BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF,	)	
	)	
POSEIDON RESOURCES (CHANNELSIDE) LP,	)	OTA NO. 240616588
	)	
APPELLANT.	)	
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____________________________________	)	

TRANSCRIPT OF ELECTRONIC PROCEEDINGS

State of California

Thursday, April 16, 2026

Reported by:
ERNALYN M. ALONZO
HEARING REPORTER

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Transcript of Electronic Proceedings, taken in the State of California, commencing at 10:36 a.m. and concluding at 11:27 a.m. on Thursday, April 16, 2026, reported by Ernalyn M. Alonzo, Hearing Reporter, in and for the State of California.

APPEARANCES:

Panel Lead:	ALJ STEVEN KIM
Panel Members:	ALJ SHERIENE ANNE RIDENOUR ALJ KEITH T. LONG
For the Appellant:	PATRICK REDDING MICHELLE PETERS KOUROSH RAHMANIAN
For the Respondent:	STATE OF CALIFORNIA DEPARTMENT OF TAX AND FEE ADMINISTRATION VANESSA BEDFORD CARY HUXSOLL JASON PARKER

I N D E X

E X H I B I T S

(Appellant's Exhibit 1 was received into evidence at page 7.)

(Department's Exhibits A-E were received into evidence at page 7.)

(Department's Exhibit F was received into evidence at page 8.)

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California; Thursday, April 16, 2026

10:36 a.m.

JUDGE KIM: So, we are now going on the record.

This is the Appeal of Poseidon Resources (Channelside) LP, OTA Case No. 240616588. The date is April 16th, 2026, and the time is 10:36 a.m. This hearing is being held electronically on Zoom with the agreement of both parties.

I am Judge Steven Kim. I will be the lead ALJ for the purpose of conducting this hearing. My co-panelists are Judge Sheriene Ridenour and Judge Keith Long. We are equal participants in deliberating and determining the outcome of this appeal.

First, let's introduce the parties. So, if you can please state your name and your title, starting with Appellant.

MR. REDDING: My name is Patrick Redding, taxpayer representative for Poseidon Resources (Channelside).

JUDGE KIM: Thank you.

And will Ms. Peters and Mr. Rahmanian also be presenting at all?

MR. REDDING: If specific questions come up, yeah.

JUDGE KIM: Okay. Do they want to introduce themselves?

MS. PETERS: I will introduce myself here. Michelle Peters, CEO for Poseidon (Channelside) Water Resources.

JUDGE KIM: Thank you.

MS. PETERS: And Kourosh Rahmanian, finance manager of Poseidon (Channelside) Water Resources.

JUDGE KIM: Thank you.

And let's move onto Respondents.

CDTFA, can you please state your name and your title.

MS. BEDFORD: Vanessa Bedford, Attorney III.

MR. HUXSOLL: Cary Huxsoll, attorney supervisor in the Department's legal division.

MR. PARKER: And Jason Parker, the Chief of Headquarters Operations Bureau with CDTFA.

JUDGE KIM: Thank you.

As stated in my prehearing conference Minutes and Orders, the issue to be decided in this appeal is whether Appellant is a qualified person for purposes of claiming the partial tax exemption for property used in a qualified activity pursuant to Revenue & Taxation Code section 6377.1(a)(1) -- subsection(a)(1).

Mr. Redding, do you agree that this is the issue on appeal?

MR. REDDING: I agree.

JUDGE KIM: And, Ms. Bedford, do you agree?

MS. BEDFORD: I agree.

JUDGE KIM: Thank you.

Appellant submitted an Exhibit 1, and Respondent CDTFA did not object to this exhibit. Therefore, Exhibit 1 is now admitted into evidence.

(Appellant's Exhibit 1 was received into evidence by the Administrative Law Judge.)

JUDGE KIM: CDTFA submitted Exhibits A through E with its opening brief. Appellant did not object to these exhibits, so Exhibits A through E are now admitted into evidence; and these exhibits are included in the hearing binder.

(Department's Exhibits A-E were received into evidence by the Administrative Law Judge.)

JUDGE KIM: After the prehearing conference, CDTFA also submitted Exhibit F, which are PDFs of websites that were previously cited in CDTFA's decision.

Mr. Redding, have you had a chance to review this exhibit?

MR. REDDING: I have.

JUDGE KIM: And do you have any objections to this exhibit?

MR. REDDING: I do not.

JUDGE KIM: All right. So, Exhibit F will also be admitted into evidence.

(Department's Exhibit F was received into evidence by the Administrative Law Judge.)

