient to satisfy a taxpayer's burden of proof. (See *Riley B's, Inc.*, *supra*, at p. 616; see also *Appeal of Magidow* (82-SBE-274) 1982 WL 11930.)

a. The Occidental Contract

The parties stipulated that Praxair was a construction contractor, and that the Occidental Contract was a construction contract. As the construction contractor, Praxair would be liable for use tax on materials consumed in the construction contract, and sales tax on fixtures, or machinery and equipment, that it furnished and installed under the construction contract with Occidental. (See Reg. 1521(b).) The construction contract at issue involved, in pertinent part, a charge of $8,073,500 for "Engineering," which the parties stipulated includes "the specifications, drawings, engineering, and services, including procurement, construction, labor and testing" for the construction of a custom-designed air separation plant. CDTFA contends that 100 percent of the $8,073,500 Engineering charge is labor or service cost for Praxair's sale of fixtures, or machinery and equipment. Praxair contends that a substantial portion of the Engineering charge is allocable to nontaxable components, and only 13 percent is taxable.

Generally, the construction contractor's measure of tax will include any amount specifically charged for fixtures, or machinery and equipment, in the construction contract. (See Reg. 1521(b)(2)(B)2, (b)(2)(C)1.) As indicated above, labor and other service charges included with the sale of tangible personal property, including the design and manufacture of custom fixtures and machinery and equipment furnished in a construction contract, are generally included in the measure of tax. Furthermore, charges for research, design, and development of custom-property are also included in the measure of tax. (Reg. 1501.1.) Therefore, charges for design and engineering of custom property are generally taxable, and as such we find it was reasonable and rational for CDTFA to issue the NOD on the basis of the information available to it: the stated charge for Engineering.

Nevertheless, after reviewing the evidence in the record, we find that it would be unfair to consider solely, in a vacuum, the title of "Engineering" that the parties assigned to the $8,073,500 charge in the contract, and then determine taxability based on title alone. The evidence, including the testimony of the time and work involved in reassembling the air separation plant piece-by-piece, and the photographs of the air separation plant with metal scaffolding and jobsite trailer, all indicate that the air separation plant was primarily furnished and installed from the ground up, as opposed to being dropped in place in a completed condition. All of this evidence factors in favor of a finding that Praxair performed nontaxable installation labor when furnishing and installing the custom-designed Equipment (including fixtures and machinery and equipment) constituting the air separation plant. Furthermore, considering the contract as a whole, it would belie logic for us to conclude that the entirety of Praxair's construction contract providing for the design, furnishing and installation of a custom air separation plant for $19,473,500 was 100 percent taxable and did not require or involve any installation labor whatsoever.

In summary, if we were to go solely off the title of the charges, for "Equipment," and for "Engineering" to design the equipment, then we would agree with CDTFA that both of the charges are included in the measure of tax. Nevertheless, the evidence establishes that Praxair performed nontaxable installation labor, and under such circumstances it is unreasonable to treat 100 percent of the "Engineering" charge as a taxable line-item charge for taxable services included in the sale of tangible personal property. Under such circumstances, we believe it appropriate to make an allocation between taxable and nontaxable components of the construction contract. (See, e.g., *Dell, Inc. v. Superior Court* (2008) 159 Cal.App.4th 911.)

Regulation 1521 generally provides that if the sale price of a fixture cannot be established from the bid sheets, price lists, or other records of the taxpayer, and the fixture is manufactured by the contractor, the cost price shall be deemed to be the aggregate of the following:

> [1] Cost of materials, including such items as freight-in and import duties,
> [2] Direct labor, including fringe benefits and payroll taxes,
> [3] Specific factory costs attributable to the fixture,
> [4] Any manufacturer's excise tax,
> [5] Pro rata share of all overhead attributable to the manufacture of the fixture, and
> [6] Reasonable profit from the manufacturing operations which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the preceding factors.

> Jobsite fabrication labor and its prorated share of manufacturing overhead must be included in the sale price of the fixture. Jobsite fabrication labor includes assembly labor performed prior to attachment of a component or a fixture to a structure or other real property.

