OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of: **S. BACHOR**	OTA Case No.: 21037482 CDTFA Case ID: 718-866

OPINION

Representing the Parties:

For Appellant: Jesse W. McClellan, Attorney

For Respondent: Chad Bacchus, Attorney
Pamela Bergin, Assistant Chief Counsel
Jason Parker, Chief of Headquarters Ops.

For Office of Tax Appeals: Corin Saxton, Attorney

K. LONG, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, S. Bachor (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's timely petition for redetermination of a Notice of Determination (NOD) issued on November 13, 2018. The NOD is for tax of $430,343, plus applicable interest, and a failure to file penalty of $43,034.25 for the period January 1, 2013, through March 31, 2018 (liability period).[2]

[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.

[2] Appellant did not file sales and use tax returns for the liability period. As such, the NOD was timely because it was issued within the applicable eight-year statute of limitations period. (See Rev. & Tax. Code (R&TC) § 6487(a).)

Office of Tax Appeals (OTA) Panel Members Josh Aldrich,[3] Sheriene Anne Ridenour, and Keith T. Long held an oral hearing for this matter in Cerritos, California on August 9, 2023. At the conclusion of the oral hearing, the record was held open for additional briefing. After briefing was completed and the record was closed, this matter was submitted for an Opinion.

ISSUES

1. Whether appellant is entitled to further adjustments to the deficiency measure for use tax due in connection with unreported purchases of fabrication labor and materials subject to use tax.
2. Whether interest relief is warranted.

FACTUAL FINDINGS

1. Appellant, dba Carmel Mountain Cabinetry, is a sole proprietor located in Murrieta, California. Appellant is a construction contractor who builds and installs custom cabinets pursuant to lump sum contracts for customers in California. Appellant's home, office, and warehouse are located in Murrieta, California. During the liability period, appellant did not file sales and use tax returns. Appellant was previously audited for the period January 1, 2007, through December 31, 2012 (prior audit).
2. Appellant is also the principal owner of a Mexican limited liability entity, also named Carmel Mountain Cabinetry (CMEX). Appellant's ownership share of CMEX is 99 percent. Appellant entered into contracts with CMEX for fabrication services. CMEX did not hold a California seller's permit or file sales and use tax returns in California.
3. On March 26, 2018, CDTFA contacted appellant with respect to an audit of the period January 1, 2013, through December 31, 2017. CDTFA later expanded the audit to include the entire liability period at issue in this appeal.[4] The contract between appellant

[3] Administrative Law Judge (ALJ) Aldrich was assigned to this panel and attended the hearing but, due to an unanticipated leave of absence, was later replaced by ALJ Greg Turner. (Cal. Code Regs., tit. 18, § 30436(b).) ALJ Turner thoroughly reviewed the record, hearing, and hearing transcript before participating in this Opinion. OTA notified the parties of the substitution, and the parties were given the opportunity to object to the panel or to request a new hearing prior to the Opinion's issuance, which the parties declined.

[4] CDTFA issued its initial contact letter on March 26, 2018, before the due date to file sales and use tax returns for the first quarter of 2018 (1Q18). The record does not include information as to when CDTFA expanded the liability period. However, there is no dispute that 1Q18 is included in the liability period.

and CMEX, the audit of appellant, and the procedural history in this matter are outlined below.

The Contract Between Appellant and CMEX

4. There is no dispute that appellant and CMEX entered into a contract for fabrication services. A copy of an unsigned contract dated January 17, 2007,[5] includes the following:

a. Clause 3(a) states that appellant will "[p]rovide from time to time orders or requests to [CMEX] regarding the products to be manufactured . . . ."
b. Clause 3(b) states that appellant will "[m]ake available to [CMEX], the materials necessary for the execution of the contracted services . . . ."
c. Clause 4(e) requires CMEX to "[f]ix its manufacturing services to the specifications and quality standards that [it] receives from [appellant], to accept the verification of these, on behalf of the personnel expressly designated by [appellant], and to accept verification of these, on behalf of the personnel expressly designated by [appellant], inspection that will be developed in the plant of [CMEX]."
d. Clause 4(f) requires CMEX to "[d]eliver the finished product to the address of [appellant], or any other addresses that he states on the dates or terms that are agreed upon in each order or manufacturing request."
e. Clause 4(g) requires CMEX to "[p]ay the expenses generated by the transportation of materials and finished products, except for those that from time back [*sic*] the parties agreed that must be covered or shared by [appellant]."
f. Clause 4(i) requires CMEX to "[r]eturn with the finished product, any material left over or that had not been approved by the quality standards imposed by [appellant]."
g. Clause 5(b) provides appellant the right to "[v]erify the quality of the finished products in terms of quality and compliance with the specifications."

[5] On appeal, appellant provides a Spanish language contract which appears to have similarities with the English language contract; however, appellant has not provided a certified translation of the signed Spanish language contract into English. OTA has previously found that is not required to sort through voluminous and unorganized documentation in an attempt to find errors in CDTFA's determination. (*Appeal of Amaya*, 2021-OTA-328P.) Similarly, it is not OTA's responsibility to attempt to translate the contract. In addition to not being OTA's responsibility to translate evidence provided by a party, such an attempt by OTA potentially undermines the integrity afforded a certified translation. Accordingly, OTA only considers the terms of the unsigned contract, which is in the English language.

h. Clause 7 states that "The parties agree that the ownership of the materials used in the production process and the products that are produced, will be at all times the property of [appellant]."

i. Clause 8 states that "The parties agree that the conclusion of this contract, does not generate dependency relationships or labor substitution, each of them is independent on their policies of hiring personnel, salaries, benefits of social security, internal regulations and labor relations."

j. Clause 15 states that "[CMEX] will maintain and elaborate at all times, during the term of this Contract, Books or Registries in which it will settle the manufacturing operations; integrating all documents and relative entries."

k. Clause 25 states that "[CMEX] retains its full capacity to manage its financial, material and human resources as best suits its interests, and to implement the systems and programs deemed appropriate for this purpose, under its strict and exclusive responsibility."

5. The contract lists CMEX's address as Tecate, Mexico, and requires that all notices, communications and other required notifications from appellant permitted by the contract or the law, which must be made between the parties, be made in writing to CMEX's Tecate, Mexico, address.

6. The parties do not dispute that the contract was carried out as follows: (1) appellant "placed" fabrication orders with CMEX, and then "received" those orders on CMEX's behalf, from his home office in California; (2) appellant purchased wood and other materials in the United States, which were transported for fabrication services to CMEX's location in Mexico; (3) CMEX's fabrication services included sanding, shaping, painting, staining and assembling cabinet and other woodworking pieces; (4) CMEX was responsible for the purchase of paint, stain, thinner, nails, screws, staples, and glue; (5) upon completion of the fabrication process, CMEX loaded the completed items onto a truck owned by appellant, which was then driven from Mexico to California; and (6) appellant used the manufactured semi-finished materials to build and install cabinets at appellant's client's designated location. Documents submitted by appellant indicate that he (or a relative) traveled to Mexico between two and four times per week to supervise CMEX operations.

7. Appellant received fabrication services only from CMEX (i.e., CMEX was appellant's only fabrication provider) and CMEX provided fabrication services only for appellant (i.e., appellant was CMEX's only customer).

The Audits of Appellant

8. During the prior audit, CDTFA determined that appellant was liable for use tax on his purchase of fabrication labor from CMEX in Mexico. During the prior audit, appellant argued that for sales and use tax purposes, Carmel Mountain Cabinetry and CMEX were one company, and therefore no sales occurred between appellant and CMEX.