JUDGE KIM: Neither party intends to call any witness.

Mr. Redding, is that still the case?

MR. REDDING: Correct.

JUDGE KIM: All right. Also, as discussed at the prehearing conference and at the Minutes and Orders, OTA will be taking judicial notice of the North American Industry Classification System, NAICS or NAICS website at www.census.gov/naics, and any relevant reference materials contained therein for the purposes of discussing the NAICS codes.

Okay. Mr. Redding, you have reserved 30 minutes for your initial presentation, and you may begin when you are ready.

PRESENTATION

MR. REDDING: Alrighty. Well, thank you, and good morning, Judge Kim and members of the panel. As I mentioned before, my name is Patrick Redding. I'm a representative for Poseidon Resources (Channelside) LP, the Appellant in this manner.

This case presents a narrow question with a clear answer. The sole issue before this panel is whether Channelside is a qualified person entitled to the partial manufacturing exemption under Revenue & Taxation Code section 6377.1. The parties have already agreed that the property at issue, propeller pump motor set and piping, qualifies as qualified tangible personal property used in a qualified activity. The only question is, whether Channelside itself qualifies. We submit that it does.

The evidence establishes that Channelside operates an industrial facility that transforms seawater, a substance that cannot sustain human life, into potable drinking water through a highly engineered intensive manufacturing process. That process creates a new product. It does not supply existing water. It manufactures potable water from scratch. Under any reasonable reading of Regulation 1525.4 in the NAICS Classification System, Channelside's activity are manufacturing activities, and Channelside is a qualified person.

Let me first walk the panel through what Channelside actually does because the facts are crucial. Channelside operates the Carlsbad Desalination Plant in Carlsbad, California. It's the largest seawater desalination facility in North America. Under a 30-year water purchase agreement with the San Diego County Water Authority, otherwise known as Water Authority, Channelside produces and sells desalinated water wholesale. Channelside does not operate a water supply system, distribution network, pumping stations, aqueducts, or delivery mains. It manufactures a product, and it sells at the plant gate. Distribution is the Water Authority's responsibility entirely.

The process itself -- and I want to be precise here because the Department has characterized this as a mere water treatment -- involves the following: Channelside draws approximately 100 million gallons of raw seawater per day from the Pacific Ocean. The seawater is not potable. It cannot be consumed by humans. It is not water in any usable sense. The seawater then undergoes two stages of pretreatment, granular media filtration and micro filtration, during which ferric sulfate polymer and sodium bisulfite can be added as chemical inputs. The pretreated seawater then enters an up to four-stage reverse osmosis system containing nearly 16,000 semi-permeable membranes housed in 2,000 pressure vessels. High pressure pumps -- the very equipment at issue in this case -- force the seawater through membranes it pressures that physically separate water molecules from dissolved salts, minerals, and virtually all biological contaminants.

The energy required to do this is approximately 4.44 kilowatt-hours per cubic meter of water produced. Conventional water treatment plants consume 0.2 to 0.4 kilowatt-hours per cubic meter. That's a 10 to 20 times greater energy demand driven entirely by mechanical intensity of the manufacturing process. That data is before the panel in Appellant's Exhibit 1. After reverse osmosis, the product water undergoes post treatment, carbon dioxide injection, limestone remineralization, fluoridation per state requirement, disinfection with sodium hypochlorite, pH adjustment with sodium hydroxide, and chloramination with ammonium hydroxide; all to meet California State Water Resource Control Board's standards for finished drinking water.

At the end of this process, Channelside delivers approximately 50 million gallons of potable drinking water per day to the San Diego County Water Authority. The remaining 50 million gallons of concentrated brine is discharged back to the ocean where it's diluted with additional seawater until it can be considered ambient seawater again. The input is seawater. The output is a new product, potable water that did not exist before. That is manufacturing.

Now, let me place those facts within the legal framework. R&TC section 6377.1 provides a partial exemption for qualified tangible personal property purchased by a qualified person to be used primarily in manufacturing. Regulation 1525.4 defines qualified person as one primarily engaged in the lines of business described in NAICS codes 3111 through 3399, with additional codes added after January 1st, 2018. The regulation further provides -- and this is critical -- that a person will not be precluded from the definition of qualified person when there's no applicable six digit NAICS code for their specific business activity; provided that their business activities are reasonably described in a qualified four-digit industry group.

