

OFFICE OF TAX APPEALS
STATE OF CALIFORNIA

In the Matter of the Appeal of:)	OTA Case No. 21037328
HANWHA Q CELLS EPC USA LLC)	CDTFA Case ID 175-012
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OPINION

Representing the Parties:

For Appellant:	Michael C. Hamersley, Attorney Jongho John Kim, Representative
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For Respondent:	Kevin B. Smith, Tax Counsel III
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S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6901, Hanwha Q Cells EPC USA LLC (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)¹ denying appellant's claim for refund of \$1,581,848 for use tax paid for the period January 1, 2017, through December 31, 2017.

This matter is being decided on the basis of the written record because appellant waived the right to an oral hearing.

ISSUE

Whether appellant is entitled to a partial exemption for use tax on its purchases of solar modules.

¹ Sales and use taxes were formerly administered by the Board of Equalization (board). Effective July 1, 2017, functions of the board relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to its predecessor, the board.

FACTUAL FINDINGS

1. Appellant is a limited liability company located in Irvine, California. Appellant is a construction contractor of solar energy power facilities and holds an active seller's permit with CDTFA with a start date of May 20, 2016.
2. On or about March 13, 2017, appellant entered into two construction contracts, one each with Sune Beacon Site 2 and Sune Beacon Site 5 (collectively, the Project Owners) to design, engineer, construct, and install solar energy power facilities at a site located in or near Cantil, California (Projects). The finished Projects were to be used for the generation, production, and storage of solar electric power.
3. During 2017, in its performance of constructions contracts for Projects, appellant made two purchases of photovoltaic solar modules (solar modules): one in the first quarter of 2017 for \$2,471,360 and another in the fourth quarter of 2017 for \$37,702,566, for a total amount of \$40,173,926. Appellant made the purchases ex-tax² from a foreign vendor and remitted a total of \$2,912,609.60 in use tax to CDTFA, representing use tax on the purchase of the solar modules.³
4. Appellant installed the solar modules at the Projects' site in late 2017. In letters dated February 28, 2018, the Project Owners self-attested that they would "be primarily engaged (50 percent or more of the time) in the 'Solar Electric Power Generation' business" as defined by the North American Industry Classification System (NAICS)⁴ Code 221114.⁵

² Ex-tax refers to purchases made without payment of sales tax reimbursement or use tax.

³ This amount represents two use tax payments: a payment on March 16, 2017 (purchase price of the first purchase (\$2,471,360) times the tax rate (7.25 percent) = \$179,173), and a payment on January 18, 2018 (purchase price of the second purchase (\$37,702,566) times tax rate (7.25 percent) = \$2,733,436).

⁴ The NAICS was adopted in 1997 as an established standard used by federal statistical agencies in classifying types of business. (See 85 Fed. Reg. 11121-11122 (Feb. 20, 2020).)

⁵ NAICS Code 221114 consists of establishments primarily engaged in operating solar electric power generation facilities, and the electric power produced in these establishments is provided to electric power transmission systems or to electric power distribution systems.

5. On or about March 5, 2018, appellant submitted to CDTFA a claim for refund of use tax in the amount of \$1,581,848, based on the partial exemption provision in R&TC section 6377.1.⁶
6. On or about April 4, 2018, appellant completed Projects.
7. On June 19, 2019, CDTFA denied appellant’s claim for refund on grounds that the Project Owners were not qualified persons prior to January 1, 2018.
8. On January 21, 2021, CDTFA issued a decision affirming the denial of the claim for refund. This timely appeal followed.

DISCUSSION

California imposes sales tax on a retailer’s retail sales of tangible personal property (TPP) sold in this state measured by the retailer’s gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, §§ 6012, 6051.) When sales tax does not apply, use tax applies to the storage, use, or other consumption of TPP purchased from any retailer for 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.)