(Reg. 1521(b)(2)(B)2.b.) Regulation 1521 provides a substantially similar formula for ascertaining the measure of tax from the sale of machinery and equipment. (Reg. 1521(b)(2)(C)2.b.)

Bid sheets or price lists for comparable items sold by Praxair are unavailable. The only cost information available in the record is a "Plant Cost Estimate" that Praxair generated for its own internal use in connection with the Occidental Contract. Based on this document, Praxair's total estimated cost for Engineering was $1,606,100 ($1,572,100 + 34,000).[14] As indicated, the sale of engineering services, including the design of the plant such as how all the fixtures and machinery and equipment all fit together, is taxable as a part of the sale of the Equipment. We believe Praxair's cost estimate is a reasonable estimation of Praxair's cost for taxable engineering and design services included as a part of the sale of Equipment under the Occidental contract. Additionally, we must add a markup of 5 percent ($80,305) to Praxair's cost price. (Reg. 1521(b)(2)(B)2.b.[6].) As such, using the figures in Praxair's cost estimate, we conclude that the selling price of taxable design and engineering included with the sale of Equipment was: $1,686,405 ($1,606,100 + $80,305). This represents 20.9 percent of the separately stated charge for Engineering in the Occidental Contract.

In summary, we conclude that Praxair established a basis for adjustment. The taxable measure shall be reduced by $5,840,868 (from $7,527,273 to $1,686,405) in connection with this audit item.

b. The Lurgi Contract

i. Whether the applicable tax is a sales tax or a use tax.

The sales tax is imposed on the retailer, who may collect reimbursement from its customer if the contract of sale so provides. (Civ. Code, § 1651.1; Reg. 1700.) When sales tax

[14] Praxair's total estimated cost for the Occidental Contract was $14,772,000, which was allocated as follows: (1) business acquisition and project support, $1,191,400; (2) engineering, $1,572,100; (3) equipment, $5,648,000; (4) construction subcontracts, $5,107,600; (5) commissioning, warranty, and startup, $313,500; and (6) contingencies, $939,400 (including an additional $34,000 for Engineering). As indicated, Praxair already reported tax on the of sale of "Equipment," which was marked up to $11,400,000.

does not apply, use tax is imposed measured by the sales price of tangible personal property purchased from a retailer for storage, use, or other consumption in California. (Rev. & Tax. Code, §§ 6201, 6401.) The use tax is imposed on the person actually storing, using, or otherwise consuming the property. (Rev. & Tax. Code, § 6202.)

Lurgi was the retailer of the fixtures, and materials and equipment, and Praxair was Lurgi's customer. As such, if the applicable tax is a sales tax, then it is undisputed that the state has no statutory authority to bill or collect any applicable sales tax on this transaction directly from the retail customer (Praxair). (See Rev. & Tax. Code, § 6051.) CDTFA contends that the applicable tax is a use tax because Lurgi did not have sufficient nexus with the state to impose a sales tax liability directly on the retailer at the time of the transaction.

As indicated above, sales tax generally applies to a retail sale of tangible personal property in this state. (Rev. & Tax. Code, § 6051.) Such a sale subject to California's sales tax includes any transfer of title or possession of tangible personal property for a consideration in this state. (Rev. & Tax. Code, § 6006.) There is an exemption from sales tax for the gross receipts from any sale that California is prohibited from taxing under the Constitution or laws of the United States or under the California Constitution. (Rev. & Tax. Code, § 6352.) Under the Commerce Clause, Congress has the power to regulate commerce among the states. (U.S. Const., art. I, § 8, cl. 3.) The issue of whether a state can require an out-of-state retailer to collect and/or remit such tax involves an interpretation of the Commerce Clause and is commonly referred to as nexus.