9. As relevant here, appellant appealed CDTFA's decision in the prior audit to OTA. On April 6, 2020, OTA issued a precedential Opinion, *Appeal of Bachor*, 2020-OTA-172P (*Bachor 1*) sustaining CDTFA's action. In that appeal, OTA found that appellant purchased wood and materials, some of which were shipped to CMEX for fabrication, which meant that "the materials were processed in some way for use in constructing the cabinets." OTA also found that, upon completion, the materials were returned to appellant for use, and appellant used the materials to build and install custom cabinets in California. CMEX did not produce prefabricated cabinets. Instead, CMEX used materials provided by appellant for the fabrication of tangible personal property, which was later used to build and install cabinets.

10. In *Bachor 1*, OTA considered whether there was a distinction between appellant and CMEX for sales and use tax purposes.[6] Citing *Mapo, Inc. v. State Bd. of Equalization* (*Mapo*) (1976) 53 Cal.App.3d 245, OTA noted that "the general rule is that courts should not disregard separate legal entities merely to grant tax relief; and whether the general rule should not be applied in a particular case depends upon the facts." (*Bachor 1*, *supra*, at p. *7.) In concluding that appellant and CMEX were distinct entities for sales and use tax purposes, OTA found the following:

    a. Appellant did not wholly own CMEX.
    b. CMEX was a registered business entity in Mexico.
    c. CMEX kept its own books and paid taxes in Mexico.
    d. Although appellant paid CMEX's expenses, he did so by transferring money to CMEX which was then paid forward by CMEX.
    e. Appellant "benefitted from the clear separation between his business and [CMEX's] business." (*Bachor 1*, *supra*, at p. *7.)

11. Appellant and CMEX's business operations did not change from the prior audit period to the liability period at issue in this appeal.

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[6] While appellant expressed his disagreement with OTA's holding in *Bachor 1*, *supra*, that precedential Opinion is final and OTA's jurisdiction in this matter is limited to the current liability period.

12. For the current liability period, appellant did not provide any books or records for the audit. To calculate the audit liability, CDTFA used appellant's federal income tax returns for 2013, 2014, and 2015, and information obtained during the prior audit. CDTFA calculated a deficiency measure of $5,422,081 based on two audit items: estimated purchases of fabrication labor from CMEX in Mexico subject to use tax (audit item 1); and estimated purchases of materials in the United States of America (U.S.) subject to use tax (audit item 2).
13. To calculate audit item 1, CDTFA used appellant's audited fabrication labor subject to use tax from the prior audit and appellant's federal income tax return information from 2008, 2009, and 2010, to calculate a fabrication labor cost ratio of 54.77 percent. CDTFA applied the 54.77 percent ratio to the gross receipts that appellant reported on his federal income tax returns to calculate quarterly purchases of $179,098 for 2013, $218,087 for 2014, and $233,508 for 2015. CDTFA then applied appellant's quarterly purchases of $233,508 from 2015 to each quarter of the period January 1, 2016, through March 31, 2018. In total, CDTFA calculated purchases of fabrication labor from CMEX in Mexico subject to use tax totaling $4,624,344 for the liability period.
14. To calculate audit item 2, CDTFA used appellant's audited purchases of materials in the U.S. subject to use tax from the prior audit and appellant's federal income tax return information from 2008, 2009, and 2010 to calculate a ratio of materials included in cost of goods sold (COGS) of 29.52 percent. CDTFA applied the 29.52 percent ratio to the COGS appellant reported on his federal income tax returns to calculate quarterly purchases in the U.S. subject to use tax of $30,370 for 2013, $37,228 for 2014, and $40,565 for 2015. CDTFA then applied appellant's quarterly purchases of $40,565 for 2015 to each quarter of the period January 1, 2016, through March 31, 2018. In total, CDTFA calculated purchases of materials from the U.S. subject to use tax of $797,737.
15. On appeal to OTA, appellant provided additional documentation, including the following: profit and loss (P&L) statements; a detailed list of tax paid purchases with corresponding invoices and letters from vendors; and declarations of import value for the first quarter of 2013 (1Q13) through 3Q17. This resulted in the completion of two reaudits by CDTFA.
    a. For audit item 1, CDTFA applied the 54.77 percent fabrication cost ratio to the gross receipts recorded on appellant's P&L statements for 2016, 2017, and 2018. Based on this, CDTFA reduced the deficiency measure of audit item 1 by $378,481, from $4,624,344 to $4,245,863.

b. For audit item 2, CDTFA reviewed appellant's purchase invoices on an actual basis which resulted in a reduction of $719,500, from $797,737 to $78,237.[7]

Procedural History

16. On November 13, 2018, CDTFA issued the aforementioned NOD to appellant. Appellant filed a timely petition for redetermination disputing the NOD in its entirety.
17. By email dated December 12, 2018, CDTFA forwarded appellant's petition for redetermination to CDTFA's petitions section.
18. On September 23, 2020, CDTFA held an appeals conference as part of its own internal appeals process.
19. On February 12, 2021, CDTFA issued a decision relieving the failure to file penalty but otherwise denying appellant's petition for redetermination. In the decision, CDTFA determined that appellant made purchases of fabrication labor from CMEX that were subject to use tax.[8] CDTFA relieved the failure to file penalty based on a finding that appellant reasonably believed that there was no filing obligation.
20. On March 8, 2021, appellant filed this timely appeal with OTA and concurrently requested additional time to provide documentation, which OTA granted. By email dated June 1, 2021, appellant requested a second extension, which OTA also granted. On July 6, 2021, appellant filed a brief and subsequently provided additional documentation on July 19, 2021.
21. OTA acknowledged appellant's submission on August 2, 2021, and extended the due date for CDTFA to file a response to appellant from September 13, 2021, to October 4, 2021. On September 24, 2021, CDTFA requested a further extension to complete a reaudit. OTA granted the request, extending the due date for CDTFA's response to November 29, 2021. CDTFA concluded the reaudit, made adjustments to appellant's liability, and filed its brief on November 24, 2021.
22. On December 2, 2021, OTA acknowledged CDTFA's opening brief and provided appellant until January 3, 2022, to file a reply brief. Appellant sent correspondence on January 3, 2022, February 11, 2022, and March 24, 2022, requesting extensions of the

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[7] Appellant does not dispute the audit methods CDTFA used to calculate the deficiency measure for audit items 1 and 2.

[8] CDTFA also found that appellant made purchases of $797,737 in materials subject to use tax. These purchases are not at issue in this appeal. However, as discussed above, during this appeal CDTFA completed two reaudits, which reduced the taxable measure by $719,500, from $797,737 to $78,237.

due date to file a reply brief. In each case, OTA granted appellant's request. Appellant filed his reply brief on May 23, 2022.

23. On June 2, 2022, CDTFA requested the opportunity to provide additional briefing, which OTA granted. CDTFA filed its brief on July 11, 2022, and appellant was given until August 11, 2022, to provide a response.
24. On August 11, 2022, appellant filed a reply brief, and OTA closed the briefing period. OTA notified the parties that it assigned the appeal to a subject matter expert for review, and that the review process typically takes 120 days.
25. On November 2, 2022, OTA notified the parties that OTA assigned the appeal to a tax appeals panel. Subsequently, on March 31, 2023, OTA notified the parties that the panel was revised pursuant to Government Code section 15674.
26. On April 6, 2023, OTA scheduled a preliminary conference with the parties to be held on May 2, 2023. Appellant did not appear at the preliminary conference.[9]
27. OTA held a prehearing conference on July 6, 2023.
28. On July 14, 2023, appellant filed a request for interest relief with CDTFA requesting relief for the period January 1, 2018, through August 9, 2023. CDTFA has agreed to relieve interest for the period May 1, 2018, through June 1, 2018.[10]

DISCUSSION

Issue 1: Whether appellant is entitled to further adjustments to the deficiency measure for use tax due for unreported fabrication labor.