It is undisputed in this record, acknowledged by the Department itself in December 2015 letter, and its December 2016 letter, and in its own briefing that there is no specific six-digit NAICS code for the operation of a desalination plant. That fact is established and unrebutted. Therefore, the question before this panel is not whether Channelside fits a specific six-digit code; the question is, is Channelside's business activity reasonably described by a qualified four-digit industry group. We submit the answer as yes; specifically, NAICS 3259, Other Chemical Product and Preparation

Manufacturing. NAICS 3259 covers establishments primarily engaged in manufacturing chemical products. Its six-digit subcode, 325998, specifically includes distilled water manufacturing.

The Department's own tax policy division at its highest level, signed by Chief of Tax Policy Division, concluded in December 2016 that desalination is properly classified under NAICS 325998. That letter is evidence Exhibit 3 within Exhibit A of the hearing's exhibit binder. The reasoning was straightforward. Both desalination and distillation use a chemical process to remove undesirable elements from a target substance and produce purified water from a non-potable input. Both processes create a new product. Both processes are manufacturing. The Department reverse that conclusion in July 2022, but reversal is not reasoning. The 2022 letter does not refute the 2016 analysis. It simply announces a different conclusion and reimports the USCB's opinion that desalination is 221310 or Water Supply and Irrigation Systems. The underlying logic of the 2016 determination that desalination creates a new product through a chemical manufacturing process was never substantially rebutted.

Now, the Department relies heavily on two things, the USCB classification, and its argument that desalination is merely water treatment. On the USCB classification, the U.S. Census Bureau classifies businesses for statistical and economic reporting purposes. That classification does not govern California tax exemption eligibility. The NAICS system itself acknowledges there's no specific code for desalination.

When the USCB says desalination would be classified under 221310 or the water supply and irrigation system, it is making a best fit statistical decision based on function. OTA is making a legal determination based on whether Channelside's activities are reasonably described by qualifying four-digit group. Those are different questions. On the water treatment argument, NAICS 221310 covers establishments primarily engaged in operating water treatment plants and water supply systems. That description contemplates pumping systems, aqueducts, distribution mains, the infrastructure of what is water delivery. The primary purpose is supply. Poseidon does none of that. It has no distribution infrastructure. It produces a product, and it sells it wholesale.

Moreover, 221310 contemplates treatment of water that is already water; fresh water from rivers, lakes, and ground water processed to make it cleaner. Channelside starts with seawater that is not water in any usable sense for consumption, and through a chemically intensive high pressure multi-stage process creates something that did not exist in usable form below. The input and output are fundamentally different substances. The Department argued that both conventional water treatment and desalination use a reverse osmosis and produce water for the same end uses. That argument proves too much.

The fact that one step in Channelside's process shares a name with a step in the water treatment does not make them the same industry. Bottled water manufacturers also use reverse osmosis, filtration, and chemical addition. The Department recognizes bottled water as manufacturers. Channelside does the same things at an industrial scale starting from seawater. The Department has never distinguished that analogy.

Finally, and this goes to the heart of what manufacturing means under Regulation 1525.4, manufacturing is the activity of converting or conditioning tangible personal property by changing its form, composition, quality, or character for ultimate sale. Channelside takes seawater. It changes its composition, removing all dissolved salts, minerals, and biological matter. It changes its quality from non-potable to potable. It changes its character from an unusable raw material to a commercially distributed consumer good. It sells that finished good at the plant gate. This is the definition of manufacturing applied exactly.

In summary, the property is conceded. The use is conceded. Channelside is a single purpose enterprise. One-hundred percent of its revenue derives from the sale of manufactured desalinated water. The 2016 BOE determination correctly classified desalination under NAICS 325998. The 2022 reversal was conclusory and not rebut the underlying reasoning. The manufacturing exemption exists precisely for capital intensive production facilities like this one. Channelside respectfully request that this panel reverse the denial of the refund claim and grant the exemption.

Thank you.

JUDGE KIM: Thank you for your presentation, Mr. Redding. I'm going to see if my panel has any questions.

Judge Ridenour, do you have any questions for Appellant?

JUDGE RIDENOUR: Not at this time. Thank you.

JUDGE KIM: And, Judge Long, did you have any questions?

JUDGE LONG: No questions. Thank you.

JUDGE KIM: Okay. I did have a couple of questions. So, who are Appellant's end customers? Like, who's getting -- who are they selling the water to?

MR. REDDING: To the San Diego Water Authority who distributes the water throughout San Diego County.

JUDGE KIM: And how is that water delivered to them?

MR. REDDING: Kourosh or Michelle, is that a question that you may be able to answer better than me?

MS. PETERS: Happy to jump in here. The water is delivered to San -- San Diego County Water Authority via a pipeline connection point here, but it's connected to our facility. Once the water essentially leaves our walls, it is no longer ours. We do not know what happens to it. That is the Water Authority's responsibility to distribute it.