As relevant here, under the Commerce Clause, the sales or use tax must apply to an activity that has a substantial nexus with the taxing state (the substantial nexus requirement). (*Complete Auto Transit, Inc. v. Brady* (1977) 430 U.S. 274, 279.) Furthermore, under the law in effect at the time of these transactions, as set forth in *National Bellas Hess, Inc. v. Dept. of Revenue of Illinois* (1967) 386 U. S. 753, and *Quill Corp. v. North Dakota* (1992) 504 U. S. 298, California could not require a retailer that had no physical presence in the state to collect its sales tax (the physical presence rule). The Supreme Court has further opined that, in cases where the taxpayer does, in fact, maintain a physical presence "and has submitted itself to the taxing power of the State," the taxpayer can avoid taxation on its in-state sales only by showing that particular transactions are dissociated from the local business and interstate in nature. (*Norton Co. v. Dept. of Revenue of State of Illinois* (1951) 340 US 534, 537 (*Norton*).) The board has interpreted the

above authorities to mean that nexus, for California sales tax purposes, requires that the retailer maintain a physical presence in the state, and that the retailer's local business office participate in the sale transaction.[15] (*Long Beach Container Terminal, Inc.* (1994-SBE-005) 1994 WL 719051 (*Long Beach Container*).)

In the instant appeal, the evidence shows that Lurgi actively participated in a single construction contract over a 15- to 21-month period with a single California customer, Praxair. Aside from addresses associated with unclaimed property totaling less than $109, for unspecified time periods, we have little, if any, evidence concerning the extent of Lurgi's other contacts and business activities within this state. Furthermore, although it is not disputed that title passed in California, the testimony at the hearing was that none of the equipment furnished and installed pursuant to the construction contract was sourced locally from California, but instead it was all shipped into this state from sources all around the world. There was also testimony that this was the first time Praxair had contracted with Lurgi. In summary, the evidence indicates that Lurgi came into this state after entering into a contract with Praxair, and only for purposes of working on that contract, and all the property furnished thereunder was shipped from points outside this state. These facts bring us within the scope of *Long Beach Container*. In that case, the board, interpreting the physical presence rule, substantial nexus requirement, and *Norton*, concluded that the establishment of a temporary construction site in California, solely for the purposes of installing property shipped into the state and sold pursuant to a contract entered into prior to establishing the job site, did not create constitutional nexus for sales tax purposes. Therefore, consistent with *Long Beach Container*, we have no basis to conclude that the substantial nexus requirement was met during the liability period at issue.[16] As such, we find that Praxair has not met its burden in establishing that use tax is inapplicable or that Praxair, as the consumer, is not liable for the use tax.

[15] The physical presence rule, a constitutional limitation on interstate collection of sales and use taxes, was overturned by the United States Supreme Court in 2018 on the basis that "[it] is an incorrect interpretation of the Commerce Clause." (See *South Dakota v. Wayfair, Inc*. (2018) 138 S.Ct. 2080, 2092 (*Wayfair*).)

[16] As indicated, the physical presence rule has now been overturned. (See footnote 15.) Nevertheless, because *Long Beach Container* is a correct application of the law at the time of the liability period (July 1, 2006, through December 31, 2009), we do not address the subsequent effect of *Wayfair* on *Long Beach Container,* if any. Nevertheless, we note that although the tax at issue in *Wayfair* was a sales tax, the sales tax was required to be collected from the customer. In California, there is no obligation for a seller to collect sales tax from a customer. Thus, *Long Beach Container, supra,* might have continuing relevance post-*Wayfair*.

ii. Whether any adjustments are warranted to the audited measure of use tax.

Similar to the Occidental Contract, the Lurgi Contract involved the furnishing and installation of a hydrogen plant. The applicable law is the same as discussed above for the Occidental Contract. Unlike the Occidental Contract (where Praxair was the construction contractor), Praxair's role was reversed in the Lurgi Contract (here, Praxair was the customer). Praxair provided Lurgi's cost information for the Lurgi Engineering and Design Price, $38,578,000, set forth in the Lurgi Contract. In addition, Praxair provided a third-party Equipment Engineering Study, prepared by Independent Project Analysis, Inc., estimating that based on industry averages, only 6 percent of the Engineering and Design Price is taxable. Based thereon, and on the cost information for the Occidental Contract, Praxair estimates that only 5 to 10 percent of the charge is taxable.