California imposes sales tax on a retailer's retail sales of tangible personal property 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.) 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.) It is the retailer's responsibility to maintain complete and accurate records to support reported amounts and to make them available for examination. (R&TC, §§ 7053, 7054; Cal. Code Regs., tit. 18, § 1698(b)(1).)

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[9] By email dated April 6, 2023, OTA requested a preliminary conference with appellant and CDTFA to discuss procedural concerns. OTA explained that this conference was not intended to replace the prehearing conference (which OTA scheduled and held on July 6, 2023). Further correspondence confirms the parties' agreed to the May 2, 2023 preliminary conference.

[10] CDTFA agrees to relieve interest during this period due to a delay caused by implementation of its case management program, known as CROS.

The term “sale” includes the following: any transfer of title or possession, exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration. (R&TC, § 6006(a).) A “sale” also includes the producing, fabricating, or processing tangible personal property for a consideration for consumers, regardless of whether the consumer provides materials for production, fabrication, or process. (R&TC, § 6006(b), (f).) 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).) A transfer of title is not necessary to accomplish a ‘sale’ under R&TC section 6006(b). (*Duffy v, State Bd. of Equalization* (*Duffy*) (1984) 152 Cal.App.3d 1156.)

When sales tax does not apply, use tax applies to the storage, use, or other consumption of tangible personal property 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.) It is presumed that tangible personal property shipped or brought to this state by the purchaser was purchased for storage, use, or other consumption in this state. (R&TC, § 6246.) Cabinets that are not determined to be prefabricated are considered custom cabinets, and a construction contractor who builds and installs custom cabinets is the consumer of materials used to complete the job. (Cal. Code Regs., tit., 18, § 1521(b)(2)(A), (c)(2); see *Bachor 1*, *supra.*)

If CDTFA is not satisfied with the amount of tax reported by the taxpayer, or in the case of a failure to file a return, CDTFA may determine the amount required to be paid on the basis of any information which is in its possession or may come into its possession. (R&TC, §§ 6481, 6511.) In the case of an appeal, CDTFA has a minimal, initial burden of showing that its determination was reasonable and rational. (*Appeal of Talavera*, 2020-OTA-022P.) Once CDTFA has met its initial burden, the burden of proof shifts to the taxpayer to establish that a result differing from CDTFA’s determination is warranted. (*Ibid*.) The applicable burden of proof is by a preponderance of the evidence, which means the taxpayer must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (Cal. Code Regs., tit. 18, § 30219(c); *Appeal of AMG Care Collective*, 2020-OTA-173P.) Unsupported assertions are not sufficient to satisfy a taxpayer’s burden of proof. (*Appeal of AMG Care* Collective, *supra*.)

Here, appellant did not provide books and records for the audit. Therefore, CDTFA used appellant’s federal income tax returns and the results of appellant’s prior audit to estimate the deficiency measure. Because appellant did not provide books and records for the audit, it was appropriate for CDTFA to use an indirect method to calculate the taxable measure. (See *Appeal of Amaya,* 2021-OTA-328P.) To compute appellant's use tax deficiency, CDTFA calculated ratios for appellant's purchases of fabrication labor from CMEX in Mexico, and appellant's purchases of materials in the U.S. CDTFA then applied those ratios to information contained in appellant's federal income tax returns to calculate the taxable measure.

During the reaudit, CDTFA used appellant's P&L statements and purchase invoices, which resulted in a reduction to the deficiency measure. For audit item 1, CDTFA applied the ratio of appellant's purchases of fabrication labor from CMEX in Mexico to the gross receipts recorded in appellant's P&L statements for 2016, 2017, and 2018. For audit item 2, CDTFA examined appellant's purchase invoices on an actual basis to verify appellant's purchases of materials in the U.S. subject to use tax.

Considering the complete lack of books and records provided initially, the fact that the prior audit is for the immediately preceding period (January 1, 2007, through December 31, 2012), and the fact that appellant and CMEX's business operations did not change from one audit period to the next, OTA finds it was reasonable and rational for CDTFA to use the prior audit results to project the deficiency measure for the current liability period. OTA finds it was also reasonable and rational for CDTFA to reduce the taxable measure based on appellant's submission of additional documents during the reaudit. Accordingly, the burden shifts to appellant to show whether a reduction is warranted. (See *Appeal of Talavera*, *supra.*)

On appeal, appellant asserts that additional reductions to the taxable measure are warranted. With respect to audit item 1, appellant argues that CMEX's employees should be treated as appellant's employees for sales and use tax purposes in accordance with *Mapo*, which would necessitate a finding that appellant did not purchase fabrication labor from CMEX. At the oral hearing in this matter, appellant stated his disagreement with OTA's holding in *Bachor 1*, but did not argue that there were any distinguishing factors between appellant's and CMEX's operations during the prior audit and their operations during the liability period at issue in this matter.[11] Appellant also asserts that CMEX is governed by Mexico's "*Maquiladora* Regime," which classifies CMEX as a *maquiladora* and prohibits CMEX from making sales of products to be consumed in Mexico.[12]

[11] At the oral hearing, OTA asked appellant whether ". . . . there are any distinguishing factors between the business operation in this appeal and the business operation in the previous appeal, which would allow for a finding that *Mapo* applies?" In response appellant stated, "[n]one that I'm aware of. No."

[12] Generally, a "maquiladora" is a Mexican entity that assembles and produces goods in Mexico, using imported materials, for export. (6 U.S.C.A., § 1401(2).)

Alternatively, appellant argues that instead of a use tax liability imposed on appellant, there is a sales tax liability due from CMEX. Citing R&TC section 6006(b) and California Code of Regulations, title 18, (Regulation) section 1620, appellant asserts that sales tax is due by the seller of fabrication labor when there is local participation by the seller and the final act of the sale occurs in this state. Appellant argues, and CDTFA concedes, that there was "local participation" by CMEX.[13] Additionally, appellant asserts that the final performance of the sale occurred in this state, when a CMEX employee driving appellant's truck, delivered the property in California. Thus, appellant asserts that the applicable tax in this appeal is the sales tax and CMEX is liable for the tax. Finally, appellant argues that the services provided by CMEX are more closely related to the definition of sale included in R&TC section 6006(f), which requires a transfer of title from the supplier (here, CMEX) and the purchaser (here, appellant), as opposed to the definition of sale included in R&TC section 6006(b), as asserted by CDTFA.

With respect to audit item 2, appellant, acknowledging the reductions that CDTFA made on reaudit, asserts that the taxable measure should be reduced further. Specifically, appellant asserts that the documents used in the reaudit are sufficient to prove by a preponderance of the evidence that the remaining measure of use tax should be reduced to zero because appellant made tax-paid purchases from vendors, who then owed a sales tax liability. OTA addresses whether appellant has substantiated that any further reductions to audit items 1 and 2 are warranted in turn.

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[13] CDTFA initially argued that there was no local participation by stating in a brief:

> In order to have "local participation" there must be participation in the sale by an office or other place of business of the retailer in California, in this case the retailer would be CMEX. (Regulation [section] 1620(a)(2)(A).) This is the same argument Appellant has made previously. Appellant is arguing that because Appellant controls many of the operations of CMEX from California, it is a California company and has "local participation" in the sales. This is simply not true, as discussed numerous times previously, CMEX is a Mexican company, organized under the laws of Mexico, that manufacturers cabinets. Appellant is an American company organized under the laws of the United States, that acts as a construction contractor. Appellant could merge the companies, but he has chosen not to because the current arrangement benefits Appellant financially. When a taxpayer elects to conduct business through separate entities, the taxpayer must suffer the attendant disadvantage as well as receiving the intended benefit of such an arrangement. (*Mercedes-Benz of North America, Inc. v. State Board of Equalization* (1982) 127 Cal.App.3d 871, 874.)