JUDGE KIM: Okay. And does Appellant provide water in any other format, other bottled or other kind of packaging, or is it just all throughout -- through the pipeline?

MS. PETERS: It's primarily through --

MR. REDDING: Go ahead, Michelle. You got it.

MS. PETERS: It is primarily through the pipeline. We do have the ability to bottle a small portion of it as requested. It's through a small permit on that, but it's primarily through the pipeline.

JUDGE KIM: Has Appellant ever been assigned the NAICS code by any federal agency for statistical purpose or any other non-statistical purpose?

MS. PETERS: Not to our knowledge.

JUDGE KIM: Has Appellant registered under any NAICS code for bidding on contracts or anything like that?

MS. PETERS: I don't -- not to my knowledge here in terms of anything we would have registered under there.

JUDGE KIM: Okay. Thank you.

We'll now move on to Respondent's presentation.

Ms. Bedford, you will have 20 minutes, and you may proceed when you're ready.

MS. BEDFORD: Okay. Thank you.

PRESENTATION

MS. BEDFORD: Good morning.

The primary issue is whether Appellant's purchase and use of tangible personal property qualify for the partial exemption from tax for property purchased for use and manufacturing under Revenue & Taxation Code section 6377.1 for the period of January 1st, 2019, through December 31st, 2020. As you know, use tax applies to the storage, use, or other consumption in this state of tangible personal property purchased for storage, use, or other consumption in California, unless specifically exempt or excluded by statute; rev & Tax Code, R&TC Section 6201.

Section 6377.1 subdivision (a)(1), partially exempts from the sales and use tax, the sale of and the storage, use and consumption of qualified tangible personal property when purchased for use by qualified person to be used primarily in any stage of the manufacturing, processing, refining, fabricating, or recycling of tangible personal property, beginning at the point any raw materials are received by the qualified person and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required. See also Reg 1525.4 subdivision (a)(1). That is to qualify for the partial exemption three requirements must be met: One, the property must be qualified tangible personal property; two, the purchaser must be a qualified person; and three, the property must be primarily used in qualified activities. If any one of these requirements is not met, the partial exemption does not apply.

The only issue on appeal is whether Appellant is a qualified person under 70 -- 6377.1 and Regulation 1525.4. Statutes granting an exemption from taxation are to be strictly construed to avoid enlarging or extending the concession beyond the plain meaning of the language used in granting it. Associated Beverage Company versus State Board of Equalization (1990) 224

Cal.App.3d 192 at 211. The party claiming an exemption bears the burden of showing it clearly comes within the terms of the authorizing exemption, EBIT. The applicable burden of proof is by a preponderance of the evidence, Regulation 30219 subdivision(b).

The Department maintains its position that Appellant does not qualify for the partial sales and use tax exemption because it is not a qualified person. Relative to this case, a qualified person is a person that is primarily engaged in those lines of business described in Codes 3111 to 3399, 221111 to 221118, 221122, 541711, or 541712 of the North American Industry Classification System, or NAICS, 2012 edition. Rev & Tax Code 6377.1 subdivision (b)(8)(A)(ii), Regulation 1525.4 subdivision (b)(10)(A). With respects to Codes 3111 to 3399, a person will not be precluded from the definition of a qualified person when there's no applicable six-digit NAICS code to describe their line of business, provided the person's business activities are reasonably described in a qualified four-digit industry group; Regulation 1525.4 subdivision (b)(10)(A).

Appellant treats seawater, non-potable salt water, and makes it potable for consumption by end users in San Diego County under contract with the San Diego County Water Authority. Appellant's process includes taking seawater through various processes and steps, including reverse osmosis to remove salt, other minerals and impurities to produce potable pure water. As part of the process, Appellant adds additional minerals to the water as required by various laws.

Here, Appellant argues that it is a qualified person for purchases of the partial exemption because its line of business falls under NAICS code 3259, other chemical product and preparation manufacturing, because it creates a new product, drinkable water, from undrinkable brackish water; whereas water treatment plants take raw potentially drinkable water and remove undesirable materials to make it -- the water fit for drinking; opening brief, page 9. Section 3259, as described in NAICS, as the industry group comprised of establishments primarily engaged in manufacturing chemical products. NAICS code 325998, includes distilled water manufacturing.