As with Occidental, after reviewing the evidence in the record, we find that it would be unfair to consider solely, in a vacuum, the title of "Engineering and Design Price" that the parties assigned to the $38,578,000 charge in the Lurgi contract, and then determine taxability based on title alone. The evidence, including the testimony of the 15 months of construction spent on the hydrogen plant, the nature of the work involved in designing the plant and how all the components fit together, and the photograph of the partially constructed plant with jobsite trailers, three construction cranes, and an exposed metal structure for the two buildings, all clearly establish that the hydrogen plant was primarily furnished and installed from the ground up, as opposed to being dropped in place in a completed condition. This proves that the construction contractor performed nontaxable installation labor when furnishing and installing the custom-designed equipment that constitutes the hydrogen plant.

In a post-hearing submission, CDTFA contends that at least 40 percent of Lurgi's Engineering and Design Price is taxable (reduced from its claim of 100 percent at the oral hearing). Furthermore, in conjunction with CDTFA's related assertion that additional use tax is owed for the ARB Price, CDTFA contends Praxair owes use tax on an amount equal to 50 percent of the Engineering and Design Price. We previously concluded that CDTFA failed to meet its burden in establishing an offset for the ARB Price. Therefore, our inquiry here is limited to the Lurgi Engineering and Design Price, and we do not further address CDTFA's claimed 10 percent offset for additional use tax owed on the ARB Price.

CDTFA did not provide audit work papers to support a 40 percent taxable ratio for the Engineering and Design Price. Instead, CDTFA estimated a 40 percent taxable ratio by dividing Praxair's reported taxable measure (from the sale of the Equipment) by the difference of the total contract price less the disputed measure of $38,578,500.[17] CDTFA considers it reasonable and rational to extend this ratio to the disputed Engineering and Design Price. We reject this approach because it fails to take into consideration the documentary evidence and testimony provided at the oral hearing.

The Consortium Agreement between Lurgi and ARB includes a detailed breakdown of Lurgi's estimated costs for furnishing and installing the Hydrogen Plant. Lurgi's cost for "Engineering & Project Management" is $10,856,000, which we will accept as a reasonable estimation of taxable engineering and design services included as a part of the sale of the equipment. (See Reg. 1521(b)(2)(C)2.b.) As with the Occidental Contract, we must add a markup of 5 percent ($542,800) to Lurgi's cost price. (Reg. 1521(b)(2)(B)2.b.[6].) We conclude that the selling price of taxable design and engineering services included with Lurgi's taxable sale of equipment was: $11,398,800 ($542,800 + $10,856,000). This represents 29.5 percent of the separately stated charge for Engineering and Design in the Lurgi Contract.

In summary, we conclude that Praxair established a basis for adjustment, and the taxable measure for this audit item shall be reduced by $27,179,200 (from $38,578,000 to $11,398,800).

V. Issue 4: Whether Praxair established a basis for adjustment for the miscellaneous disallowed claimed nontaxable sales.

The law creates a statutory presumption that all gross receipts are subject to tax until the contrary is established. (Rev. & Tax. Code, § 6091.) The retailer has the burden of proving that a sale of tangible personal property is not a retail sale unless the retailer timely and in good faith obtains a resale certificate from the purchaser. (Rev. & Tax. Code, § 6091; Reg. 1668(a).)

a. NBC

Regarding the disallowed sale of CO2 to NBC for resale, the law presumes that Praxair's sales are taxable retail sales because appellant failed to obtain a resale certificate from NBC.

[17] The reason CDTFA uses these numbers is because CDTFA contends that, at the time of the audit, it was undisputed that the ratio of taxable to nontaxable items on the undisputed measure was 40/60 percent (i.e., ARB Price and Equipment Price). Thus, CDTFA contends it is reasonable to project this ratio onto the disputed measure, because everyone *previously* agreed that these items were reported properly (CDTFA now disputes the ARB price).

