STATE OF CALIFORNIA

BOARD OF EQUALIZATION

440.2690

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
M--- P--- CEMENT CO.	)	Nos. SY – XX-XXXXXX-010 -020
Petitioner	)	

The preliminary hearing on the above taxpayer's petition for redetermination was held on October 29, 1985 in Arcadia, California.

Hearing Officer:	H. L. Cohen
Appearing for Petitioners:	Mr. W. B---, President
	Mr. T. J--- Former Vice President Operations
	Mr. B. A---, Director Corporate Services
	Mr. J. F. C--- Attorney at Law
Appearing for the Board:	Mr. J. Dandurand, Auditor Arcadia District

Protested Item

Petitioner filed written petitions for redetermination dated May 12, 1982 and March 25, 1985, which contain written arguments and authority for its position. The protested tax liability for the period October 1, 1977 through December 31, 1980 (-010 protest) is measured by:

	Item	State, Local and County
A.	Claimed sales for resale disallowed	$ 24,405

C.	Unreported sales	15,872
D.	Self-consumed flyash purchased ex-tax	513,096
E.	Ex-tax purchases not reported:	
	1. Coal hauling charges	2,168,171
	2. Flourspar	394,985
	3. Reax G-1	462,614
	4. Sinter Mix	379,816
	5. Consumable supplies	538,448
	Total	$ 4,497,407

The protested tax liability for the period July 1, 1981 through June 30, 1984 (-020 protest), is measured by:

	Item	Amount State, Local and County	Amount Transit District
B.	Self-consumed flyash purchased ex-tax	$ 580,842	-0-
E.	Manufacturing aids purchased ex-tax		
	1. Reax 65-D and G-1	347,899	-0-
	2. Fluorspar	92,690	-0-
	3. Sinter Mix	301,562	-0-
F.	Coal Hauling charges	3,157,404	-0-
G.	Consumable supplies	970,923	$2,011
	Totals	$5,451,320	$2,011

Contentions

Petitioner contends that:

1. The sale claimed as an exempt sale for resale was actually an exempt sale in interstate commerce for which petitioner has supporting evidence.

2. On transaction which the auditor regarded as an unreported sale was not a sale.

3. Other transactions which the auditor regarded as unreported sales were sales of scrap to a scrap dealer for resale.

4. The flyash, fluorspar, reax, and sinter mix are incorporated into petitioner's final product and are resold.

5. The transportation charges in question were separately stated and therefore exempt.

6. Many of the items regarded as consumable supplies by the auditor are exempt.

1. Introduction

Petitioner is a corporation which is ingaged in the manufacture and sale of Portland cement. Two audits are involved here.

2. Claimed Sales for Resale Disallowed, -010 Protest, Audit Item A.

a. Summary

The auditor asserted tax on two entries in petitioner's list of claimed sales for resale. One item of $1,988 had been claimed twice. The other item was a sale to J. D. Dutton, Inc. in the amount of $22,417. Petitioner concedes the tax on the first item, but claims that the sale to Dutton was an exempt sale in interstate commerce. The purchase order calls for delivery outside California, and petitioner states that delivery was via an independent carrier, B--- T--- Co. Petitioner did not submit any shipping documentation.

b. Analysis and Conclusions

Sales and Use Tax Regulation 1620 provides in subdivision (a)(3)(D) that bills of lading or other documentary evidence of delivery of property to a carrier for shipment outside of this state must be retained by the retailer to support deductions taken for sales claimed to be exempt sales in interstate commerce. The purchase order submitted by petitioner is not sufficient to support the claim of exemption. Subsequent to the hearing, petitioner submitted copies of bills of lading. An adjustment should be made by deleting from the amount subject to tax those transactions to which the bills of lading pertain.

3. Unreported Sales, -010 Protest, Audit Item C.

a. Summary

The auditor examined petitioner's miscellaneous income account asserted tax on five transactions. One transaction in the amount of $8,544 was listed as pallets; one in the amount of $4,438 was listed as scrap; one in the amount of $154 was listed as old brick; one in the amount of $780 was listed as mineral filler; and there were miscellaneous items totaling

$1,956.45. Petitioner held no resale certificates for these transactions and had no evidence of actual resale.