At the oral hearing, and in post-hearing briefs, CDTFA indicated it now concedes the local participation issue based on the fact that appellant maintained an office in California and appellant owned 99 percent of CMEX's business. Based on CDTFA's concession, the issue of whether there was local participation by CMEX in California is no longer before OTA and will not be addressed further.

Whether Any Further Reductions to Audit Item 1 are Warranted.

A. *Application of Mapo*

Initially, OTA addresses the question of whether, for sales and use tax purposes, appellant and CMEX should be treated as one company. Should appellant prevail on this point, then there would be no sale of fabrication labor by CMEX and no tax liability. Appellant's argument relies on a narrow set of circumstances considered in *Mapo*, *supra.*

The *Mapo* case involved a corporation and its wholly owned subsidiary. In that case, the court found that the subsidiary's personnel were directed, employed, and controlled by its corporate grandparent, and that the sole reason for the subsidiary's existence was to enable the corporations to negotiate agreements with a single vertical labor union. (Mapo, *supra*, 53 Cal.App.3d at p. 248.) Therefore, transactions between the corporation and its subsidiary were not sales within the meaning of R&TC section 6006(b). (*Id.*) Further, the court noted the general rule that courts should not disregard separate legal entities merely to grant tax relief. (*Id.*) However, the application of the general rule depends on the facts and circumstances of the case. (*Id.*) Factors include the length of time the corporations separately exist, the degree to which the corporations maintain distinct corporate identities, the independent business purposes of the corporations, and the observance of the usual formalities of purchase and sale between corporate entities. (*Bachor 1*, *supra*.)

Here, OTA previously issued a precedential case concluding that appellant's business did not meet the limited exception laid out in *Mapo* based on a lack of total common ownership. (*Bachor 1*, *supra*.) In the current appeal, there is no dispute that the relationship between appellant and CMEX is no different than it was when OTA issued its opinion in *Bachor* 1. Thus, OTA continues to find that the limited exception laid out in *Mapo* does not apply. Thus, appellant and CMEX should not be treated as one company for sales and use tax purposes.

B. *Whether the tax at issue is a sales tax or a use tax liability.*

On appeal, appellant and CDTFA disagree on the location where any sales by CMEX took place. Whether the sale took place in California affects the type of tax (sales or use) and the party responsible for the tax liability. There is no dispute regarding the following: appellant did not hold a Seller's Permit or Certificate of Registration -- Use Tax during the liability period; CMEX did not have a retailer's license in California; CMEX did not collect sales tax reimbursement, file sales and use tax returns, or otherwise register to do business in California; CMEX fabricated TPP using in Mexico using materials supplied by appellant, which were later used by appellant to build and install cabinets; upon fabrication, CMEX placed the property on a truck owned by appellant at CMEX's business location; appellant exclusively used CMEX's fabrication services, and appellant was CMEX's exclusive customer; and appellant is a construction contractor who builds and installs custom cabinets pursuant to lump sum contracts for customers in California.

Regulation section 1521(a)(4)-(6) defines "construction contract" to include a contract to erect construct, alter, or repair any building or other structure, project, development, or other improvement on or to real property. Regulation section 1521 classifies property furnished under a construction contract into three categories: materials, fixtures, and machinery and equipment. (Cal. Code Regs., tit. 18, 1521(a)(4)-(6).) As relevant here, a construction contractor is the consumer of materials they furnish and install in the performance of a construction contract and tax applies with respect to the sale of the materials to or the use of the materials by the construction contractor. (Cal. Code Regs., tit. 18, § 1521(b)(2)(a).)

Regulation section 1521(c)(2) provides that "a cabinet will be considered to be "prefabricated" and a "fixture" when 90 percent of the total direct cost of labor and material in fabricating and installing the cabinet is incurred prior to affixation to the realty. In determining this 90 percent, the total direct cost of all labor and materials in fabricating the cabinet to the point of installation will be compared to the total direct cost of all labor and materials in completely fabricating and installing the cabinet. Conversely, according to Regulation section 1521, cabinets that are not determined to be prefabricated are considered custom cabinets, and pursuant to Regulation section 1521(b)(2)(A), the construction contractor who builds and installs custom cabinets is the consumer of the materials used to complete the job.

As stated above, there is no dispute that appellant was a construction contractor engaged in the installation of custom cabinets. Appellant and CDTFA previously agreed that materials received from CMEX were not prefabricated cabinets. (See *Bachor 1*, *supra*.) Appellant also does not dispute that his business practices did not change from the prior audit to the current liability period. Instead, appellant continues to assert that it did not purchase prefabricated cabinets from CMEX and is an installer of custom cabinets, which is supported by provided documentation. For example, appellant obtained and submitted to CDTFA and OTA, a legal opinion dated October 22, 2020, from the Procopio law firm, which describes the operation with CMEX as follows: "[appellant] will send materials to [CMEX] to be stained, cut, and manufactured and then send back to [appellant] . . . . [appellant] uses the manufactured semi-finished materials to build and install cabinets at their client's designated location." OTA finds that appellant, as a construction contractor who builds and installs custom cabinets is the consumer of materials used to complete the job.

Here, the parties disagree with respect to which tax applies. According to CDTFA, CMEX made sales of fabrication labor in Mexico, which was then used by appellant in California. Thus, CDTFA argues that the appropriate tax is a use tax liability owed by appellant. By comparison, appellant argues that he is not liable for the use tax because, if CMEX made any sales to appellant, then those sales occurred in California, and are subject to sales tax.[14] Appellant asserts that upon completing fabrication, CMEX placed the fabricated items onto a truck owned by appellant but driven by a CMEX employee for delivery in California. Appellant asserts that he "loaned his truck" to CMEX to make delivery in California and that that under the terms of the loan, CMEX took possession and control of the truck. Appellant argues that since CMEX had possession and control of the truck, appellant did not take delivery of tangible personal property in Mexico; rather, that the final act of the sale occurred when a CMEX employee delivered the tangible personal property in California. In support of his arguments, appellant cites to California Civil Code section 1884, and *Entremont v. Whitesell* (1939) 13 Cal.2d 290, 295 (*Entremont*). Appellant also relies on CDTFA's Business Taxes Law Guide Annotations (annotation) 557.0616 (11/4/80) and 557.0640 (12/2/64).[15]

The sales tax applies to a retail sale of tangible personal property from another state if two conditions are satisfied: (1) the sale occurs in California;[16] and (2) there is some participation in the sale by a California location of the retailer. (R&TC § 6051; Cal. Code Regs., tit. 18, § 1620(a)(1) & (2).) Thus, in order for sales tax to apply, the sale must occur in California, *and* there must be some participation in the sale by a California location of CMEX.

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[14] Appellant and CDTFA both rely on *Duffy*, *supra,* 152 Cal.App.3d 1156 for their respective positions. In *Duffy*, the court considered whether a tailor's alteration to new clothing was a sale of fabrication labor and thus taxable under R&TC section 6006(b). The court found, among other things, that the tailor's alteration did constitute fabrication labor, that a purchaser need not provide all of the materials to be fabricated, and that no transfer of title was required for a sale to occur under R&TC section 6006(b). (*Duffy, supra*, 152 Cal.App.3d 1156 at 1167, 1169.) In the current appeal, appellant entered into a contract for the fabrication of tangible personal property, which is a sale subject to tax under R&TC section 6006(b). Rather than whether a sale occurred, the issues in the current appeal are: where did the sales occur; and which tax applies. Neither of these concerns are addressed in *Duffy*.

