2002-SBE-003

BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeals of	)	
	)	
Jon and Rita Minnis	)	No. 100638
and	)	
Milpitas Materials Company	)	No. 104667
	)	

Representing the Parties:

For Appellants:[1] Derick J. Brannan
Robert Reynolds, CPA
Kathleen Dill
Kathleen Matranga Benson, CPA

For Respondent: Geoffrey S. Way, Tax Counsel III

Counsel for Board of Equalization: Reed Schreiter, Tax Counsel

O P I N I O N

[1] Milpitas Materials Company is an S corporation in which Jon and Rita Minnis are the sole shareholders. Pursuant to California Code of Regulations, title 18 (Regulation), section 5074, and as noted in correspondence dated May 7, 2001, the Board consolidated the appeals for hearing and decision under Case Number 100638. Hereinafter, "appellant" refers to both Milpitas Materials Company and Jon and Rita Minnis, unless otherwise indicated.

These appeals are made pursuant to section 19324, subdivision (a),[2] of the Revenue and Taxation Code from the actions of the Franchise Tax Board in denying the claim of Jon and Rita Minnis for refund of personal income tax in the amount of $1.00 or more for the years 1995 and 1996, and in denying the claim of Milpitas Materials Company for refund of franchise tax in the amount of $1.00 or more for the year ended December 31, 1995. The issue presented by these appeals is whether appellant's ready mixed concrete trucks meet the requirements for qualified property for purposes of the Manufacturers' Investment Credit (MIC).[3]

Milpitas Materials Company supplies ready mixed concrete for construction projects throughout the San Francisco Bay Area. Mr. Minnis began working in the ready mixed concrete industry in 1954, purchased an interest in Milpitas Materials Company in 1965, and became the sole owner in 1974. Appellant utilizes ready mixed concrete mixer trucks in the mixing and delivery of its ready mixed concrete. Instead of purchasing standard ready mixed concrete mixer trucks as one unit, appellant purchases mixer barrels (and the accompanying components) and truck chassis[4] units separately from different suppliers. Appellant's employees assemble the mixer barrels and truck chassis at appellant's facilities, making modifications during the assembly process not made on standard trucks purchased as one unit. Appellant claims to make the modifications to improve safety, to increase the life of the trucks, and to maintain the cleanliness of the trucks. Once assembled, the completed mixer trucks appear appropriate only for the purposes of mixing and transporting ready mixed concrete.

To assemble appellant's mixer trucks, appellant's employees first install a hydraulic pump on the front of the truck. The pump is attached to, and apparently powered by, a "power take off" drive line, which is connected to the truck engine. A hydraulic motor is installed behind the truck cab and is charged by the hydraulic pump. The hydraulic motor turns a gearbox, which turns the mixer barrel. The mixer barrel is installed after the hydraulic

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[2] Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the year in issue.

[3] The appeals originally presented two issues, the second issue being whether the amounts allowed to appellant by a truck dealer as credit for trade-ins at the time appellant purchased the new trucks at issue herein are properly chargeable to a capital account, and thus constitute qualified costs for purposes of the MIC. The second issue remained in contention until appellant withdrew opposition to respondent's position several days before the scheduled hearing. Appellant confirmed the withdrawal of opposition during oral argument at the hearing.

[4] The term "truck chassis," as used in this opinion, includes all components of appellant's mixer trucks, such as the engine, transmission, and cab, with the exception of the mixer barrels and the accompanying components (including the hydraulic system) installed by appellant after purchase.

components. In order to avoid damage to the drum ring, the face of the rollers, the roller bearings, and the hydraulic pump, the mixer barrel apparently must turn at all times, even when empty. The truck engine thus must always provide power to the hydraulic pump to turn the mixer barrel.