(Rev. & Tax. Code, § 6091; Reg. 1668(a).) In such cases, the law provides, in pertinent part:

> [I]f the seller does not timely obtain a resale certificate . . . the seller will be relieved of liability for the tax only where the seller shows that the property:
>
> (1) Was in fact resold by the purchaser [prior to use[18]] or
>
> (2) Is being held for resale by the purchaser and has not been used by the purchaser . . . or
>
> (3) Was consumed by the purchaser and tax was reported directly to the [state] by the purchaser on the purchaser's sales and use tax return, or
>
> (4) Was consumed by the purchaser and tax was paid to the [state] by the purchaser pursuant to an assessment against or audit of the purchaser . . .

(Reg. 1668(e).) It is undisputed that NBC did not report or pay any tax to the state on these transactions. Praxair provided evidence confirming that NBC used the CO2 during the manufacturing process to lower the temperature of raw beef products that it did resell.

As relevant, the Sales and Use Tax Law provides for a limited exemption from tax on the sale and purchase of "[c]arbon dioxide [(CO2)] used or employed in packing and shipping or transporting fruits or vegetables for human consumption" even if the CO2 is no longer contained in the package when the fruits or vegetables are sold to the consumer. (Rev. & Tax. Code, § 6359.8 [emphasis added].) Praxair contends OTA should expand the scope of Revenue and Taxation Code section 6359.8 to Praxair's sale of meat products. OTA is an administrative agency and we have no authority under the constitution to decline to enforce the clear and unambiguous provisions of that code section. (Cal. Const., art. III, § 3.5.) Praxair concedes that NBC used the CO2 to cool meat products, as opposed to fruits or vegetables. As such, we find that Praxair failed to establish that its sale of CO2 to NBC meets the statutory requirements to qualify for exemption. In conclusion, we find that no adjustment is warranted for this audit item.

b. Ralph's

In order to be valid, a resale certificate must be timely issued, in good faith, and must contain all the required elements. (Reg. 1668(b).) One required element is that the resale certificate must include a statement that the property described in the document is purchased for

[18] For these purposes, "use" and "used" mean a use for any purpose other than retention, demonstration, or display while holding it for sale in the regular course of business. (Reg. 1668(e)(1).)

resale. (Reg. 1668(b)(1)(D).) The resale certificate only applies to the purchase of property described in the certificate, and if a purchaser issues a general description of the items to be purchased, and subsequently issues a purchase order which indicates that the transaction covered by the purchase order is taxable, the resale certificate does not apply with respect to that transaction. (Reg. 1668(b)(3).) If the purchaser insists that it is buying property not normally resold in the purchaser's business for resale, the seller should require a specific statement from the purchaser that the property at issue is being purchased for resale in order to establish that the certificate was accepted in good faith. (Reg. 1668(c).)

Here, Praxair maintained a blanket resale certificate on file for Ralph's for the purchase of "retail groceries and related items." The resale certificate was issued on June 2, 2000, long before the transactions at issue. We do not believe the description of "retail groceries and related items" covers the sale of liquid oxygen. There is no evidence or contention that Ralph's sold liquid oxygen at retail to its retail customers, and there was no testimony or evidence to support that liquid oxygen is the type of property that may be purchased at a retail grocery store. Furthermore, the evidence indicates that Praxair delivered the liquid oxygen to a packing facility, as opposed to a retail grocery store, and it is also Praxair's understanding that the liquid oxygen was used to cool meat. Therefore, we conclude that the resale certificate did not apply to the purchase of liquid oxygen. As such, Praxair has the burden of establishing that Ralph's resold the liquid oxygen, or that the sale is otherwise exempt or excluded from tax. Here, Praxair raises the same argument as discussed in item a., above, that Revenue and Taxation Code section 6359.8 should apply to exempt the sale of liquid oxygen used in the packaging of meat products. We already concluded above that we lack authority to expand the scope of Revenue and Taxation Code section 6359.8 to the sale of meat products. As such, we conclude that no adjustment is warranted for this audit item.

c. STI

A sale includes the producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish, either directly or indirectly, the materials used. (Rev. & Tax. Code, § 6006(b).) Thus, for example, tax applies to the entire amount charged to convert a vehicle into a limousine. (See, e.g., Reg. 1526(c).) Here, Praxair installed new components on a used trailer in order to modify the intended use of the trailer. This was not a repair job. The trailer was being stored on the customer's property and used to

transfer hydrogen gas, and the modification changed the transfer capabilities of the trailer. Praxair invoiced the customer a lump sum charge of $45,000 for the modification. The trailer is tangible personal property, and as such tax would apply to a charge to modify the intended use of the trailer for the customer as described, whether the trailer was supplied by Praxair or by the customer. (Rev. & Tax. Code, § 6006(b).)

