OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 21088332
	) CDTFA Case ID: 831-380
SNOWMAGIC, INC.	)
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Bradley Marsh, Attorney
For Respondent:	Amanda Jacobs, Attorney Chad Bacchus, Attorney Jason Parker, Chief of Headquarters Ops.
For Office of Tax Appeals:	Steven Kim, Attorney III

S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, Snowmagic, Inc. (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's petition for redetermination of the Notice of Determination (NOD) dated December 7, 2018. The NOD is for a tax of $119,479.00, plus applicable interest, and a 10 percent failure-to-file penalty of $11,947.90, for the period January 1, 2012, through December 31, 2015 (liability period).

OTA Administrative Law Judges Suzanne B. Brown, Natasha Ralston, and Keith T. Long held an oral hearing for this matter in Sacramento, California, on March 21, 2023. At the conclusion of the hearing, the parties submitted the matter and the record was closed. On March 24, 2023, OTA reopened the record to allow the parties to address one specific topic. The parties submitted additional briefing, and OTA again closed the record on June 30, 2023.

[1] Sales and use taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE 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 BOE; and when this Opinion refers to acts or events that occurred on or after July 1, 2017, "CDTFA" shall refer to CDTFA.

ISSUES

1. Whether adjustments are warranted to the audit liability for unreported sales subject to use tax collection for the liability period.
2. Whether the failure-to-file penalty should be relieved.
3. Whether relief of interest is warranted.

FACTUAL FINDINGS

1. Appellant is a Delaware corporation with its headquarters in New Jersey. Appellant contracts with its customers to operate snowmaking equipment, produce artificial snow on-site, and provide related services. Appellant uses a refrigeration system and water from its customers' waterlines to produce the snow without chemical additives.
2. During the liability period, appellant did not hold a California seller's permit or certificate of registration for use tax. On May 24, 2018, CDTFA involuntarily registered appellant for a seller's permit with a retroactive start date of January 1, 2012.
3. At issue in this appeal are transactions pursuant to contracts between appellant and four of its customers, all of which operate entertainment venues located in California; those venues are Legoland California; Petco Park; SeaWorld San Diego; and Universal City Studios. Pursuant to these contracts, appellant and the customer agreed that appellant would "supply the snow" or "produce and maintain the snow" at the customer's location for a designated time period.[2]
4. According to the contracts, and consistent with appellant's promotional materials (including its website and photos) and the testimony of appellant's president, the services appellant performed for these four customers included the following: setup, layout, and implementation of snowmaking equipment; snowmaking and running the system for startup; and snowmaking equipment takedown and removal. Appellant also provided on-site supervisory and management services, which included: supervising and managing snowmaking staff; managing equipment operation and maintenance; responsibility for staff for snowmaking, grooming, and tilling; and assisting in training of event staff for day-to-day operations. The contracts also specify areas that were the customer's

[2] Appellant's president testified that occasionally appellant has provided consultation services to customers that did not involve appellant providing any snow. However, those transactions are not part of the liability at issue.

responsibility, such as providing: water source and hookup (plumber); electricity source and hookup (electrician); supplies such as tiller, fuel, rakes, shovels, and a workspace for an on-site supervisor; and a crane for setup and takedown.