Petitioner states that the amount listed as pallets constituted the application of pallet deposits owed to a customer to the amount owed by that customer to petitioner for cement sold to the customer. Petitioner states that the amount listed as scrap consisted of worn out parts sold to a scrap dealer presumably for resale.

b. Analysis and Conclusions

Sections 6091 of the Revenue and Taxation Code provides that it shall be presumed that all gross receipts are subject to tax until the contrary is established. The burden of proving that a sale of tangible personal property is not a retail sale is upon the seller unless he takes a resale certificate from the buyer.

Petitioner's allegations, if proven, would relieve petitioner of the tax asserted on the pallets and scrap book entries. We cannot, however, accept petitioner's unsupported allegations. Testimony is not a substitute for records. See People v. Schwartz, 31 Cal. 2d 59. Petitioner should be allowed 20 days in which to submit to the auditor the accounts receivable record showing the credit for the pallets and a statement from the scrap dealer verifying that the scrap purchased was in fact resold. An adjustment should be made to the extent warranted by the evidence submitted.

4. Self-Consumed Flyash Purchased Ex-Tax, -010 Protest, Audit Item D and -020 Protest, Audit Item B.

a. Summary

Petitioner purchases coal tax paid for heating its kilns. Petitioner claims a deduction for the value of the flyash content of the coal on the basis that the flyash is a necessary ingredient of the cement which petitioner manufactures.

The auditor concluded that flyash is a waste product and is not purchased for the purpose of including it in petitioner's products. The auditor also concluded that the flyash is not a required ingredient in petitioner's product. The auditor disallowed petitioner's claimed deduction for the value of the flyash. The auditor relied at least in part on a proposed revision to Sales and Use Tax Regulation 1525 dealing with property which is incidentally incorporated into a final product which is sold. The flyash is residue which remains in the kiln after the coal is burned for heat. In the kiln it mixes with the other ingredients used to manufacture the cement. The auditor states that he was informed by some of petitioner's personnel that the coal is purchased for heat only and that the flyash does not contribute usable ingredients to the final product.

Petitioner states that flyash contains inorganic elements that are required in the production of cement. If the flyash were not incorporated into the mixture with the other

ingredients, additional quantities of the required inorganic elements would have to be purchased and added. Petitioner points out that the Board has regarded as exempt that portion of aluminum which is added to steel during the manufacture of steel which is added to produce fine grain quality even though the remaining portion of the aluminum becomes slag and is regarded as taxable. See Kaiser Steel Corp. v. State Board of Equalization, 24 Cal.3d 188. Petitioner also points out that the Board granted petitioner a refund of tax based on the value of flyash in an earlier claim for refund.

b. Analysis and Conclusions

Sales and Use Tax Regulation 1525 provides that tax does not apply to sales of tangible personal property sold to persons who purchase it for the purpose of incorporating it into the manufactured article to be sold. The Board has already concluded that the flyash portion of coal used in the manufacture of cement is property which is purchased for the primary purpose of incorporation into the product to be sold. Since the primary purpose is resale, and there is no intervening use of the flyash, tax does not apply to petitioner's use of flyash in the manufacture of cement.

The auditor apparently disallowed petitioner's claimed deduction in total without other investigation. While we have concluded that flyash is no subject to tax, we do not know that petitioner's deduction was correctly calculated. Although flyash is not actually a by-product, we believe that the method outlined in Regulation 1525.5 for reporting tax on consumed by-products is appropriate here. The calculation should be verified by the auditor. The tax should be deleted to the extent that the auditor verifies the calculation.

5. Unreported Transportation Charges for Coal, -010 Protest, Audit Item E.1, and -020 Protest, Audit Items F and G.

a. Summary

Petitioner purchases coal from suppliers located outside California. The coal is transported by truck from the mine to the railhead and by rail to petitioner's California plants. Charges for coal, for loading, handling and transportation to the railhead, and for transportation from the railhead to petitioner's locations are separately stated on the invoices. Petitioner reports tax to the Board based on the cost of the coal only; the transportation, loading and handling charges were regarded as exempt.