Ready mixed concrete may be manufactured by one of three processes: 1) Central-mixed concrete is mixed in a stationary mixer and delivered in a truck agitator, a truck mixer operating at agitating speed, or a special nonagitating truck; 2) shrink-mixed concrete is mixed partially in a stationary mixer and completed in a truck mixer; and 3) truck-mixed concrete is mixed entirely in a truck mixer.[5] Appellant utilizes the third process, providing truck-mixed concrete to its customers. Most concrete must meet specifications of uniformity set forth in the Standard Specification for Ready-Mixed Concrete, published by the American Society for Testing and Materials. The guidelines, among other things, indicate the proper mixture of materials, the proper agitating speed and mixing speed, and the total allowable mixing time. The parties agree that the manufacturing process for truck-mixed concrete begins when appellant adds raw materials to the truck mixer barrel and ends when appellant discharges the concrete from the truck mixer at the job site.

The record includes several invoices detailing appellant's truck chassis purchases in 1995 and 1996. In 1995, appellant purchased five new 1996 Peterbilt 3-axle conventional truck chassis and traded in five used trucks for which appellant received a trade-in allowance against the cost of the new trucks. Appellant also purchased five new 1997 Peterbilt 3-axle conventional truck chassis in 1996, but did not trade in any trucks to the dealer with the 1996 purchase.

Appellant filed amended tax returns for 1995 and 1996 claiming the MIC for the entire cost (without adjustment for the trade-in allowance) of the ten new ready mixed concrete trucks placed into service during those years. Upon review, respondent bifurcated the trucks for purposes of the MIC, allowing a refund for the cost of the mixer barrels (and accompanying components) but disallowing a refund for the cost of the truck chassis.[6] Appellant protested respondent's determination, arguing the mixer trucks should not be bifurcated but should be

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[5] Code 3273 of Division D of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, identifies as a manufacturing activity the manufacture of portland cement concrete manufactured and delivered to a purchaser in a plastic and unhardened state. The SIC Manual further indicates the ready mixed concrete industry includes the production and sale of central-mixed concrete, shrink-mixed concrete, and truck-mixed concrete.

[6] Respondent also disallowed the portion of the claimed cost of the trucks representing the trade-in allowance. Appellant conceded this issue several days before the hearing. (See fn. 3, *ante*.)

treated as a single integrated piece of manufacturing equipment. Respondent affirmed its conclusions in Notices of Action. Appellant timely appealed to this Board.

The MIC provides an income tax credit to any qualified taxpayer for specified qualified costs paid or incurred on or after January 1, 1994, for qualified property placed into service in this state. (Rev. & Tax. Code, §§ 17053.49, subd. (a)(1) & 23649, subd. (a)(1); Cal. Code Regs., tit. 18, §§ 17053.49-1, subd. (a) & 23649-1, subd. (a).)[7] Qualified property includes tangible personal property defined in Internal Revenue Code (IRC) section 1245(a)(3)(A)[8] and used by a qualified taxpayer in an activity which is both described in Division D of the SIC Manual and qualified under the statute. (Cal. Code Regs., tit. 18, §§ 17053.49-5, subd. (a) & 23649-5, subd. (a).) Qualified activities include manufacturing, processing, refining, fabricating, or recycling of property, beginning when the qualified taxpayer receives and introduces the raw materials into the process and ending when the process alters the tangible personal property to its completed form. (Rev. & Tax. Code, § 17053.49, subd. (d)(1)(A) & 23649, subd. (d)(1)(A).) We have not previously addressed the issue of what constitutes qualified property under the MIC, and thus this is a case of first impression.

In framing the issue for our consideration, the parties agreed (we believe rightly so) on the following points: 1) Code 3273 (Ready Mixed Concrete) in Division D of the SIC Manual describes appellant's manufacturing activities; 2) appellant is a qualified taxpayer under the MIC statute;[9] 3) the manufacturing process for truck-mixed concrete begins when appellant adds raw materials to the mixer barrel and ends when appellant discharges mixed concrete from the mixer barrel at the job site; 4) appellant's mixer barrels (and the accompanying components) are used primarily in the manufacturing process and thus satisfy the various requirements of qualified property; and 5) if we find each of appellant's ready mixed concrete trucks to be single integrated pieces of manufacturing equipment, then the entire truck is used primarily in manufacturing. The disagreement arises as to whether or not the truck chassis of appellant's ready mixed concrete trucks are primarily used in manufacturing, and thus also satisfy the various requirements of qualified property under the MIC.