5. Appellant did not lease or rent any equipment to these customers, and did not relinquish control of the equipment to the customers.
6. On December 6, 2018, CDTFA issued a Field Billing Order (FBO)[3] finding appellant had $1,478,000 of unreported taxable sales subject to use tax.
7. On December 7, 2018, CDTFA issued the NOD for the liability disclosed in the FBO.
8. On January 4, 2019, appellant filed a petition for redetermination with CDTFA.
9. On July 31, 2019, CDTFA issued a first reaudit report proposing to increase the measure of unreported taxable sales by $492,750, from $1,478,000 to $1,970,750.
10. On October 18, 2019, CDTFA issued a timely Notice of Increase for the lability disclosed in the first reaudit report, increasing the tax liability to $158,295 and the failure-to-file penalty to $15,829.52, and adjusting the interest accordingly.[4]
11. On November 24, 2020, appellant filed Form CDTFA-735 (Request for Relief from Penalty, Collection Cost Recovery Fee, and/or Interest) with CDTFA, requesting relief from all applicable penalties and interest.[5]
12. On February 12, 2021, CDTFA issued a decision denying appellant's petition for redetermination. On March 12, 2021, appellant filed a request for reconsideration with CDTFA. On June 30, 2021, CDTFA issued a supplemental decision continuing to deny the petition for redetermination.
13. This timely appeal followed.
14. During this appeal to OTA, CDTFA conducted a second reaudit and found some inconsistencies between the total fees from the contracts and the determined measure of tax as scheduled in CDTFA's audit work papers. CDTFA found that its review of the SeaWorld San Diego contract had counted the same $41,800 twice, and also determined

[3] CDTFA uses an FBO examination to recommend an additional tax liability using procedures that are not as comprehensive as those used in a regular audit. (CDTFA Audit Manual, § 0201.09.)

[4] R&TC section 6563 allows CDTFA to decrease or increase the amount of a determination before it becomes final.

[5] Although the request is signed under penalty of perjury, appellant did not set forth any facts on which the claim for relief was based.

that its review of the Legoland California contract had excluded an incorrect amount for total shipping charges. Pursuant to that second reaudit, CDTFA concedes to an adjustment of $45,050, which reduces the total taxable measure to $1,925,700.

DISCUSSION

Issue 1: Whether adjustments are warranted to the audit liability for unreported sales subject to use tax collection for the liability period.

Use tax applies to the storage, use, or other consumption in California of tangible personal property purchased from any retailer for storage, use, or other consumption in this state, unless that use is specifically exempted or excluded from taxation by statute. (R&TC, § 6201.) Generally, use tax is owed by the person who purchased the property for storage, use, or consumption in this state. (R&TC, § 6202(a).) In addition, out-of-state retailers who are engaged in business in this state have an obligation to collect and remit use tax from the purchaser on sales of tangible personal property for use, storage, or consumption in this state. (R&TC, § 6203(a).)

The total amount of the sales price includes any services that are a part of the sale of tangible personal property. (R&TC, § 6011(b)(1).) "Gross receipts" are the total amount of the sale price without any deduction for labor, service cost or other expense, and include any services that are part of the sale. (R&TC, § 6012(a)(2), (b)(1).) Gross receipts do not include the amount charged for labor or services rendered in installing or applying the property sold. (R&TC, § 6012(c)(3).) For the purpose of the proper administration of the Sales and Use Tax Law and to prevent the evasion of the sales tax, the law presumes that all gross receipts are subject to tax until the contrary is established. (R&TC, § 6091.)

"Tangible personal property" means personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses. (R&TC, § 6016.) Therefore, water, either in its liquid or solid forms, is considered tangible personal property. Gross receipts derived from the sale of water, or the storage, use, or other consumption of water in California, are exempt from tax when the water is delivered to consumers through mains, lines, or pipes. (R&TC, § 6353.) When a right to an exemption from tax is involved, the taxpayer has the burden of proving this right to the exemption. (*H.J. Heinz Company v. State Board of Equalization* (1962) 209 Cal.App.2d 1, 4.) Any taxpayer seeking exemption from the

tax must establish that right using the evidence specified by the authorizing statute or regulation. The applicable burden of proof is by a preponderance of the evidence. (Cal. Code Regs., tit.18, § 30219(b).) A mere allegation that sales are exempt is insufficient. (*Paine v. State Board of Equalization* (1982) 137 Cal. 3d 438, 442.)