[15] CDTFA's annotations are not regulations, and they are not binding upon taxpayers, CDTFA, or OTA. (*Appeal of Martinez Steel Corporation*, 2020-OTA-074P.) The annotations are digests of opinions written by the legal staff of CDTFA which are evidence of administrative interpretations made by CDTFA in the normal course of its administration of the Sales and Use Tax Law. (*Ibid*.) The annotations have substantial precedential effect within CDTFA and the interpretation of its meaning whether embodied in a formal rule or less formal representation. (*Ibid*.)

[16] Regulation section 1620(a)(1) states that "[i]f title to the property sold passes to the purchaser at a point outside this state, or if for any other reason the sale occurs outside this state, the sales tax does not apply, regardless of the extent of the retailer's participation in California in relation to the transaction."

The Sales and Use Tax Law provides that a sale or purchase includes any transfer of title *or* possession in lieu of a transfer of title, conditional or otherwise. (R&TC, §§ 6006(a) &(b), 6010(a); *Duffy, supra*, 152 Cal.App.3d at 1169; *see also Appeal of Snowflake Factory, LLC.*, 2020-OTA-270P.) When delivery of the property is by facilities of the retailer, title passes when the property is delivered to the purchaser at the destination. (See Cal. Code Regs. tit. 18, §§ 1620(a)(1), (a)(3)(B), 1628(b)(3)(D).) However, "[u]nless explicitly agreed that title is to pass at a prior time, the sale occurs at the time and place at which the retailer completes [its] performance with reference to the physical delivery of the property, even though a document of title is to be delivered at a different [(i.e., later)] time or place." (Cal. Code Regs., tit. 18, § 1628(b)(3)(D), see Cal. U. Comm. Code, § 2401.)

1. <u>Terms of the Contract</u>

During the liability period (January 1, 2013, through March 31, 2018), appellant engaged in numerous transactions with CMEX, however, the only contract in evidence is the *unsigned* contract from 2007. As such, it is unclear whether the unsigned contract's terms were final, let alone whether the terms were valid during the liability period. Accordingly, OTA finds that the unsigned contract is not reliable evidence of the agreement between appellant and CMEX.

Furthermore, appellant has a 99 percent ownership share of CMEX; therefore, appellant (dba Carmel Mountain Cabinetry as sole proprietor) and CMEX are "under common control." Where a transaction is between a closely held corporation and its controlling shareholders, the transaction cannot be said to have been dealing at arm's length. (*Maxwell v. Commissioner*, 95 T.C. 107, 116.) The Tax Court will generally give "extra scrutiny" to transactions not undertaken "at arm's length." (See *Cuthbertson v. Commissioner*, T.C. Memo 2020-9.) OTA finds that any transaction between appellant and CMEX, including the unsigned contract, are not undertaken "at arm's length and, therefore, warrant "extra scrutiny". While OTA finds the unsigned contract is not reliable evidence of the agreement between appellant and CMEX, and warrants extra scrutiny, OTA nevertheless considers, out of abundance of caution, the contract terms for indications of whether any sales took place in California.

Clause 7 of the contract states that "ownership of the materials used in the production process and the products that are produced, will be at all times the property of" appellant. As such, there was never a transfer of title. Accordingly, the sale of the fabricated products occurred at the time and place when possession was transferred. Or, more specifically, when CMEX completed its "performance with reference to the physical delivery of the property." (Cal. Code Regs., tit. 18, § 1628(b)(3)(D); see R&TC, §§ 6006(a); see Cal. U. Comm. Code, § 2401.)

Clause 4(g) of the contract contains delivery terms requiring CMEX to "[p]ay the expenses generated by the transportation of materials and finished products except for those that from time [to time,] the parties agreed that must be covered or shared by [appellant]." Thus, the contract contemplates that in some instances CMEX would be required to pay delivery costs, and in other instances, appellant would bear the cost. That appellant did in fact pay shipping expenses is corroborated by appellant's statements to the board confirming such payment.[17] By comparison, appellant has not provided any evidence that CMEX paid transportation costs, which would include costs associated with any purported loan of a truck. For example, appellant has not provided any evidence that CMEX paid shipping fees, trucking charges, gasoline cost, truck maintenance expenses, customs clearance fees, or potential customs duties.[18] Appellant also has not provided purchase orders, which would include the applicable delivery terms. Thus, without further evidence, OTA cannot conclude from clause 4(g) that a sale occurred in California.

Appellant also contends that pursuant to the contract, the products were subject to inspection and approval by appellant "inside California," and therefore the sale occurred in California. However, clauses 4(i) and 5(b) (the inspection clauses, collectively), which provide appellant the right to inspect the goods fabricated by CMEX, do not include language defining where inspection occurs. Therefore, even without the extra scrutiny generally given to transactions not undertaken at arm's length, OTA finds that the inspection clauses do not support a finding that the inspection and sale occurred in California.

Appellant additionally argues that clause 4(i) requires CMEX to "return the items to Mexico to correct any shortcomings," and that pursuant to Regulation section 1620(3)(c), when a sale is on approval, the sale does not occur until the purchaser accepts the property. However, clause 4(i) simply does not say what appellant contends. Instead, clause 4(i) requires CMEX to "[r]eturn with the finished product, any material left over or that has not been approved by the quality standards imposed by [appellant]." Even if CMEX was required to correct shortcomings, the inspection clauses do not bear the additional scrutiny. As previously stated,

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[17] During an oral hearing before the board on July 28, 2017, appellant stated "[w]e just pay the drivers, and we pay, you know, the shipping." As noted above, appellant confirmed to OTA during the oral hearing in this matter on July 6, 2023, that there were no distinguishing factors between the business operation in this appeal and the business operation in the previous appeal.

[18] Appellant provided proof of custom's expenses for CMEX's driver; however, appellant has not provided any evidence to show whether appellant or CMEX reimbursed the driver or otherwise paid such expenses (i.e., accounting entries, canceled checks, etc.) As previously discussed, appellant stated that he paid the drivers and the shipping. Thus, it is reasonable to conclude from the available evidence that appellant paid CMEX's driver's expenses.

the contract between CMEX and appellant was not made "at arm's length" because both businesses were under common control. With respect to inspection, the record reveals that appellant, or his relative, went to Mexico several times per week to supervise CMEX's operations as fabrication occurred. As a result, it is unclear where or when appellant purportedly inspected and rejected materials fabricated by CMEX. Appellant has not provided any evidence to support such a finding. As such, OTA finds that the inspection clauses have no meaningful effect on determining where the sale occurred.

For the aforementioned reasons, even if the contract was signed and shown to be in effect during the liability period, OTA cannot conclude from its terms that the sales by CMEX to appellant occurred in California.

2. Loan of The Truck

Regarding the appellant's truck, appellant asserts that a CMEX employee crossed the United States – Mexico border on several occasions while driving appellant's truck. Appellant provides transportation documents to support his assertion. Thus, OTA finds there is evidence substantiating that on the dates of the provided documents, a CMEX employee transported tangible personal property from Mexico into California.

Appellant argues that the key-factor with respect to delivery is the driver of the truck, citing annotations 557.0616 (11/4/80) and 557.0640 (12/2/64). However, these annotations discuss whether transportation charges are subject to tax, which is not at issue here.[19] Instead, OTA must resolve whether sales between CMEX and appellant occurred in Mexico or California. While having an employee of the seller deliver the products may generally cause the sale to occur when property is delivered to a location other than the transporting vehicle, those circumstances are not present in this appeal. The parties do not dispute that a CMEX employee crossed the United States -- Mexico border on several occasions. However, the driver was not an independent contractor; rather, the driver was an employee of CMEX, and CMEX is not a

[19] Annotation 557.0616 considers whether the delivery of gravel by independent contractors should be considered "delivery by 'facilities other than the facilities of the retailer.'" In that scenario, CDTFA found that the drivers performed their hauling duties as independent contractors, that the drivers were not paid a set monthly wage, and that there were no evidence of employee benefits or withholdings. Thus, CDTFA concluded that the gravel deliveries were by facilities other than facilities of the retailer.