Appellant points to its increased energy usage as a critical distinction between itself and other water treatment plants; opening brief, page 10. Appellant's activities are not reasonably described by section 3259. Appellant is not manufacturing distilled water. As described, Appellant's desalination plant is in the business of converting water through the use of water filtration from a form where salt and other minerals are included from a form where salt and other minerals are included into a form that can be used for human consumption or irrigation.

This line of business is best described in NAICS code 221310, water supply and irrigation systems. This code comprises establishments primarily engaged in operating water treatment plants and/or operating water supply systems, including water filtration plants. Water supply systems may include pumping stations, aqueducts, and/or distribution mains, and the water may be used for drinking, irrigation, or other uses. While the NAICS code does not define water treatment, the term generally means the use of various methods and processes to change and improve water for a specific end use, including providing safe and potable water for consumption.

The Centers for Disease Control describe the processes used by Appellant as water treatment, Exhibit F. Further, the Environmental Protection Agency has described reverse osmosis, including for the process of desalination, as a wash treatment method, Exhibit F. Appellant's own website discusses the desalination process in the context of water treatment, including the pretreatment and post treatment occurring at its site, Exhibit A and Exhibit 7, page 1.

While treatment processes and various facilities may differ in some respects from Appellant's, include an energy usage, those facilities use many of the same processes, including reverse osmosis. And the treated water from Appellant's facility, like other water treatment facilities, is used for similar purposes, including drinking and irrigation. Appellant has not met its burden and shown by the preponderance of the evidence that it is a qualified person for purposes of section 6377.1 and Regulation 1525.4. Their line of business is not reasonably described by NAICS code 3259.

Further, the United States Census Bureau previously informed staff as follows: An establishment primarily engaged in desalination plant operations will be classified under NAICS code 221310, water supply and irrigation systems. This industry comprises of establishments primarily engaged in operating water treatment plants and/or operating water supply systems. The water supply system may include pumping stations, aqueducts, and/or distribution mains. The water may be used for drinking, irrigation, or other uses; Exhibit A and Exhibit 2, page 2.

Based on the foregoing, Appellant's process, desalination, is a water treatment process, and its desalination plant is engaged in a form of a water treatment. As such, Appellant is primarily engaged in the operation of desalination plant, which falls under NAICS code 221310. Since the six-digit code that describes Appellant's line of business is NAICS code 221310, which does not fall within the qualified lines of business included in R&TC section 6377.1, Appellant is not a qualified person within the maintaining of R&TC section 6377.1 and Regulation 1525.4. As such, Appellant's use of the items in question does not qualify for the partial exemption under R&TC section 6377.1 and Regulation 1525.4.

Thank you.

JUDGE KIM: Thank you, Ms. Bedford.

Let me see if my panel have any questions.

Judge Ridenour, did you have any questions?

JUDGE RIDENOUR: I might at the end, but not right now. Thank you.

JUDGE KIM: And, Judge Long?

JUDGE LONG: No questions. Thank you.

JUDGE KIM: Okay. I had just one question. Do you know what the basis was for CDTFA's reversal from the first position to the second position?

MR. HUXSOLL: I do not have personal knowledge other than what's written in the second position, the 2016 letter. As part of this claim for refund, staff noted the Board had issued conflicting letters in 2015 and 2016, which reached opposite conclusion as to Appellant's activities. So, as part of this claim for refund, we re-examined the issue and determined that the analysis in 2015 was the proper analysis; that is that Appellant is not described specifically in section 325998 because it is not manufacturing distilled water. And it is not reasonably described by section 3259, which involves other chemical product in preparation manufacturing.

JUDGE KIM: Thank you.

Okay. Mr. Redding, you have reserved 30 minutes to make closing statement or a rebuttal, and you may proceed when you're ready.

MR. REDDING: Okay. Thank you, Judge Kim.

And thank you, Vanessa, for your opening statement as well.

CLOSING STATEMENT

MR. REDDING: A few different points I want to clarify. The CDTFA has placed significant weight on the United States Census Bureau's informal response classifying desalination under NAICS 221310. That response does not support the weight CDTFA asks this panel to give it. The USCB was contacted by a BOE staff member in December 2015 as part of an internal review. There's no formal determination letter, no official classification ruling, and no case number. It was an informal inquiry responded to for federal statistical reporting purposes, not interpretation of California Revenue & Taxation Code section 6377.1.

More importantly, the BOE's own Tax Policy Division, the authoritative body of California's manufacturing exemption reviewed that identical USCB response and one year later expressly rejected it as the basis for California tax classification. The December 27, 2016, letter signed by Tricia Gonzalez, Chief of Tax Policy Division, concluded that the USCB's classification did not control the analysis under California law. CDTFA is now asking this panel to defer to an informal federal statistical inquiry over its own agency's highest level written guidance. That is not a sound basis for denying this refund claim.