One contract was submitted for examination. It was with C--- R--- C--- for the period from December 28, 1981 through December 31, 1983. Pertinent provisions were as follows:

"Section VI: Point of Delivery

"The coal shall be delivered from Seller to Buyer in loaded railcars, at Seller's rail loadout facility located at T---, New Mexico (herein called the "Point of Delivery').

"The title and risk of loss to all coal shall pass to the buyer at the Point of Delivery."

The auditor regarded the charges for transportation from the railhead to petitioner's California locations as exempt under Regulation 6012. The auditor did not regard the charges for handling, loading, and transportation from the mine to the railhead as exempt because title to the coal passed at the railhead. The auditor asserted tax on these amounts.

Petitioner contends that these charges were exempt under Section 6012 and Regulation 1628 because they were separately stated and the transportation was by common carrier.

We note that petitioner has included $813,683 of the amount of Audit Item G of protest -020 in this category. At the hearing petitioner conceded that tax applies to the remaining amount of $157,240. The auditor stated at the hearing that $566,086 represented purchases of coal or coke upon which petitioner had failed to accrue tax, and that only $247,597 represented charges for handling and transportation. Petitioner state that it was unaware of this distinction but would investigate.

b. Analysis and Conclusions

Section 6011 of the Revenue and Taxation Code provides in subdivision (c)(7) that sales price which is the amount subject to use tax does not include separately stated charges for transportation from the retailer's place of business or other point from which shipment is made directly to the purchaser, but the exclusion shall not exceed the cost to the retailer of transportation by other than facilities of the retailer. Further, if transportation is by facilities of the retailer, the exclusion shall be applicable solely with respect to transportation which occurs after the purchase of the property.

Looking first to the C--- R--- C--- contract, we conclude that the transportation charge is subject to tax. Tax applies because the charge is not for "transportation from the retailer's place of business or other point from which shipment is made directly to the purchaser." The shipment in question was made to the "seller's rail loadout facility", rather than directly to the purchaser. The vendor's responsibilities included transfer of the coal from truck to rail car.

The bulk of the charges in question are described in the audit work papers as for loading; loading and handling; or loading, handling, and hauling. Charges so identified do not

qualify for exclusion because they either are not for transportation or are not separately stated charges for transportation.

If petitioner can produce invoices showing that the charges are solely for transportation and shipment was directly to petitioner via facilities other than the seller's, then an adjustment would be appropriate. Petitioner should be allowed 20 days in which to supply to the auditor satisfactory evidence to support exclusion.

6. Self-Consumption of Flourspar, REAX G-1, Reax 65-D, and Sinter Mix, -010 Protest, Audit Items E.2, E.3, and E.4, and -020 Protest, Audit Items E.1, E.2 and E.3.

a. Summary

Petitioner purchases fluorspar, Reax G-1, Reax 65-D, and sinter mix for resale on the basis that these items are incorporated into and resold with the final product which petitioner sells. The auditor regarded these materials as manufacturing aids and asserted tax on the cost of the materials to the petitioner.

The auditor's research indicates that fluorspar is added to the mix to facilitate clinkering. Flourspar reduces the temperature at which liquid is formed, thus reducing the clinkering temperature. The fluorspar is also used to lower the alkali content and as a flux to help prevent the slurry from adhering to the lining of the kiln. The presence of fluorspar has no beneficial effect on the finished product and in some cases may reduce the strength of the concrete. Petitioner contends that the fluorspar is a source of calcium, a necessary ingredient in the cement.

Reax G-1 is used to aid grinding. It does this by reducing static electricity. This permits faster and more complete mixing. It remains in the mix after grinding. At this point it acts as an inhibitor to packing. Reax G-1 helps to control the flow characteristics of bulk cement and prevents it from settling into a dense mass during bulk transportation.

Reax 65-D is an air-entraining agent. Mortar, plaster and stucco have improved workability and greater climatic durability if air is entrained. Petitioner states that there is no market for cement that does not contain an air-entraining agent, because masons have difficulty in working with cements which do not contain such an agent.