A "sale" and "purchase" means and includes any transfer of title or possession, exchange, or barter of tangible personal property for a consideration, conditional or otherwise, in any manner or by any means whatsoever.[6] (R&TC, §§ 6006(a); 6010(a).) "Transfer of possession" includes only transactions found to be in lieu of a transfer of title, exchange, or barter. (*Ibid*.) A "sale" also means and includes the producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who, either directly or indirectly, furnish the materials used in the producing, fabricating, processing, printing, or imprinting. (R&TC, § 6006(b); Cal. Code Regs., tit. 18, § 1526(a).) Producing, fabricating, and processing include any operation which results in the creation or production of tangible personal property or which is a step in a process or series of operations resulting in the creation or production of tangible personal property. (Cal. Code Regs., tit. 18, § 1526(b).)

Here, appellant brought its snowmaking equipment to its customers' sites and used its customers' liquid water to make snow on site. The water belonged to the customers, both before and after it was processed into snow, and the snowmaking occurred entirely on the customers' properties. The act of processing tangible personal property for customers who provide the material used in the processing is a taxable sale. (See R&TC, § 6006(b); Cal. Code Regs., tit. 18, § 1526(a).) Using its snowmaking equipment, appellant processed the water provided by its customers to create snow. Appellant's process of making snow for its customers is a sale of tangible personal property.

After appellant created the snow using its customers' water, appellant's customers and the customers' guests then used the snow in California. Because appellant operated in California for the purpose of selling tangible personal property and that tangible property was used by

[6] A "sale" also means and includes any lease of tangible personal property for a consideration, in any manner or by any means whatsoever, except for certain types of leases not at issue in this appeal. (R&TC, § 6006(g).) Appellant states that it does not lease or rent any equipment to its customers, and it is undisputed that the contracts did not involve any leases of tangible personal property.

appellant's customers in California, appellant was a retailer engaged in business in this state and, at a minimum, had an obligation to collect and remit use tax.[7] (See R&TC, § 6203.)

Appellant contends that its snowmaking process does not constitute a taxable sale of tangible personal property because the process does not use chemical additives and simply reconditions water from a liquid form to a solid form. Appellant argues that because the water retains its molecular composition as H_2O, nothing different is created. However, there is no requirement under R&TC section 6006(b) and California Code of Regulations, title 18, section 1526(a) that tangible personal property must undergo a change in its molecular composition to be considered a taxable sale. For instance, annotations have found that crushing broken concrete rubble represents a taxable process because it results in a processed product having different characteristics, shape, form, and qualities from the rubble it was crushed from (CDTFA Sales and Use Tax Annotation (Annotation) 315.0070 (1/21/77)) and that cutting fallen timber into firewood constitutes a taxable sale of tangible personal property (Annotation 435.0827 (7/11/83)).[8] None of these examples involve any change in the molecular composition of the tangible personal property produced. Similarly, appellant's snowmaking process created tangible personal property (snow) in a completely different form from the tangible personal property (liquid water) used in its creation. Therefore, OTA finds unpersuasive appellant's position that processing (by freezing) water to make snow does not constitute a taxable sale of tangible personal property.

Appellant also contends that it did not sell any tangible personal property because there was no transfer of title or possession (in lieu of title) of tangible personal property. Appellant also argues that it removed all snow at the conclusion of the events and that its customers did not retain any of the snow. However, a sale of tangible personal property also includes processing or producing tangible personal property (snow) for a consideration for consumers who furnish the materials used in the producing (liquid water), even if there was no transfer of title or possession of any tangible personal property. (See R&TC, § 6006(b); Cal. Code Regs., tit. 18, § 1526.)

[7] CDTFA is asserting use tax. This Opinion does not address whether the applicable tax is properly a sales tax because appellant's overall tax liability would be unchanged.

[8] Annotations are brief summaries of legal opinions written by CDTFA's legal department and published as an aide to taxpayers and tax practitioners. Annotations do not have the force or effect of law. (*Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25.) Nevertheless, OTA may afford weight to an annotation. (See *Appeal of Martinez Steel Corporation*, 2020-OTA-074P.)

Moreover, after appellant produced the snow, the sale of tangible personal property was completed; thus, it is immaterial whether appellant removed all the snow at the conclusion of the events.