The USCB's reasoning is also internally flawed. It states that construction in manufacturing codes do not apply because Poseidon is primarily engaged in the plant's operation, not in the latter. That is circular. It assumes the answer without analyzing whether operational activities constitute manufacturing under California's definition. It does not engage with Regulation 152.5.4 at all. The USCB classifies businesses for federal census purposes. It does not interpret California tax exemptions.

CDTFA has also argued by analogy that because construction of a desalination plant falls under NAICS 237110, water and sewer line related structure construction, the operation of a desalination plant should be classified similarly under NAICS 221310. That analogy is legally and logically unsound. NAICS construction codes and NAICS operational codes are entirely separate classification systems describing entirely different activities.

The construction of a pharmaceutical manufacturing plant falls under NAICS 236210, industrial building construction, but the operation of that same plant classified under NAICS 325412, pharmaceutical preparation manufacturing, squarely within the manufacturing sector. The construction of an automobile assembly plant, likewise, falls under a construction code, but the operation of that plant classified under NAICS 336111, automobile manufacturing, also unambiguously within the manufacturing sector. In both cases the construction NAICS code and the operational NAICS code are completely different and reflect completely different activities. The activity performed during construction of a facility has no bearing whatsoever on the nature of the activity performed during its operation. CDTFA's construction analogy proves nothing about what Poseidon does every day inside that facility, and this panel should give it no weight.

Finally, the USCB itself acknowledged there's no specific NAICS code for the operation of a desalination plant. That acknowledgement is precisely the situation Regulation 1525.4 subdivision (b) was designed to address. Allowing a classification under a qualifying four-digit group where no six-digit code specifically fits. The legal question before this panel is whether Poseidon's activities are reasonably described by NAICS 3259. They are.

To the point of desalination as water treatment, CDTFA argues that desalination is simply water treatment and therefore, falls within NAICS 221310. The argument collapses when examined against what NAICS 22131 actually describes. NAICS 221310 comprise of establishments primarily engaged in operating water treatment plants and operating water supply systems, pumping stations, aqueducts, and distribution mains delivering water to end users. Poseidon has none of that infrastructure. Poseidon does not distribute water. Poseidon does not serve end users. Poseidon manufactures a product and sells it wholesale to the San Diego County Water Authority under a 30-year water purchase agreement.

The Water Authority distributes. Poseidon manufactures. That is a profile of a manufacturer selling to a wholesaler, not a utility serving the public. The energy record in Appellant's Exhibit 1 makes this undeniable. As stated before, Poseidon averages 4.44 kilowatt hours per cubic meter produced where the conventional water treatment plant typically consumes between 0.2 and .04 kilowatt hours per cubic meter.

Poseidon's energy intensity is 10 to 20 times higher than a standard water treatment facility. That differential is not explained by water treatment. It is explained entirely by high-pressure reverse osmosis manufacturing forcing Pacific ocean seawater through 2,000 pressure vessels housing more than 16,000 membranes under extreme pressure supported by 144 energy recovery devices required simply to make the process economically valuable. No water utility in California operate this way. No water utility needs to. The fundamental input distinction cannot be missed. NAICS 221310 establishments take water that already exist in usable or near usable form and treat or distribute it. Poseidon's input is the Pacific Ocean seawater, legally and chemically unfit for human consumption. It cannot be distributed, sold, or consumed as water in its raw form.

Poseidon creates a legally distinct regulated product that did not exist before the process began. Under California Code of Regulations Title 18 section 1525.4 subdivision (b)(2), manufacturing means the activity of converting tangible personal property by changing its composition, quality, character for ultimate sale. That is precisely what Poseidon does every single day.

I also want to readdress the 2016 BOE ruling. CDTFA argues that 2022 rescission of the 2016 BOE letter eliminates that letter from consideration. That is incorrect on two levels. First, this panel reviews the classification question independently on the merits. The 2022 rescission is CDTFA's administrative position change. It does not bind the Office of Tax Appeals. OTA's authority is to conduct a de novo review of whether Poseidon qualifies under R&TC section 6377.1. The rescission is a party position, not a legal determination.