Consistent with our decision, we note that it has been the long-standing position of CDTFA (and before that, the board) in interpreting and implementing the Revenue and Taxation Code to consider charges made for modifying the existing use of used tangible personal property as taxable fabrication labor. (See, e.g., Sales and Use Tax Annotations 435.0320 [nontaxable repair labor versus taxable fabrication labor]; 435.0400 (10/2/53) [charges for applying coating to used pipe are taxable]; 435.0418 (12/13/96) [charges for converting a used school bus into a motorhome are taxable].)[19] And here, Praxair's own records state that this is "a new use" for the trailer.

Although Praxair contends that this is a nontaxable service contract involving the incidental transfer of tangible property; here, the materials' cost was $28,483, which is 63 percent of the total charge to the customer. Furthermore, the purpose of the modification was for use in the sale of hydrogen, which is generally taxable. Finally, we note that the hydrogen manifold scenario at issue is analogous to *Culligan Water Conditioning v. State Bd. of Equalization* (1976) 17 Cal. 3d 86, 96, where the California Supreme Court concluded that the true object of a water conditioning contract is the furnishing of the tangible personal property used to condition the water (the exchange units), and the installation and maintenance services performed were incidental to the functioning of the exchange units.

At the oral hearing, CDTFA conceded that an allowance is warranted for tax that Praxair already paid at the time it purchased the components. (See Reg. 1701(a).) As such, we conclude that the $45,000 charge to STI is taxable and no further adjustments are allowable.

HOLDINGS

1. CDTFA failed to establish a basis to increase Praxair's use tax liability, from the amount of its original determination, on account of the ARB Price.

[19] Although CDTFA's annotations do not have the force or effect of law, they are "nonetheless entitled to 'great weight'[especially] when, as here, [CDTFA] is construing a statute it is charged with administering and that statutory interpretation is long-standing." (*Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25.)

2. We strike stipulation 34 for good cause.

3. Praxair established a basis for a $5,840,868 adjustment (i.e., from $7,527,273 to $1,686,405) in connection with the Occidental Contract, and a $27,179,200 adjustment (i.e., from $38,578,000 to $11,398,800) in connection with the Lurgi Contract.

4. Praxair failed to establish a basis for additional adjustments to the miscellaneous disallowed claimed nontaxable sales.

DISPOSITION

CDTFA's action in denying the petition for redetermination is reversed, in part, and sustained, in part. CDTFA shall make the $15,249 adjustment for tax-paid purchases resold to STI, pursuant to its concession at the oral hearing, plus any other adjustments provided for in CDTFA's D&R.

In addition, CDTFA shall make the following adjustments as determined by OTA:

(1) the taxable measure shall be reduced from $7,527,273 to $1,686,405 in connection with the Occidental Contract; and

(2) the taxable measure shall be reduced from $38,578,000[20] to $11,398,800 in connection with the Lurgi Contract.

The liability shall be redetermined as described above.

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Andrew J. Kwee
Administrative Law Judge

We concur:

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John O Johnson
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John O. Johnson
Administrative Law Judge

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Teresa A. Stanley
Administrative Law Judge

[20] Based on our finding that the correct measure of tax is $11,398,800, CDTFA is directed to reduce the measure of tax from the audited measure for this item to $11,398,800. Although it is unclear if the entire $38,578,000 was picked up in the audit (see footnote 11), it is not necessary for us to determine if the audited measure for this item is $38,227,460, $38,227,482, or the entire Engineering and Design Price of $38,578,000. CDTFA shall make any adjustments necessary to reduce the taxable measure for the Lurgi Contract to $11,398,800.