Simply stated, appellant argues each of its ready mixed concrete trucks constitutes a single integrated piece of manufacturing equipment, while respondent argues the concrete

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[7] Section 17053.49 sets forth the MIC for purposes of the Personal Income Tax Law, while section 23649 sets forth the MIC for purposes of the Bank and Corporation Tax Law. The accompanying regulations for each section are found in Regulation sections 17053.49-0 through 17053.49-11 and Regulation sections 23649-0 through 23649-11.

[8] IRC section 1245(a)(3)(A) defines "section 1245 property" as any personal property subject to depreciation under IRC section 167. IRC section 167 allows a depreciation deduction for property used in trade or business, or for the production of income, which precludes a deduction for property held as inventory.

[9] See Rev. & Tax. Code, §§ 17053.49, subd. (c)(1), & 23649, subd. (c)(1).

trucks contain a manufacturing element (the mixer barrels and the accompanying components) and a transportation element (the truck chassis). We agree with appellant and conclude the ready mixed concrete trucks comprise a single integrated piece of manufacturing equipment and thus constitute qualified property for purposes of the MIC. Our conclusion recognizes the reality that a truck-mounted mixer barrel cannot perform its designated manufacturing function apart from a truck chassis. This reality stems not only from the fact that the mixer barrel relies on the truck chassis for power, but also from the unique nature of manufacturing ready mixed concrete.

The SIC Manual describes ready mixed concrete manufacturing to include the manufacture and delivery of ready mixed concrete to the purchaser in a plastic and unhardened state. The SIC Manual description acknowledges the unique nature of the ready mixed concrete manufacturing process by recognizing that to achieve the proper concrete mix ready mixed concrete must be mixed and/or agitated enroute to the job site. Thus, the SIC Manual definition of ready mixed concrete manufacturing contemplates and incorporates the truck chassis' compound functions of providing power to the mixer barrel (whether in the mixing mode or agitation mode) while also transporting the mixture to the job site. We note the SIC Manual definition, as well as our conclusion, are consistent with the parties' stipulations that the manufacturing process for truck-mixed concrete begins with the addition of raw materials to the mixer barrel and ends with the discharge of mixed concrete from the mixer at the job site and that the mixer barrels are used primarily (more than 50 percent of the time)[10] in the manufacturing process.[11]

We also find support for our decision in respondent's MIC regulations, specifically, Regulation section 17053.49-5, subdivision (b)(4), example 5, and section 23649-5, subdivision (b)(4), example 5. These regulations deem a forklift used to transport raw materials within a manufacturing plant as qualified property because once the raw materials are received at the plant the movement of the materials via the forklift is treated as part of the manufacturing process. The transportation function of appellant's trucks within the ready mixed concrete manufacturing context is analogous to the transportation function of the forklift within the manufacturing plant context. We note, however, that appellant's trucks also serve a manufacturing function in addition to the transportation function within the manufacturing

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[10] See Rev. & Tax Code, §§ 17053.49, subd. (e)(5), & 23649, subd. (e)(5).

[11] Given our conclusion that appellant's ready mixed concrete trucks constitute a single integrated piece of manufacturing equipment and are thus qualified property, we do not address or express an opinion regarding appellant's alternative arguments that the truck chassis are qualified property because they serve to maintain, or avoid damage to, components of the mixer barrel, or that they serve to facilitate the return of excess concrete to the main plant for recycling, or that they serve as packaging.

context, while the forklift serves merely a transportation function within the manufacturing context.