Second, and more importantly, the 2022 rescission letter never rebutted the underlying reason of the 2016 ruling. It declared the prior conclusion incorrect without engaging with the chemical process analysis that supported it. The 2016 letter, signed by the Chief of Tax Policy Divisions, highest level written guidance that division issues, conducted that desalination and distillation both use a chemical process to produce a new product from a non-potable input, and that both processes are, therefore, manufacturing processes. It further concluded that operating a water supply system under NAICS 221310 has the primary purpose of supplying water for different uses, not producing a new product, and that this is fundamentally different from Poseidon's operations. That reasoning was analytically sound in 2016. CDTFA has never provided a substantive response to it.

This panel should also note the timing. CDTFA issued the 2016 letter confirming Poseidon's qualified status. Poseidon relied on that guidance, made capital investments, and filed a refund claim in February of 2022. CDTFA rescinded the 2016 letter in July 2022, five months after receiving the refund claim. The rescission did not emerge from a policy review or a regulatory change. It emerged in direct response to Poseidon's refund claim. This panel may weigh that timing accordingly.

To Poseidon's website language, CDTFA cites language from Poseidon's public website, specifically, the use of terms "water treatment," "pretreatment," and "post treatment" as evidence that Poseidon's primary activity is water treatment under NAICS 221310. This argument has no legal basis. Marketing and communication language is not determinative of a NAICS classification for California tax exemption purposes.

Pretreatment and post treatment are standard engineering terms describing process stages within the reverse osmosis system. They describe filtration steps that precede and follow the core membrane separation process. They do not describe Poseidon's business in the way NAICS classification requires.

The legal standard under Regulation 1525.4 is what Poseidon is primarily engaged in, measured by its revenue and operating activity. One hundred percent of Poseidon's revenue comes from the sale of manufactured desalinated water to the San Diego County Water Authority. That is the only product Poseidon sells. That is the only activity Poseidon performs. Furthermore, the same Carlsbad desalination project document CDTFA cited from Poseidon's website describes Poseidon delivering its output to the Water Authority under purchase agreement, a manufacturer selling to a distribution entity. That document does not describe utility. It describes a production facility.

As it relates to distillation verse reverse osmosis, CDTFA argues that because distillation and reverse osmosis are different processes, the analogy to NAICS 325998's inclusion of distilled water manufacturing fails. The argument misunderstands the bases of the clarification. The point is not that desalination is identical to distillation. The point is that both processes share the essential characteristic that defines manufacturing under California law. They create a new product, potable water from non-potable water input through a chemical transformation.

The 2016 BOE letter made this finding explicitly. Regulation 1525.4 does not require that a taxpayer's process be identical to a listed example. It requires only that the taxpayer's activity be reasonably described by the qualifying four-digit industry group. CDTFA's own regulatory guidance recognizes bottled water manufacturers as manufacturers, even though they use reverse osmosis and filtration to produce their product. Poseidon performs those same processes at industrial scale starting from raw input ocean water that is fundamentally more challenging and more removed from potable water than anything a bottled water manufacturer possesses. If CDTFA's position is that reverse osmosis and filtration constitute manufacturing when applied to a spring water, but constitute water treatment when applied to seawater, that distinction has no basis in the statute, the Regulation, or record before this panel.

The record in this case establishes the following without dispute: Poseidon's equipment qualifies; Poseidon's equipment is used in qualifying activities.

The only question is whether Poseidon is a qualified person. Poseidon takes specific ocean seawater, legally unfit for human consumption, and through a 19-stage chemical manufacturing process involving high pressure reverse osmosis, multiple chemical additions under regulatory mandate, remineralization, disinfection, and fluoridation produces potable water that is sold wholesale to the San Diego County Water Authority.

It consumes 10 to 20 times the energy of conventional water treatment plants. It operates under 30-year product purchase agreement with its sole customer. It produces 50 million gallons of new and regulated product every single day. The California Department of Tax and Fee Administration's own tax policy division concluded in 2016 that this activity is manufacturing under NAICS 3259. CDTFA reversed that conclusion only after Poseidon files its refund claim and has never analytically rebutted the reasoning behind it.

Poseidon respectfully request that this panel reverse the denial of the refund claim and find that Poseidon Resources (Channelside) LP is a qualified person under Revenue & Taxation Code section 6377.1 and Regulation 1525.4, and that its claim for refund in the amount of $225,000 plus applicable interest be granted in full.

I appreciate your time. Thank you.

JUDGE KIM: Thank you, Mr. Redding.

Now, I'll turn to my panel for a final time to see if there are any questions.

Judge Ridenour, did you have any questions?

JUDGE RIDENOUR: First, thank you for taking me back to, like, my hydroscience class at UC Davis as an under grad. That was -- it's been a while.