The auditor stated sinter mix is an iron-containing steel mill by-product. It is mixed into the cement slurry to aid in the uniform heating and drying of the slurry. Petitioner contends that the sinter mix is a source of iron which is necessary in the final product.

Petitioner cites the Kaiser Steel case, supra, as support for its position that these four materials are not subject to tax.

b. Analysis and Conclusions

Sales and Use Tax Regulation 1525 provides that tax applies to tangible personal property which is purchased for the purpose of use in manufacturing, producing or processing tangible personal property and not for the purpose of physically incorporating it into the manufactured article to be sold. Tax does not apply to tangible personal property purchased for the purpose of incorporating it into the manufactured article to be sold.

Under the regulation, the criteria for applying tax is not whether or not the property remains in the article to be sold; the criteria is whether or not the property purchased is for the purpose of incorporating it into the article to be sold. The Kaiser Steel case clarifies the application of tax to property purchased for a dual purpose: use in manufacturing and incorporation into the article to be sold. Property purchased for dual purposes will be taxed under Kaiser Steel if the primary purpose for its use is in manufacturing.

The uses for fluorspar described above are manufacturing uses. Petitioner contends that flourspar is a source of calcium in the final product. The principal raw material for cement is calcium carbonate. Calcium carbonate is the principal source of calcium in the final product. Although fluorspar contributes calcium to the final product, it is our conclusion that this is not the primary purpose for adding fluorspar to the mix. Tax was properly applied to fluorspar.

The initial use of Reax G-1 is admittedly a manufacturing use. It does appear to add beneficial properties to the final product; however, the manufacturing use occurs prior to resale. Therefore, it was not resold without intervening use. Tax applies.

The sole purpose for using Reax 65-D appears to be to add beneficial and perhaps necessary properties to the final product. We conclude that it was properly purchased for resale and no tax applies.

The primary purpose for adding sinter mix to the mixture appears to be to add a necessary ingredient, iron. We conclude that tax does not apply to sinter mix.

7. Consumable Supplies Purchased Ex-Tax, -010 Protest, Audit Item E.5.

a. Summary

In reviewing petitioner's paid bill records, the auditor found ex-tax numerous purchases of supplies. The auditor asserted tax on these supplies. The purchases appear to be mostly of tools, parts, and printed matter. Petitioner was unable in the brief to specifically identify purchases which were believed by petitioner not to be subject to tax. Petitioner stated at the hearing that approximately $88,000 of the purchases were delivered to its Wyoming plant and that approximately $257,000 of the purchases were of grinding media. The grinding media

consists of steel balls which wear down and altimately become part of the final product. Petitioner also stated that the remaining purchases were still under investigation.

b. Analysis and Conclusions

Section 6244 of the Revenue and Taxation Code provides that if a purchaser who give a resale certificate or purchases property for the purpose of reselling it, makes any storage or use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, that storage or use is taxable. Petitioner purchased the property in question ex-tax. To avoid tax, petitioner must show that it was not stored or used in this state or that it was purchased for resale. Petitioner has stated that a part of the property was delivered to Wyoming. If petitioner can produce documentation showing that the vendor shipped the property to Wyoming no tax will apply. With respect to the grinding media, the primary purpose for purchase is use in manufacturing. The iron is only incidentally incorporated in the product. See Business Taxes Law Guide, Annotation 440.1740 (May 16, 1952). Petitioner should be allowed 20 days in which to provide evidence to the auditor to show shipment of property to Wyoming and to identify any basis for not applying tax to the remaining purchases.

Recommendation

1. Allow petitioner 20 days in which to submit evidence to the auditor as discussed above with respect to:

-010 Protest, Audit Items B, E.1 , and E.5

-020 Protest, Audit Items F and G
Make adjustment based on the evidence submitted.

2. Delete from the amount subject to tax Audit Items A and D in Protest -010 and Audit item B in Protest -020, to the extent the amounts are verified by the auditor as correct.

3. Delete from the amount subject to tax Audit Item E.4 in the -010 Protest, Audit Item E-3 in the -020 Protest, and the purchases of Reax 65-D.

4. Redetermine without other adjustment.

Arcadia District to make adjustments.

H. L. Cohen, Hearing Officer — 1-17-86 Date