In light of our conclusion that the compound functions of the truck mixers are inherent in the SIC Manual description of ready mixed concrete manufacturing, as well as in the stipulation of the parties, we find respondent's argument regarding the dual purpose or dual nature of the truck mixers unpersuasive. Initially, we observe that respondent's "dual-purpose" argument appears to stray from the statutory language of the MIC. Respondent's approach seems to look to the primary "purpose" of the asset, rather than to requiring the primary "use" of an asset to be in one of the qualified activities, such as manufacturing. This distinction may be mere semantics; however, respondent appears to use the argument to distance itself from its stipulation that the mixer barrels are used primarily in manufacturing. Further, even if the truck chassis do contain a transportation element, this element is inherent in the ready mixed concrete manufacturing activity. Thus, although we agree with respondent that transportation is not a qualified activity under the MIC statute, the "transportation" element is subsumed into the manufacturing category in the ready mixed concrete manufacturing context.[12]

In conjunction with this position, we find respondent's reliance on the former federal excise tax levied on specified highway vehicles inapposite. (See former Int.Rev. Code, §§ 4061 & 4063, repealed by Tax Reform Act of 1984, Pub.L. No. 98-369 (July 18, 1984), 98 Stat. 980, eff. Jan. 7, 1983.)[13] Respondent argues that the federal tax bifurcated the cement mixer trucks for transportation tax purposes into a transportation element and a manufacturing element and taxed only the transportation element. Respondent claims it merely seeks to do the same in this case, i.e., to tax only the primary purpose of the respective portions of the asset. In its argument, respondent ignores the obvious distinction between the purposes of the former federal transportation excise tax and the MIC. The transportation tax sought to impose tax on those vehicles utilizing the nation's highway system, while the MIC seeks to encourage manufacturers to purchase manufacturing equipment for use in California. Thus, it may have made sense in the context of the federal transportation tax to bifurcate mixer trucks into a "transportation" element and a "manufacturing" element when determining the value on which to measure the tax, just as it makes sense to treat the mixer trucks as a single integrated piece of

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[12] Respondent also contends appellant's purchase of the truck chassis portion of the mixer trucks from a supplier of transportation vehicles and the mixer barrel from another supplier illustrates the dual-purpose aspect of the trucks. We query whether or not under this approach the standard mixer trucks would qualify for the MIC, since they too would be purchased from a supplier of transportation vehicles. We need not answer this question, however, because we find no reason to determine classification under the MIC according to where or from whom an asset is purchased.

[13] Former IRC section 4063 imposed a transportation excise tax under former IRC section 4061 applicable to the truck chassis but not to cement mixer barrels and the accompanying components.

manufacturing equipment for purposes of the MIC when the transportation activity of the trucks is contemplated within the manufacturing activity.

In conclusion, we find that a ready mixed concrete mixer truck, comprised of a truck chassis and mixer barrel (including the accompanying components and hydraulic system), constitutes a single integrated piece of manufacturing equipment, and thus the truck satisfies the requirements of qualified property for purposes of the MIC.

O R D E R

Pursuant to the views expressed in the opinion of the Board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED, pursuant to section 19333 of the Revenue and Taxation Code, that the action of the Franchise Tax Board in denying the claim of Jon and Rita Minnis for refund of personal income tax in the amount of $1.00 or more for the years 1995 and 1996, and in denying the claim of Milpitas Materials Company for refund of franchise tax in the amount of $1.00 or more for the year ended December 31, 1995, based on the Franchise Tax Board's refusal to treat appellant's ready mixed concrete mixer trucks, comprised of both truck chassis and mixer barrels, as qualified property, be and the same is hereby reversed.

Done at Sacramento, California, this 20th day of June, 2002, by the State Board of Equalization, with Board Members Mr. Chiang, Mr. Klehs, Mr. Parrish, and Ms. Marcy Jo Mandel* present, Mr. Andal not participating.

Mr. John Chiang, Chairman

Mr. Johan Klehs, Member

_____, Member

Mr. Claude Parrish, Member

*Ms. Marcy Jo Mandel, Member

*For Kathleen Connell per Government Code section 7.9.