The next step in this analysis is whether the transactions at issue involved the transfer of tangible personal property incidental to the performance of a service. The providing of a service that is not part of a sale of tangible personal property is not subject to tax. (Cal. Code Regs., tit. 18, § 1501.) Persons engaged in the business of rendering service are consumers, not retailers, of the tangible personal property which they use incidentally in rendering the service. (*Ibid*.) The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true objects of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service. (*Ibid*.) If the true object of the contract is the service per se, the transaction is not subject to tax even though some tangible personal property is transferred. (*Ibid*.) When a transaction is regarded as a sale of tangible personal property, tax applies to the gross receipts from the furnishing thereof, without any deduction on account of the work, labor, skill, thought, time spent, or other expense of producing the property. (*Ibid.*; see *Appeal of Thomas Conglomerate*, 2021-OTA-030P.)

Appellant contends that it provided event production services of "Wintertainment," including winter-themed attractions and events, from initial concept to final execution, and that making snow was just one component of its services. Appellant argues that it was responsible for planning and designing the entire events, building and maintaining the attractions, operating and maintaining snowmaking equipment, and removing all components at the conclusion of the events. Appellant states that these transactions were nontaxable because the customers' true object was not to purchase the artificial snow, but to purchase appellant's services as an event producer.

Here, appellant sold tangible personal property (as discussed above) and provided services to its customers. The services appellant provided to its customers were related to the sales of tangible personal property, that is, the production of snow. These services include setting up and taking down snowmaking equipment, operating and maintaining snowmaking equipment, managing and training snowmaking staff, and grooming and tilling the snow. The true object desired by appellant's customers appears to have been the snow itself. Appellant's

contracts with its customers state that appellant will "supply the snow" or "produce and maintain the snow" based on the customers' projects. Furthermore, there is no indication that the snow-related services were optional, or that appellant's customers could have contracted for the provision of snow without any of the related services. OTA finds it highly unlikely that appellant's customers would have contracted for any of appellant's snow-related services if appellant did not provide any snow. Rather, the totality of the evidence establishes that snow-related services were incidental to the provision of the snow itself. This is consistent with Annotation 515.1307 (9/15/92), which similarly found that for the manufacture of artificial snow at the customer's site, the true object desired by the customer is the snow rather than the service of making the snow. Accordingly, any portion of the fees attributable to appellant's snow-related services is also included in the measure of tax. Therefore, tax applies to the gross receipts from both the sale of tangible personal property (processing water to make snow), as well as any other related services that were part of the sale.

In support of its position, appellant cites Annotation 515.0978 (7/3/95), in which CDTFA found that an event producer was the consumer, not retailer, of tangible personal property which it used incidentally in rendering the service. In the annotation, the event producer's internal staff created shows using freelance artists and other vendors, and was responsible for operating, setting up, tearing down, and returning property to the rental company. The event producer did not transfer possession of tangible personal property to its customers at any time, and the customers did not retain any of the tangible personal property used during the event. The event producer was involved in the event from initial concept to final execution. Appellant argues that its services were similar in nature to the event producer, and thus, its services are not taxable.

Here, the facts of the instant case are distinguishable from those in Annotation 515.0978. The evidence indicates that appellant was only responsible for the portion of its customers' events that related to the provision of snow. As discussed above, the snow was the true object of the transactions at issue, and the transfer of the snow was not merely incidental to appellant's performance of services. Moreover, while appellant was responsible for operating the snowmaking equipment, producing the snow, and providing other services related to maintenance of the snow, appellant did not *use* the snow in rendering its services. Appellant's customers and the customers' guests used the snow. In addition, unlike the taxpayer in this Annotation, appellant's customers were responsible for some aspects of the event production,

such as providing supplies used during the events and providing plumbers and electricians to hook up appellant's equipment to water and electricity outlets. Furthermore, it is irrelevant that appellant did not transfer title or possession of any tangible personal property to its customers. Appellant's process of making snow from water furnished by its customers constituted a taxable sale of tangible personal property. Therefore, appellant's argument that it only provided event production services for its customers is unpersuasive.