Annotation 557.0640 states that any trucker who is carried on the company's payroll must be treated as an employee if they receive benefits and are treated as an employee for purposes of payroll deductions and taxes. Delivery by these employees is considered transportation by the facilities of the retailer and the resulting transportation charges are subject to tax. Second, the annotation concludes charges for transportation by independent carriers where sales were made "f.o.b. plant," were not subject to tax since there was sufficient doubt with respect to the question of title passage.

common carrier[20] or a transportation for hire company. Moreover, CMEX does not use its own vehicle. Instead, CMEX provides fabrication services only to appellant and *uses appellant's vehicle* for transportation. OTA notes that neither annotation appellant references contemplates a circumstance where the retailer (CMEX) uses the purchaser's (appellant's) vehicle to make a delivery; therefore, the annotations are distinguishable from the current matter. OTA finds that evidence indicating a CMEX employee crossed the United States-Mexico border using appellant's truck, on its own, is insufficient to meet appellant's burden of proof that the sale occurred in California.

Regarding the purported loan of the truck, California Civil Code section 1884 defines a loan for use as a contract by which one gives to another the temporary possession and use of personal property, and the latter agrees to return the same thing to him at a future time, without reward for its use. In *Entremont*, *supra*, the court considered whether there was a change in possession of a truck for the purposes of a lease. In that case, the court determined that no change in possession and control occurred because of contractual terms which made the purported lessor responsible for fuel and oil, keeping the truck in repair, expenses incidental thereto, and to carry compensation insurance on the drivers. (*Entremont*, *supra*, at p. 295.)

Unlike in *Entremont*, *supra*, there is no evidence in the record to support the existence of a lease contract between appellant and CMEX for the truck. At best, appellant loaned his truck to CMEX in the informal sense of the term; appellant has not provided any documentation to substantiate the purported loan of his vehicle to CMEX. Appellant has not provided a loan contract, and OTA finds appellant has provided no evidence from which a determination of possession and control can be made (i.e., documentation showing who paid for fuel, oil, keeping the truck in repair, et cetera). OTA also finds no provision in the unsigned contract between appellant and CMEX for the loan of a vehicle. Thus, without further evidence, OTA cannot conclude that appellant loaned his vehicle to CMEX. Accordingly, OTA finds that the transfer of possession of the fabricated goods, and therefore the sale, took place when CMEX placed the goods on appellant's truck in Mexico. Appellant has not met his burden of proving otherwise.[21]

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[20] A "common carrier" means any person who engages in the business of transporting persons or property for hire or compensation and who offers these services indiscriminately to the public or to some portion of the public. (Cal. Code Regs. tit. 18, § 1621.)

[21] While the dissent focuses on the parties' intent, this question was not raised or briefed by the parties on appeal. As a result, OTA does not address the dissent's position. Instead, OTA addresses the question at hand: whether the sale from CMEX to appellant took place in California or Mexico.

As discussed above, Regulation section 1620(a)(1) & (2) requires the satisfaction of two elements for the sales tax to apply. Not only must there be some local participation, but, in addition, the sale must occur in California. (Cal. Code Regs., tit. 18, § 1620(a)(1), (a)(2).) Thus, even if a taxpayer proves, or the parties concede, local participation in the sale by a California location of the retailer, the sales tax still would not apply unless the sale occurred in California. As discussed above, OTA finds that the fabrication occurred in Mexico and possession of the fabricated property transferred from CMEX to appellant in Mexico. Therefore, the sale occurred when CMEX loaded the fabricated property onto appellant's truck. Accordingly, OTA concludes that the use tax applies on the sales, which were made by CMEX to appellant in Mexico.

C. *Application of Mexico's "Maquiladora Regime"*

Appellant argues that Mexico's "*Maquiladora* Regime" prohibits CMEX, a registered *maquiladora*, from making sales in Mexico. However, OTA is tasked with making factual analysis of the transactions at issue, applying California Sales and Use Tax Law to the facts, and analyzing whether the sales at issue took place in Mexico or California. As discussed above, OTA finds that the sales at issue took place in Mexico. Even if OTA were to accept as true appellant's assertion that OTA's finding means appellant's business practices violates Mexican *Maquiladora* law, such an assertion does not negate OTA's finding that, based on *California* tax law, the sales took place in Mexico.

Whether Any Further Reductions to the Measure of Audit Item 2 are Warranted.

Regarding audit item 2, appellant asserts that the documents used in the reaudit are sufficient to prove by a preponderance of the evidence that the remaining measure of use tax should be reduced to zero. As discussed above, CDTFA reviewed appellant's purchase invoices and calculated the measure of audit item 2 on an actual basis. CDTFA reasonably and rationally reduced the measure of use tax for transactions supported by an invoice indicating that appellant paid sales tax reimbursement to the retailer. As a result, the burden shifts to appellant to show that further adjustments are warranted. (*See Appeal of Talavera*, *supra.*) To satisfy his burden of proof, appellant must prove both: 1) that the tax assessment is incorrect, and 2) the proper amount of the tax. (*Appeal of AMG Care Collective*, *supra*.) On appeal, appellant has not provided any evidence supporting his contention that additional reductions to audit item 2 are warranted. Appellant's unsupported assertions are insufficient to meet his burden of proof. (*Appeal of Talavera*, *supra*.) Therefore, OTA finds that appellant has not demonstrated that further adjustments are warranted.

Issue 2: Whether interest relief is warranted.

The imposition of interest is mandatory. (R&TC, § 6482.) There is no statutory right to interest relief. (R&TC, § 6593.5.) The law allows CDTFA, in its discretion, to grant relief of all or any part of the interest on a person under the Sales and Use Tax Law where the failure to pay the tax is due in whole or in part to an unreasonable error or delay by CDTFA's employee(s) acting in their official capacity. (R&TC, § 6593.5(a)(1).) Such a delay could be, for example, due to an unreasonable failure to work on an appeal. (*Appeal of Micelle Laboratories, Inc.*, 2020-OTA-290P.) An unreasonable 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 failure to act by the taxpayer. (R&TC, § 6593.5(b).) Any person requesting interest relief must include a statement under penalty of perjury setting forth the facts on which the request is based. (R&TC, § 6593.5(b).) The burden of proving unreasonable error or delay rests with the taxpayer. (Cal. Code Regs., tit. 18, § 30219(a), (b).)

OTA reviews CDTFA's decision to deny interest relief on an abuse of discretion standard. (*Appeal of Micelle Laboratories, Inc., supra*.) To show an abuse of discretion, a taxpayer must establish that, in refusing to relieve interest, CDTFA exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Appeal of Eichler*, 2022-OTA-029P; see *Woodral v. Commissioner* (1999) 112 T.C. 19, 23.)

Appellant requests relief for the periods November 13, 2018, through September 23, 2020, and from September 23, 2020, through August 9, 2023.[22] With respect to November 13, 2018, through September 23, 2020, appellant contends that CDTFA took 23 months to schedule an appeals conference. Appellant argues that CDTFA should have scheduled an appeals conference within six months of issuing the NOD. Here, OTA notes that appellant's petition for redetermination was not signed until December 11, 2018. As such, CDTFA could not have scheduled an appeals conference during the period November 8, 2018, through December 11, 2018, because appellant had not yet filed an appeal.

