OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

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

OPINION ON PETITION FOR REHEARING

Representing the Parties:

For Appellant: Bradley Marsh, Attorney
Ruben Sislyan, Attorney
Jennifer Vincent, Attorney

For Respondent: Amanda Jacobs, Attorney

S. BROWN, Administrative Law Judge: On October 4, 2023, the Office of Tax Appeals (OTA) issued an Opinion modifying a decision issued by respondent California Department of Tax and Fee Administration (CDTFA).[1] CDTFA's decision denied a petition for redetermination filed by Snowmagic, Inc. (appellant) of a Notice of Determination dated December 7, 2018. The Notice of Determination is for 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. OTA's Opinion granted relief of the failure-to-file penalty, but otherwise sustained CDTFA's decision.

On November 3, 2023, appellant timely filed a petition for rehearing (PFR) with OTA on the basis that there is insufficient evidence to support OTA's Opinion, the Opinion is contrary to law, and an error in law occurred during the appeals hearing. OTA concludes that the grounds set forth in the PFR do not constitute a basis for a new hearing.

OTA may grant a rehearing where one of the following grounds is met and materially affects the substantial rights of the party seeking a rehearing: (1) an irregularity in the

[1] Sales and use taxes were formerly administered by the State Board of Equalization (board). In 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 events that occurred before July 1, 2017, "CDTFA" shall refer to the board.

proceedings which occurred prior to issuance of the Opinion and prevented the fair consideration of the appeal; (2) an accident or surprise, occurring during the appeal proceedings and prior to the issuance of the Opinion, which ordinary caution could not have prevented; (3) newly discovered evidence, material to the appeal, which the filing party could not have reasonably discovered and provided prior to issuance of the Opinion; (4) insufficient evidence to justify the Opinion; (5) the Opinion is contrary to law; or (6) an error in law that occurred during the appeals hearing or proceeding. (Cal. Code Regs., tit. 18, § 30604(a)(1)-(6); *Appeal of Riedel*, 2024-OTA-004P.)

In order to find that there is insufficient evidence to justify the Opinion, or the Opinion is contrary to law, OTA must determine that the Opinion is "unsupported by any substantial evidence." (*Appeal of Graham and Smith*, 2018-OTA-154P.) This requires a review of the Opinion to indulge in all legitimate and reasonable inferences to uphold the Opinion. (*Appeals of Swat-Fame Inc., et al.*, 2020-OTA-045P.) The relevant question is not over the quality or nature of the reasoning behind the Opinion, but whether the Opinion can or cannot be valid according to the law. (*Ibid.*) In this review, OTA must examine the evidence in the light most favorable to the prevailing party. (*Ibid.*) For purposes of this section, the "contrary to law" standard of review shall involve a review of the Opinion for consistency with the law. (Cal. Code Regs., tit. 18, § 30604(b).)

Initially, appellant points to the Opinion's footnote 7, which notes that CDTFA is asserting use tax and states that the Opinion "does not address whether the applicable tax is properly a sales tax because appellant's overall tax liability would be unchanged." Appellant contends that because much of the analysis varies depending on whether appellant is a consumer, reseller, or retailer of tangible personal property, a rehearing should be granted to decide whether the liability is sales tax or use tax.

Further, appellant disputes the Opinion's reasoning and conclusions regarding the following: (1) that appellant's process of making snow for its customers is a sale of tangible personal property; (2) that 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; and (3) that the exemption for the sale of water pursuant to Revenue and Taxation Code (R&TC) section 6353 does not apply because appellant's customers, not appellant, were the consumers receiving the delivery of water through mains, lines, or pipes.

Regarding appellant's contention about footnote 7, appellant fails to identify how the footnote language is contrary to law, or that there is insufficient evidence to support that language, or that it constitutes an error in law that occurred during the appeals hearing or proceeding. The footnote provided clarification that the Opinion was not addressing a topic that was not in dispute and would not change the amount of appellant's tax liability. As such, the fact that the Opinion does not address whether the applicable tax was sales tax or use tax does not support any grounds for rehearing.

On the remaining points, appellant raises arguments that are essentially the same as those considered and addressed in the Opinion. OTA finds that the Opinion's analyses of these topics are sound, and there is no need to repeat them here. The Opinion found appellant's positions unpersuasive, and OTA again rejects them.

Some key findings of the Opinion were that appellant's production of snow for its customers is a sale of tangible personal property, that the services appellant provided to its customers were related to that sale of tangible personal property (snow), and that the true object desired by appellant's customers was the snow itself. These findings were the basis for OTA's determination that appellant's transactions constituted a "sale" as that term is defined in R&TC section 6006.

In analyzing what constituted the true object of the transactions, the Opinion found that it was highly unlikely that appellant's customers would have contracted for any of appellant's services, the vast majority of which were snow-related, if appellant did not provide any snow.[2] OTA notes that the dissent disagrees with the Opinion's citation to CDTFA's Sales and Use Tax Annotation 515.1307 (9/15/92), which found that for the manufacture of artificial snow at a customer's site, the true object desired by the customer is the snow, rather than the service of making the snow. This annotation is consistent with, although not the sole basis for, the Opinion's conclusion that appellant's snow-related services were incidental to the provision of the snow.

[2] The dissent notes that appellant's president testified that appellant did not charge its customers for the amount of snow produced. But appellant's contracts reflect that appellant billed customers for both snow and related services as a lump sum; thus, appellant did charge for snow, but it was not separately stated from the charges for appellant's services. Moreover, this is consistent with a conclusion that transactions were taxable sales of tangible personal property, given that the transfer of snow was the true object of the sales. (See, e.g., Annotation 515.0006 (4/23/91).)