Appellant also cites several other annotations in which CDTFA found that service providers are consumers and not retailers of tangible personal property used in rendering the services. (See Annotations 515.1320 (7/28/57); 515.0990 (10/7/81); 515.1000 (10/21/54); 360.0180 (5/24/54).) However, here appellant processed its customers' water to create snow (which, as discussed above, is a sale of tangible personal property) in addition to providing services. Moreover, appellant's customers and the customers' guests used the snow; appellant was not the consumer of the snow. Accordingly, OTA finds that these Annotations are distinguishable from the facts of the present case.

Appellant contends that, even if the contracts at issue involved a sale of tangible personal property, only the portion of the fees attributable to making snow should be taxable, and that the portion of the fees attributable to services should not be taxable. However, "gross receipts" means the total amount for which tangible personal property is sold without any deduction for the cost of materials used, labor or service cost, or any other expenses, and all of a retailer's gross receipts are subject to tax unless otherwise exempt. (See R&TC, §§ 6012(a)(2); 6051.) Appellant's snow-related services were part of the provision of snow, and thus part of the sale of tangible personal property.

Next, regarding the exemption for the sale of water pursuant to R&TC section 6353, the exemption applies only when the water is delivered to consumers through mains, lines, or pipes. In contrast, here appellant's customers are the consumers receiving the delivery of water through mains, lines, or pipes. The transactions at issue do not involve appellant delivering the water to its customers through mains, lines, or pipes, and thus the exemption does not apply.

Finally, OTA considers whether any portion of the fees that appellant charged its customers were for labor or services rendered for installation or application of the snow to the customers' sites. Although "sales price" and "gross receipts" mean the total amount for which tangible personal property is sold or leased or rented, including the cost of materials used, labor

or service cost, interest charged, losses, or any other expenses, as well as any services that are a part of the sale (R&TC § 6012(a)(2), (b)(1)), charges for labor or services rendered in installing or applying the property sold are excluded from the measure of tax. (R&TC, § 6012(c)(3); Cal. Code Regs., tit. 18, § 1546(a).)

OTA requested that the parties provide argument and evidence regarding what portion, if any, of the fees that appellant charged its customers were for labor or services rendered for installation or application of the snow to the customers' sites. Citing R&TC section 6006(g), appellant contends that the costs of installation or application of the snow can be measured by the fair market rental value of the equipment appellant used, either by relying on evidence of equipment rentals pursuant to a sample contract appellant had with out-of-state customers, or else by examining the useful life and depreciable costs of snowmaking equipment that appellant sold to out-of-state customers.

Here, the contracts are silent as to the amount for installation or application, nor is there anything else in the evidence showing how much of the fees were for installation or application of the snow. The fair rental value of the equipment is not relevant to costs of installation or application, particularly given that there is no rental of the equipment in California; moreover, the estimates that appellant proposes are based on dissimilar contracts that are not at issue in this appeal.

Accordingly, there is no basis to exclude any charges for installation or application of snow from the audited measure from tax. Based on all of the above, OTA finds that appellant has not established that any adjustments are warranted to the determined measure of unreported taxable sales.

Issue 2: Whether the failure-to-file penalty should be relieved.

Any person who fails to file a return shall pay a penalty, also known as a failure-to-file penalty, of 10 percent of the amount of taxes. (R&TC, § 6591(b).) The failure-to-file penalty may be relieved if the person's failure to make a timely return or payment was due to reasonable cause and circumstances beyond the person's control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect. (R&TC, § 6592(a)(1).)

Appellant contends that it is entitled to penalty relief because its failure to file returns was based on reasonable cause and not willful neglect. Appellant argues that it used ordinary business care by employing experienced, knowledgeable tax professionals, who advised

appellant that it did not need to file sales and use tax returns due to the services nature of its business. Appellant's president testified about how appellant had never previously paid sales tax on the services it provides to its customers, and therefore had no reason to believe that it owed sales tax.