Statutes granting exemption from taxation must be reasonably, but nevertheless strictly, construed against the taxpayer. (*Standard Oil Co. v. State Bd. of Equalization* (1974) 39 Cal.App.3d 765, 769.) The taxpayer bears the burden of showing its entitlement to the exemption. (*Ibid.*; *Appeal of Snowflake Factory LLC*, 2020-OTA-270P.) Any doubt must be resolved against the right to an exemption. (*Associated Beverage Co. v. State Bd. of Equalization* (1990) 224 Cal.App.3d 192, 211.)

California Code of Regulations, title 18, (Regulation) section 1521(a)(2) provides that a “construction contractor” is any person who, for itself, in conjunction with, or by or through others, agrees to perform and does perform a construction contract. In general, construction contractors are consumers of the materials they furnish and install when they perform construction contracts, and either sales tax or use tax applies to the sale of materials to, or the use

⁶ As discussed below, R&TC section 6377.1(a)(4) partially exempts from the sales and use tax the sale of, and the storage, use, or other consumption of qualified tangible personal property (TPP) purchased for use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person, that will use that property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, the generation or production, or storage and distribution, of electric power, or as a research or storage facility for use in connection with those processes.

of materials by, the construction contractor. (Cal. Code Regs., tit. 18, § 1521(b)(2)(A)(1).)

Construction contractors are usually the retailers of the fixtures they furnish and install in the performance of construction contracts and tax applies to their sales of fixtures. (Cal. Code Regs., tit. 18, § 1521(b)(2)(B)(1).)

R&TC section 6377.1, effective July 11, 2013, and operative July 1, 2014, provides a partial exemption from sales and use tax for the sale or use of qualified TPP purchased for use by a contractor purchasing that property for use in the performance of a construction contract for the qualified person, that will use that property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, the generation or production, or storage and distribution, of electric power, or as a research or storage facility for use in connection with those processes. (R&TC, § 6377.1(a)(4).) Under Assembly Bill 398 (AB 398), effective July 25, 2017, R&TC section 6377.1 was amended in part to expand the definition of “qualified person” to include, operative January 1, 2018, businesses primarily engaged in operating electric power generation facilities as described in Codes 221111 to 221118, inclusive, or primarily engaged in the storage and distribution of electric power as described in Code 221122 of the North American Industry Classification System published by the United States Office of Management and Budget, 2012 edition (hereinafter “NAICS Code”). Thus, as relevant to this appeal:

(8)(A) “qualified person” means:

(i) Prior to January 1, 2018, a person that is primarily engaged in those lines of business described in [NAICS] Codes 3111 to 3399, inclusive, 541711, or 541712

(ii) On and after January 1, 2018, and before July 1, 2030, a person that is primarily engaged in those lines of business described in [NAICS] Code 3111 to 3999, inclusive, 221111 to 221118, inclusive, 221122, 541711, or 541712

(R&TC, § 6377.1(b).)

Additionally, operative January 1, 2018, the definition of “qualified tangible personal property” was expanded to include special purpose buildings and foundations used for the generation or production or storage and distribution of electric power. (R&TC, § 6377.1(b)(9)(A)(iv)(II).) In summary, there are three requirements to qualify for the partial exemption: (1) qualified person; (2) qualified use; and (3) qualified TPP.

Here, the relevant facts are not in dispute. As stated above, in March 2017 appellant entered into the construction contracts for Projects. Also in 2017, appellant purchased the solar modules, which were qualified TPP pursuant to section 6377.1(a)(4),⁷ and installed the solar modules at the Projects' site. Appellant reported the purchases of the qualified TPP and paid the use tax to CDTFA in 2017. The Project Owners became qualified persons in 2018.

Since the facts are not disputed, the issue is essentially one of law, specifically whether the Project Owners were qualified persons for the purposes of the partial exemption provision in R&TC section 6377.1(a). The exemption pertains to the “sale of, and the storage, use, or other consumption” of the qualified TPP purchased for use by the contractor (emphasis added). Because appellant, not the Project Owners, is the construction contractor claiming the use tax exemption, “the sale of, and the storage, use, or other consumption” refers to the actions of appellant, not the actions of the Project Owners. Supporting this clear reading of the statute is subdivision (a)(4), which describes qualified TPP as being “purchased for use by a contractor purchasing that property for use in the performance of a construction contract” (emphasis added).