But I did want to ask CDTFA if they can -- the reverse osmosis are you -- because reverse osmosis is used for both purifying and desalination, and it seems like you guys are really hinging a lot on that part of the process. And so, I was wondering why you would -- how it differs between desalination and purified water for this purpose?

MR. HUXSOLL: I'm trying to -- I don't know if this will answer your question. But for purposes of this exemption, in 325998, which deals with distilled water, there can be no argument that Appellant makes distilled water. They don't fit within that six-digit NAICS code. Appellant bears the burden of establishing that they are a qualified person under the law. And they argue that based on being reasonably described in the four-digit NAICS code in 3259, because distilled water falls underneath that, that they are a qualified person.

There is no other reference to any forms of water production under section 3259. Rather, it encompasses things like printing ink manufacturing, explosives manufacturing, compounding of resins. And even 325998 lists numerous chemical compounds that are being manufactured. And the only reference to water production is distilled water, and Appellant is not producing distilled water.

And while I can't get into your UC Davis hydroscience processes, I would note that if Appellant's pretreatment water flow that they show on their website involves going through several stages of water filtration, the reverse osmosis is described in various materials included in Department's Exhibit F as being comparable to water filtration. That is -- I know Appellant disagrees on this, but that's -- we just want to note that it -- we believe it comes within -- sorry. I'll misstate the section number -- 221310.

With that being said, the burden is on Appellant to show that it comes within a qualifying use, and it does not come within 325998. And it's the Department's position that it can't be reasonably described by 3259. So, I hope that helps answer some of your question.

MR. REDDING: Can I -- can I clarify that at all, Judge?

JUDGE RIDENOUR: Mr. Redding, please.

MR. REDDING: I understand -- I understand what the CDTFA is saying, and they're correct, but it's irrelevant. The point is not that desalination is distillation, and this is a point we've tried to make many times. The point is that both processes share the essential characteristic that makes them manufacturing. They create a new product, again, potable water from non-potable water input through a chemical transformation process. The 2016 BOE letter drew that analogy correctly, and then the Department abandoned it without explanation.

Thank you.

JUDGE RIDENOUR: That though, distillation, you can still take potable water and make it distilled into -- you know what I mean? So I don't know -- maybe Ms. Peters would like to talk about this. Because you don't have to have non-potable water to make distilled water, and you're really -- it just seems like your crux is that it goes from non-potable to potable, but you don't need to have that.

I'm sorry. Ms. Peters, do you want to or Mr. Redding?

MR. REDDING: Yeah. I guess what -- what I'm trying to make the distinction between is the definition surrounding manufacturing. We're still making the chemical change -- the chemical and physical change here between non-potable and potable. That is just the -- to give the idea of what the process truly entails. Since there is no NAICS code distinctive for a desalination plant, that is the closest NAICS code for Poseidon (Channelside).

JUDGE RIDENOUR: Thank you.

Ms. Peter's, I see you shaking your head -- I mean, nodding your head. Did you want to add anything?

MS. PETERS: Just echoing what Mr. Redding said there, and adding perhaps here. We -- when you're looking at reverse osmosis step process in itself, that key step here, that is the only way that we can take a product and turn it into a new product, into drinking water. The other treatments steps here as outlined or as part of these steps at our facility are -- they may mirror other systems, but the reverse osmosis is truly the key step. We -- you know, I'll say we -- we call it the heart of our system here, and it's the focus of how we are able to turn one product into a new product.

JUDGE RIDENOUR: Thank you both very much. No more questions from me.

JUDGE KIM: Judge Long, do you have any questions?

JUDGE LONG: No questions. Thank you.

JUDGE KIM: Thank you.

I also don't have any additional questions. So, I'm going to -- this case is submitted on April 16, 2026. The evidentiary record is now closed.

Thank you, everyone, for participating in the hearing today.

My co-panelists and I will meet to deliberate this appeal, and we will issue a written opinion within 100 days of today.

Today's hearing in the Appeal of Poseidon Resources (Channelside) LP is now concluded, and we are going off the record.

(Proceedings concluded at 11:27 p.m.)

HEARING REPORTER'S CERTIFICATE

I, Ernalyn M. Alonzo, Hearing Reporter in and for the State of California, do hereby certify:

That the foregoing transcript of proceedings was taken before me at the time and place set forth, that the testimony and proceedings were reported stenographically by me and later transcribed by computer-aided transcription under my direction and supervision, that the foregoing is a true record of the testimony and proceedings taken at that time.

I further certify that I am in no way interested in the outcome of said action.

I have hereunto subscribed my name this 4th day of May, 2026.

____
ERNALYN M. ALONZO
HEARING REPORTER