Annotation 515.1307 has remained unchanged since it was written in 1992, and there appears to be no other annotation or legal authority that supersedes or conflicts with it. In this instance, OTA considers that the annotation and its back-up letter reflect a well-reasoned, longstanding interpretation that is consistent with California Code of Regulations, title 18, section 1501. Moreover, that interpretation of the regulation and true object test is consistent with precedent such as *Culligan Water Conditioning v. State Bd. of Equalization* (1976) 17 Cal.3d 86, 96 and *Appeal of Thomas Conglomerate*, 2021-OTA-030P. Thus, OTA gives weight to the annotation and finds it supports the analysis of the present case.

In light of all of the above, OTA finds that the Opinion is not contrary to law and that sufficient evidence justifies the Opinion.

Finally, appellant claims that, regarding these same four points identified above, there was an error in the law. An error in law refers to a procedural error in law in the appeals hearing or proceeding. (See Code Civ. Proc., § 657(7); *Appeals of Swat-Fame, Inc., et. al., supra*.) However, appellant does not identify any procedural error in law in the appeals hearing or proceeding, and OTA finds that no procedural error occurred.

Therefore, OTA finds that there are no grounds for a rehearing, and the PFR is denied.

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

I concur:

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Lauren Katagihara
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Lauren Katagihara
Administrative Law Judge

M. GEARY, dissenting:

I disagree with the majority opinion and would have granted a new hearing.

According to OTA's October 4, 2023 Opinion (Opinion), appellant connected its customers' water supplies to appellant's snow-making machines (machines), which froze the water and allowed appellant's machine operator to spray the resulting ice crystals (snow) on the customers' property, thus creating a snow-covered environment for the use of the customers or others. Appellant did not lease or relinquish possession or control of the machines to its customers. Appellant's customers never loaned, leased, or sold their water to appellant. Appellant exercised exclusive control over the water only while it was inside the machine over which appellant exercised exclusive control.[1] Appellant managed and maintained the snow-covered environment for days, weeks, or months. During this time, the snow gradually melted and appellant regularly replenished and groomed it. At the conclusion of the event the machines, structures and supports were disassembled and everything, including any remaining snow, was removed from the customer's property.[2]

Relying on R&TC section 6006(b) and California Code of Regulations, title 18, (Regulation), section 1526(a), the Opinion concludes: "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 [(TPP)]." The Opinion also cites CDTFA's Sales and Use Tax Annotation (Annotation) 515.1307 (9/15/92), in which CDTFA specifically opines that the "manufacture of artificial snow at the customer's site is a sale of [TPP] subject to sales tax." I disagree and would find that the Opinion is contrary to law and that OTA should not defer to the opinions expressed in Annotation 515.1307.

In my view, there was no taxable sale of TPP, and the facts described in the Opinion warranted a finding to that effect. The owner of the company testified that appellant did not charge for the snow. I would conclude that appellant's charges were for nontaxable services required for the production and maintenance of snow-covered environments. Appellant simply

[1] Although appellant also performed services related to the maintenance and grooming of the snow after it was sprayed on the customers' property, the majority appears to agree that these services are subject to tax only to the extent that they are part of the sale of tangible personal property.

[2] There is nothing in the evidence to show how the remaining snow was "removed" (e.g., by accelerating the melting process, hauling it away, or some other method).

transformed its customer's TPP temporarily from a liquid to a solid as one small step in the process of achieving that goal.[3] I would also find that appellant's services to its California customers were not the kind of production, fabrication, or processing that constitutes taxable labor because those services did not result in the creation or production of TPP, as required by Regulation section 1526(a).

I can find no binding court decision or precedential opinion that supports the Opinion's interpretation of the law. Annotation 515.1307 is the only opinion that clearly supports CDTFA's determination, but it is not a statement of law. (*Yamaha Corp. of Am. v. State Bd. of Equalization* (1998) 19 Cal.4th 1, 25 (*Yamaha*).) It is a summary of CDTFA's opinion. My review of the letter upon which Annotation 515.1307 is based (the backup letter) persuades me that the author of the letter based the opinion that making snow for customers is a sale of TPP on a factual finding that the true object of the transaction was the sale of snow. There is nothing in the factual background that distinguishes the operative facts under consideration then from what is before OTA here: the taxpayer used its machines to turn the customers' water into snow, which was dispersed over the customer's property, eventually returning to its liquid state. There is no factual analysis in the backup letter that explains why the author concluded that the true object was the sale of snow, as opposed to, for example, the use of appellant's machines and operators to create and maintain a snow-covered environment. (See Annotation 330.2465 (8/05/93), which states that when the owner of machinery or equipment will only provide it with an operator, the transaction is not a lease, and the charges made by the owner are regarded as charges for nontaxable services.)

In *Yamaha, supra*, 19 Cal.4th at p. 14-15, the Supreme Court stated, "The deference due an agency interpretation – including [CDTFA]'s annotations at issue here – turns on a legally informed, commonsense assessment of their contextual merit. 'The weight of such a judgment in a particular case,' to borrow again from Justice Jackson's opinion in *Skidmore* [*v. Swift & Co.* (1944) 323 U.S. 134,]'will depend upon *the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control*.' (*Skidmore, supra*, 323 U.S.

[3] The evidence suggests that far more labor is required and expense is incurred for management and maintenance of the snow-covered environment than for making the snow.

at p. 140. . . ., italics added.)" In my view, Annotation 515.1307 lacks the power to persuade, and I would not defer to the opinions expressed therein.

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Michael F. Geary
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Michael F. Geary
Administrative Law Judge

Date Issued: 5/21/2024