The record reflects that CDTFA forwarded appellant's petition for redetermination to its petition's section to complete a summary analysis on December 12, 2018, one day after

[22] Appellant's request for interest relief identifies a requested relief period of January 1, 2013, through March 31, 2018. However, appellant does not raise any contentions with respect to periods prior to November 13, 2018. Accordingly, OTA finds that the periods prior to November 13, 2018, are not at issue and shall not be discussed.

appellant signed the petition. According to CDTFA, the summary analysis was completed on September 26, 2019. CDTFA argues that in consideration of its workload the approximately 10-month period was reasonable. CDTFA states that, thereafter, based on appellant's request, it deferred the appeal from October 31, 2019, until April 6, 2020, when OTA issued its *Bachor 1* Opinion. CDTFA argues that after the deferral, it scheduled an appeals conference for June 15, 2020 (approximately two months after the deferral period), but appellant requested a further postponement until September 23, 2020. On September 23, 2020, CDTFA held its appeals conference. However, CDTFA argues that after its appeals conference, the parties were given until November 24, 2020, to provide additional information. OTA notes that CDTFA issued its decision on February 12, 2021, which is within 90 days of the close of CDTFA's evidentiary period. (Cal. Code Regs., tit. 18, § 35065.)

Based on this information, it appears that CDTFA worked continuously on appellant's file during the periods December 12, 2018, through September 26, 2019, and September 23, 2020, through February 12, 2021. Any delays during the period September 26, 2019, and September 23, 2020, are directly attributable to appellant's request for deferral and postponement. Absent evidence to the contrary, appellant has not established that in refusing to relieve interest during the period November 13, 2018, through February 12, 2021 (the date that CDTFA issued its decision), CDTFA exercised its discretion arbitrarily, capriciously, or without sound basis in fact or law. (*Appeal of Eichler*, *supra;* see *Woodral v. Commissioner*, *supra.*)

On March 8, 2021, appellant filed this timely appeal. OTA notes that the briefing period lasted from March 8, 2021, through August 11, 2022, during which time both parties requested and were granted extensions. Thereafter, OTA assigned an appeals panel and informed appellant of the panel on November 2, 2022 (subject to a panel revision on March 31, 2023), held a preliminary conference on May 2, 2023,[23] and held a prehearing conference with the parties on July 6, 2023.

OTA finds no authority in R&TC section 6593.5 to grant interest relief for a delay by OTA. Even if there was authority, appellant has not provided any evidence or argument to show an unreasonable delay occurred that was not attributable to him. Rather, the record reflects that upon filing his appeal, appellant requested, and received, a number of extensions to file briefing. Additionally, appellant provided information during the appeal, which led to CDTFA conducting a

[23] As discussed above, appellant did not appear at the preliminary conference.

reaudit. For the above reasons, OTA finds that CDTFA did not abuse its discretion in denying appellant's request for interest relief.

HOLDINGS

1. Appellant is not entitled to further adjustments to the deficiency measure for use tax due in connection with unreported purchases of fabrication labor and materials.
2. Interest relief is warranted with respect to the period May 1, 2018, through June 1, 2018, as conceded by CDTFA in this appeal. Additional interest relief is not warranted.

DISPOSITION

Reduce the taxable measure of Audit item 1 from $4,624,344 to $4,245,863 and the measure of Audit item 2 from $797,737 to $78,237 in accordance with the reaudits. Relieve interest for the period May 1, 2018, through Jun2 1, 2018. Otherwise, CDTFA's action in denying the petition for redetermination is sustained.

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K Long
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Keith T. Long
Administrative Law Judge

I concur:

DocuSigned by:
Sheriene Anne Ridenour
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Sheriene Anne Ridenour
Administrative Law Judge

G. TURNER, dissenting:

I agree with the majority's conclusion that Carmel Mountain Cabinetry (CMEX) and appellant are separate companies. The application of *Mapo, Inc. v. State Bd. of Equalization* (1976) 53 Cal.App.3d 245, to the matter before OTA was asked and answered in *Appeal of Bachor*, 2020-OTA-172P and there has been no suggestion that the circumstances relevant to that question have changed.

On the question of whether the sales or use tax applies, the parties construct a false dichotomy regarding application of Revenue and Taxation Code (R&TC) section 6006(b) and (f) for the taxation of fabrication labor. Whether taxable fabrication labor includes the transfer of title to the thing fabricated or not is of no consequence here.[1] What is in dispute is where the sale of the fabrication labor takes place.

The California Department of Tax and Fee Administration (CDTFA) argues that the "sale" occurred in Mexico because the *act* or *event* of fabrication is the taxable incident, and that event was "completed" in Mexico. CDTFA's conclusion lacks support in the law,[2] as it can only be reached by assuming R&TC section 6006(b) establishes a wholly independent excise tax on fabrication services. As explained more fully below, it does not.

While escaping CDTFA's erroneous "fabrication as an excise tax" construction, the majority finds CMEX completed its performance with respect to the physical delivery of the property in Mexico when CMEX employees placed the fabricated goods onto a truck owned by appellant based on appellant's failure to establish the existence of facts irrelevant to resolving the inquiry here: the intent of the parties.

Sourcing the Sale of Fabrication Labor

The sales tax is one expressly upon the privilege of the "selling of tangible personal property … *in this state*. . ." (R&TC, § 6051, italics added.) A "sale" means "[a]ny transfer of title or possession … of tangible personal property for a consideration." (R&TC, § 6006(a).) This definition "was designed to parallel the common law and the Commercial Code definitions

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[1] As noted in *Duffy v. State Bd. of Equalization* (1984) 152 Cal.App.3d 1156, the transfer of title to property is not a necessary ingredient of a "sale" for fabrication labor.

[2] During the hearing, Mr. Bacchus (for CDTFA) stated: "And our [(CDTFA's)] interpretation is that the taxable event or the taxing event occurs when the fabrication or printing or processing, whatever the term is in [R&TC section] 6006(b), when that happens. We're not saying *Duffy* expressly states that, but we are using the holdings from *Duffy* and *Banken* to make that interpretation." (Transcript of Proceedings, *In the Matter of the Appeal of S. Bachor* (OTA Case No. 21037482), Aug. 9, 2023, (Transcript) p. 43.)

of 'sale.'" (*King v. St. Bd. of Equalization* (*King*) (1972) 22 Cal.App.3d 1006, 1012; see *Cal-Metal Corp. v. State Bd. of Equalization* (1984) 161 Cal.App.3d 759.) Because a tangible article sold at retail is necessarily an amalgam of values created by material and services, the economic burden of the sales tax might be evaded by a consumer who furnished components to a person who supplied nothing but the service of fabricating these materials into a product. Consequently, R&TC section 6006(b) was enacted to forestall that evasion. (*King*, *supra*, 22 Cal.App.3d at pp. 1012-1013; *Duffy v. State Bd. of Equalization* (*Duffy*) (1984) 152 Cal.App.3d 1156.) "Whether the retailer supplies the consumer with a completely fabricated article *or only fabrication services, he delivers title or possession to the consumer and thus effects a 'sale.'*" (*King*, *supra*, 22 Cal.App.3d at p. 1013, italics added.) R&TC section 6006(b), adding fabrication services to the definition of "sale", was designed to facilitate effective administration of the sales tax, not extend the sales tax to a subject (the taxation of services) escaping the scope of the tax's express imposition on tangible personal property. (*Banken v. State Bd. of Equalization* (*Banken*) (1947) 79 Cal.App.2d 572, 576 [the transfer of fabricated goods is a transfer of title or possession.])