There is no dispute that the sale of, and the storage, use, or other consumption (i.e., installation) by appellant, all occurred in 2017. That is, appellant contracted with the Project Owners, purchased the solar modules, and installed the solar modules at the Projects' site, all in 2017. However, as the Project Owners acknowledge, they did not become qualified persons (as defined in R&TC section 6377.1(b)(8)(A)(ii)) until 2018. Because appellant is claiming the partial use tax exemption for the purchase and use that occurred in 2017, when the Project Owners were not yet qualified persons under the statutory provision, and because the Projects did not meet the statutory definition of qualified TPP until 2018, we find that appellant is not entitled to the statutory exemption.

Appellant agrees that pursuant to Regulation section 1521, a construction contractor's taxable event generally occurs when the contractor purchases materials. However, appellant argues that the status of the construction contractor's customer, as a qualified person, is not contingent on the circumstances at the time of purchase, but is instead contingent on the circumstances at the time the construction contract is complete. In support of this argument, appellant states that the qualifying use of the property is dependent on actions following the

⁷ The parties appear to dispute whether Regulation section 1521 is incorporated by reference in R&TC section 6377.1(a)(4). We need not address this question because R&TC section 6377.1(a)(4) is wholly dispositive of the issue.

completion of the construction contract, which, appellant argues, indicates that the qualifying use and qualifying person requirements are interconnected. Additionally, appellant notes that R&TC section 6377.1 was expanded on an urgency basis by AB 398 to include the exemption at issue here, and appellant argues that basing a qualified person analysis on the purchase date would therefore conflict with the intent of AB 398. (AB 398, Chapter 135, Stats. 2017.) Furthermore, appellant argues that, under such an analysis, first-time power producers would never qualify for the exemption at issue, which would significantly undermine the legislative intent of AB 398.

We find these arguments unpersuasive. The qualified person and qualified use requirements are separate, and while R&TC section 6377.1(a)(4) refers to the qualified use requirement prospectively, the qualified person requirement is tied to the purchase because the subsection's language explicitly requires the property be purchased pursuant to a construction contract with a qualified person, and such a contract cannot exist if the construction contractor's customer is not a qualified person at the time of purchase.

With respect to appellant's arguments concerning the intent of AB 398, we note that while AB 398 was enacted on an urgency basis, it explicitly provided a January 1, 2018 operative date for the exemption at issue. Consequently, limiting application of the exemption to purchases taking place on and after January 1, 2018, is wholly consistent with the legislative intent of AB 398. Lastly, there is no basis for appellant's assertion that first-time power producers cannot qualify for the exemption at issue when the qualified person requirement is based on status at the time of purchase. Regulation section 1525.4 provides that first-time businesses are among those who can meet the requirements for being a qualified person that is primarily engaged in a qualifying line of business. Although generally, the gross revenue or operating expenses during the prior financial year must be examined, Regulation section 1525.4(b)(10)(A) provides that in cases where the purchaser was not primarily engaged in a qualifying line of business for the financial year preceding the purchase of the property, "the one year period following the date of purchase of the property" at issue will be used to examine whether the purchaser meets the definition of a "qualified person."

HOLDING

Appellant has not established that it is entitled to the partial exemption for the use tax paid on its purchases of the solar modules.

DISPOSITION

CDTFA’s action in denying appellant’s claim for refund is sustained.

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

We concur:

DocuSigned by:
Josh Aldrich
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Josh Aldrich
Administrative Law Judge

DocuSigned by:
Andrew J. Kwee
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Andrew J. Kwee
Administrative Law Judge

Date Issued: 5/10/2022