Although this Opinion has concluded that appellant's sales to customers constituted taxable sales of tangible personal property, appellant has established that its failure to file was based on its reasonable reliance on the legal advice of knowledgeable, experienced tax professionals that its sales were not subject to sales and use tax. (See also *Appeal of Cremel and Koeppel*, 2021-OTA-222P [good faith reliance on professional advice may, in certain circumstances, provide a basis for a reasonable cause defense for late filing of income tax returns].) The credible testimony of appellant's president regarding appellant's good faith understanding of the taxability of its services supports appellant's position that it had reasonable cause to believe it was not required to file sales and use tax returns. In light of all evidence, OTA finds that appellant's failure to file was due to reasonable cause and circumstances beyond appellant's control, and occurred notwithstanding the exercise of ordinary care and the absence of willful neglect. Accordingly, relief of the failure-to-file penalty is warranted.

Issue 3: Whether relief of interest is warranted.

There is no statutory right to interest relief. OTA may, in its discretion, relieve all or part of the interest imposed on a taxpayer where the failure to pay tax is due in whole or in part to an unreasonable error or delay by a CDTFA employee acting in his or her official capacity. (R&TC, §§ 20(b), 6593.5(a)(1); *Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.)[9] An error or delay shall be deemed to have occurred only if no significant aspect of the error or delay is attributable to an act of, or a failure to act by, the taxpayer. (R&TC, § 6593.5(b).) OTA does not generally second-guess the standard timeframes determined by CDTFA for purposes of granting discretionary interest relief, and will defer to CDTFA's decision absent evidence of an abuse of discretion. (*Appeal of Micelle Laboratories, Inc.*, *supra*.) Any person seeking interest relief must file with CDTFA a statement under penalty of perjury setting forth the facts on which

[9] R&TC section 6593.5 states that the "board" may relieve interest, but on and after July 1, 2017, the term "board" generally means CDTFA. (R&TC, § 20.) On and after January 1, 2018, the term "board," with respect to an appeal, means OTA. (R&TC, § 20(b).)

the claim for relief is based and any other information which CDTFA may require. (R&TC, § 6593.5(c).)

CDTFA issued the NOD for the liability period on December 7, 2018, well within the statute of limitations period to issue a timely NOD.[10] Appellant filed a petition for redetermination on January 4, 2019. CDTFA issued a first reaudit report on July 31, 2019, and a Notice of Increase on October 18, 2019. CDTFA then issued its decision on February 12, 2021, and its supplemental decision on June 30, 2021.

Appellant contends that interest relief is warranted because CDTFA's audit commenced on or around September 20, 2017, but CDTFA did not reach a final determination until it issued its supplemental decision on June 30, 2021. Appellant argues that the nearly four-year period between the start of the audit and CDTFA's final determination was unusually long and due to unreasonable error or delay by CDTFA employees in conducting the audit and appeals process.

However, other than its general allegation, appellant has not identified any particular unreasonable error or delay, nor any specific time frame when it alleges such delay occurred within the 2017-2021 period. Although appellant states that it offered to submit additional evidence to CDTFA to support its contention, appellant did not submit any such evidence to OTA. In light of these facts and circumstances, there is no evidence of any unreasonable errors or delays caused by CDTFA, nor evidence that CDTFA abused its discretion in denying any interest relief.

Accordingly, appellant has failed to establish that any interest relief is warranted.

[10] In the case of a failure to file a return, except in the case of fraud, CDTFA may issue a timely notice of determination within eight years after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined. (R&TC, § 6487(a).)

HOLDINGS

1. No further adjustment to the determined measure of unreported taxable sales is warranted.
2. Relief of the failure-to-file penalty is warranted.
3. Interest relief is not warranted.

DISPOSITION

The failure-to-file penalty is abated. Otherwise, CDTFA's action of reducing the total taxable measure to $1,925,700 and denying the petition is sustained.

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

We concur:

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Natasha Ralston
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Natasha Ralston
Administrative Law Judge

DocuSigned by:
Emily Bell
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Emily Bell
Staff Services Analyst, on behalf of
Keith T. Long
Administrative Law Judge

Date Issued: 10/4/2023