"[T]he sales tax law employs relatively artificial, relatively self-contained, concepts. . . To pursue the will-o'-the-wisp definitions, concepts and distinctions from other areas of law—where they are shaped by purposes and by social and economic factors unrelated to sales taxation – leads to false goals." (*King*, *supra*, 22 Cal.App.3d at pp. 1010-1011.) Following the path of CDTFA to source the taxation of fabrication labor to the location of the act of fabricating one must presume R&TC section 6006(b) is an independent excise tax on "fabrication services" because only then can the incidence of the tax be the act of fabrication. While it is true, as the court noted in *Duffy*, that taxable fabrication does not require the transfer of title to the property fabricated, by constructing fabrication as a "sale" the Sales and Use Tax Law necessarily treats fabrication services as the transfer of title or possession, regardless of whether title to the property fabricated actually transfers. (*King*, *supra*, 22 Cal.App.3d at pp. 1012-1013; *Banken*, *supra*, 79 Cal.App.2d at pp. 575-576.) Consequently, CDTFA's argument constructs a conflict between R&TC sections 6006(b) (including fabrication services in the definition of "sale") and 6051 (imposing tax on the privilege of selling tangible personal property) that would otherwise not exist validating the lack of foundation in the law for its position.

The resolution of the question, where does the "sale" of fabrication services occur, does not require OTA to look beyond the Sales and Use Tax Law for unique or heretofore undefined rules. Because R&TC section 6006(b) treats fabrication *as if a sale of tangible personal property*, one simply looks to the normal rules to ascertain where the sale occurs. R&TC

section 6010.5 provides that the place of sale or purchase is the place where the property is physically located at the time the act *constituting the sale* or purchase takes place.[3] The "sale" occurring upon the passage of title or possession, the courts and CDTFA have long used California Uniform Commercial Code (CUCC) section 2401 to determine when title passes between sellers and buyers triggering a sale. (*City of South San Francisco v. Bd. of Equalization* (2014) 232 Cal.App.4th 707, 728.) CUCC section 2401(2) provides "[u]nless otherwise explicitly agreed title passes to the buyer at the time and place at which the seller completes his performance with reference to the physical delivery of the goods. . . " (See also Cal. Code Regs., tit. 18, § 1628(b)(3)(D).)

Completion of Performance

Performance is not an objective fact, but a question of the parties' intent. The cardinal factor upon which the passing of title between a seller and buyer depends is the intention of the parties. (*O'Kelley-Eccles Co. v. State* (1958) 160 Cal.App.2d 60, 64, see *Select Base Materials, Inc. v. Bd. of Equalization* (1959) 51 Cal.2d 640, 647-648.) The case law looks "primarily to the intent of the contracting parties to determine when title passed…" (*City of Fontana v. Cal. Dept. of Tax & Fee Admin* (2017) 17 Cal.App.5th 899, 926.)[4] Title in this context, however, is not title to the materials fabricated, which *Duffy* instructs is irrelevant. (*Duffy*, *supra,* 152 Cal.App.3d at p. 1165.) Title in the context of fabrication labor is the transfer of possession of the fabricated goods. (*King*, *supra*, 22 Cal.App.3d at p. 1013). OTA's inquiry, then should be *what did the parties intend* to be the place for the transfer of possession of the fabricated goods?

Here, the record establishes the parties entered into a contract for fabrication services to be provided by CMEX in Mexico.[5] That contract expressly provides that CMEX deliver the

[3] "The reason for section 6010.5, added by Assembly Bill No. 1, effective September 17, 1965, is to forestall any possible contention that under the provisions of the new Uniform Commercial Code, the place of sale might be deemed to be other than the place where the property is physically located at the time of sale." Sales and Use Tax Annotation 495.0680.

[4] Of course, the contract language does not itself necessarily control. (*Northrup Corp. v. State Bd. of Equalization* (1980) 110 Cal.App.3d 132, 139.) The inquiry, however, is the intent of the parties.

[5] The majority references the contract between the parties as "unsigned" and consequently unreliable. Except, appellant did provide an executed copy of a contract between appellant and CMEX, it was simply in Spanish. The majority ignores their own oversight by citing to appellant's failure to provide a certified translation and asserting OTA has no obligation to do it themselves. However, even a casual review of the contract by a non-Spanish speaker makes the duplicate nature of the contracts obvious. The paragraph numberings are all identical. And the terms requiring CMEX to delivery the fabricated goods to appellant in California under the same paragraph numbering. The executed Spanish version thus serves to validate the agreement between the parties, notwithstanding the majority's unwillingness to recognize it.

finished product to the address of appellant, or any other location supplied by appellant. While the truck utilized by CMEX in fulfillment of that obligation was owned by appellant, shipping manifests and customs documents show the truck to have been operated by an employee of CMEX when traversing the US / Mexican border. CDTFA has not disputed the veracity of the contract nor suggested the terms of the contract were not adhered to[6] which, absent specific conduct to the contrary, controls the expression of the intent of the parties. (Cal. Civ. Code, § 1639; *City of Fontana*, *supra*, 17 Cal.App.5th at p. 926 ["Traditionally, the most significant source of intent would be the written contract, if the parties made one."].) Appellant's declaration, signed under penalty of perjury, confirms the express terms of the contract that CMEX was responsible for delivering the finished goods to appellant inside California and CMEX's employee (the same one shipping manifests identify as driving truck shipping the fabricated good) was responsible for that delivery. All of which comports with the acknowledged prohibition against *Maquiladoras* completing sales in Mexico.[7]

Against this backdrop, the majority constructs an artificial barrier of "insufficient evidence" presented by appellant that the parties in fact adhered to the express terms of their contract. Except, none of the alleged shortcomings identified by the majority are relevant to the inquiry: whether CMEX paid the costs of transportation, the absence of specifying that inspection was to occur in California, and the lack of a written rental agreement for use of appellant's truck. Appellant's alleged failure to produce evidence answering these questions does not show the actual intent of the parties deviated from the express contract terms with respect to the delivery of the property. Where the sale is made by written contract, the intention of the parties as to when title shall pass is to be gathered from those writings, and those alone, in the absence of any ambiguity therein. (*Ayako Sakamu v. Zellerbach Paper Co.* (1938) 25 Cal.App.2d 309, 315-316.) Even the majority's dismissal of the contract as having been signed outside the audit period cannot find support in the law.

[6] Transcript, p. 17, Mr. Bacchus (for CDTFA): "According to Appellant's Exhibits 5 and 10, during the liability period an employee of [CMEX] would pick up materials purchased by Appellant, transport those materials to [CMEX]'s location in Mexico, and complete the agreed upon fabrication of those materials pursuant to the agreement between Appellant and [CMEX], which is Appellant's Exhibit 7. The [CMEX] employee would deliver the fabricated materials to Appellant's business location or to various job sites in California."

[7] The majority dismisses appellant's argument that the *Maquiladora* Regime prohibits sales in Mexico as essentially irrelevant because any conclusion thereon is not controlling as to California law. Except, the point being raised was not that the *Maquiladora* Regime controlled the determination of what a "sale" is under California law, but that it was evidence of the parties' intent, as they obviously would not intend a "sale" to occur in Mexico if such were proscribed by Mexican law. What the parties to the contract intended with respect to where the sale occurred is the central question of the matter before OTA.

The essence of the transfer of possession for sales and use tax purposes is a reflection of the transfer of dominion and control in the absence of actual title. (*Culligan Water Conditioning v. State Bd. of Equalization* (1976) 17 Cal.3d 86, 95.) Here, neither CDTFA nor the majority assert any legal authority for the proposition that a mere placing of goods on a truck owned but not controlled by appellant, by that fact alone, constitutes the transfer of dominion and control ("possession" for sales and use tax purposes) of the goods. Because there is none. Having no evidence of conflicting conduct expressing an alternative intent of the parties that delivery occur in California, it is not within the prevue of OTA to construct alternative terms of sale between the parties. The majority's conclusion that possession of the fabricated goods transferred in Mexico is therefore at odds with the law and the facts.

For these reasons, I dissent and would find that the applicable tax is the sales tax, not the use tax.

Signed by:
Greg Turner
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Greg Turner
Administrative Law Judge

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