

1 CALIFORNIA STATE BOARD OF EQUALIZATION

2 APPEALS DIVISION BOARD HEARING SUMMARY

3 In the Matter of the Petition for Redetermination)
 4 Under the Sales and Use Tax Law of:)
 5 R & G SCHATZ FARMS, INC., dba Peltier Station) Account Number SR KH 100-768733
 Case ID's 547724, 588579, 592624
 6 Petitioner) Acampo, San Joaquin County

7 Type of Business: Wine retailer

8 Liability periods: 07/01/05 – 06/30/06 (Case ID 592624)
 9 07/01/06 – 06/30/07 (Case ID 547724)
 10 07/01/07 – 06/30/09 (Case ID 588579)

11 <u>Item</u>	12 <u>Disputed Amount</u>					
	13 <u>592624</u>		14 <u>547724</u>		15 <u>588579</u>	
	<u>Tax</u>	<u>Penalty</u>	<u>Tax</u>	<u>Tax</u>	<u>Penalty</u>	
16 Disallowed partial exemption for purchases of farm equipment						
17 As determined	<u>\$7,841.31</u>	<u>\$784.13</u>	<u>\$23,309.21</u>	<u>\$10,555.65</u>	<u>\$1,055.58</u>	
18 Pre-D&R adjustment			<u>3,492.72</u>			
19 Post-D&R adjustment		<u>- 784.13</u>			<u>-1,055.58</u>	
20 Proposed redetermination, protested	<u>\$7,841.31</u>	<u>00.00</u>	<u>\$26,801.93</u>	<u>\$10,555.65</u>	<u>00.00</u>	
21 Proposed tax redetermination	\$ 7,841.31		\$26,801.93	\$10,555.65		
22 Interest through 04/30/14	<u>4,835.40</u>		<u>13,691.18</u>	<u>3,307.19</u>		
23 Total tax and interest	<u>\$12,676.71</u>		<u>\$40,493.11</u>	<u>\$13,862.84</u>		
24 Payments				- 1.01		
25 Balance Due				<u>\$13,861.83</u>		
26 Monthly interest beginning 05/01/14	<u>\$ 39.21</u>		<u>\$ 134.01</u>	<u>\$ 52.77</u>		

27 This matter was scheduled for Board hearing in May 2013, but was postponed for settlement
 28 consideration. It was rescheduled in January 2014 but was postponed at petitioner's request to allow
 additional time to prepare.

UNRESOLVED ISSUES

29 **Issue 1:** Whether the Notice of Determination (NOD) was timely issued for the period July 1,
 30 2005, through June 30, 2006. We find that the NOD was timely issued.

1 Petitioner operates a farm in Acampo, California, selling grapes for wine, bulk must (freshly
2 pressed fruit juice that contains the skins, seeds, and stems of the fruit), bulk juice, and bulk wine. The
3 Sales and Use Tax Department (Department) issued a seller's permit to petitioner in 2001 after
4 receiving a seller's permit application from Beer and Wine Services. At that time, petitioner's sales
5 consisted entirely of grapes, bulk juice, must, and bulk wine to wineries. Although petitioner did file
6 sales and use tax returns under this permit, it reported zero sales on all of those returns, rather than
7 reporting its total sales and claiming deductions for its sales for resale of wine to wineries. Therefore,
8 the seller's permit was closed effective December 31, 2003, based on the Department's determination
9 that petitioner was not actively engaged in or conducting a business as a seller of tangible personal
10 property. Petitioner then applied for another seller's permit in June 2006. That seller's permit was
11 issued with an effective date of July 1, 2006, although the Department changed the effective start date
12 to July 1, 2005 when it found that petitioner had purchased a grape press machine in July 2005. As
13 more fully explained under Issue 3, the Department concluded that petitioner owed tax because it
14 improperly issued a partial exemption certificate to the seller of the grape press, and the Department
15 issued an NOD on May 12, 2011, for the period July 1, 2005, through June 30, 2006.

16 Petitioner argues that the May 12, 2011 NOD was not timely issued because it was not issued
17 within the three-year statute of limitations set forth in Revenue and Taxation Code section 6487,
18 subdivision (b). While petitioner acknowledges it did not file returns for this period, it argues that the
19 eight-year statute of limitations does not apply because it was not required to file returns for periods
20 before July 1, 2006 since it did not hold a seller's permit. Alternatively, petitioner argues that, even if
21 it was required to file a return to report tax related to the purchase of the grape press, the eight-year
22 statute of limitations should not apply because petitioner had no reason to believe it should have been
23 filing returns, since the Department had closed the seller's permit petitioner previously held.

24 There is no dispute that petitioner did not file any returns for the period July 1, 2005, through
25 June 30, 2006. Consequently, an NOD issued for the period would have been timely if filed by July
26 31, 2014 (eight years after July 31, 2006). (Rev. & Tax. Code, § 6487, subd. (b).) The NOD, issued
27 well within that time period, was timely. It is immaterial whether petitioner was required to hold a
28 seller's permit, was required to file a return, or had knowledge that it was required to file a return.

1 **Issue 2:** Whether the Department properly asserted an increase to the tax liability for the period
2 July 1, 2006, through June 30, 2007. We find that it did.

3 Prior to completing its audit, the Department issued a timely NOD for the period July 1, 2006,
4 through June 30, 2007, based on estimated disallowed partial farm equipment exemptions of \$443,985.
5 After completing the audit, the Department asserted an increase in tax based on additional disallowed
6 partial farm equipment exemptions identified in the audit.

7 Petitioner argues that the Department failed to properly assert an increase to the tax due for this
8 period. Although petitioner's argument is not entirely clear, it appears that petitioner may have
9 misunderstood a comment in a letter from the Department dated November 23, 2010. In any event,
10 regardless of the source of confusion, the Department's December 6, 2011 letter asserting an increase
11 in this liability was timely issued because it was issued before a Board hearing on this matter and
12 within three years of the July 28, 2010 NOD to which it relates.

13 **Issue 3:** Whether adjustments are warranted to the disallowed partial farm equipment
14 exemptions. We find no adjustment is warranted.

15 The Department examined petitioner's purchase records on an actual basis and determined that
16 petitioner issued partial exemption certificates to vendors with respect to purchases of farm-related
17 equipment and then did not use the equipment primarily in producing and harvesting agricultural
18 products. Accordingly, the Department disallowed the partial exemption for these purchases and
19 issued NOD's for the amounts of the partial exemptions from tax.

20 Petitioner does not dispute the measures established by the Department for the disallowed
21 partial exemptions. Instead, petitioner argues that it properly issued partial exemption certificates to its
22 vendors for these purchases because it used the equipment to manufacture wine, which petitioner
23 argues is a qualifying use under Revenue and Taxation Code section 6356.5 and California Code of
24 Regulations, title 18, section (Regulation) 1533.1, subdivision (b)(5). Petitioner likens its use of the
25 machinery to sun drying or artificially dehydrating fruits and vegetables, performed by a qualified
26 person, which is defined as a qualifying use by Regulations 1533.1. Petitioner asserts that it used all
27 the equipment at issue to convert the grapes it grew on its farm into wine, and that it only converted the
28 grapes into wine so that the grapes would not rot on the ground. On that basis, petitioner claims that

1 this practice is tantamount to using crop drying equipment to convert grapes into raisins, and therefore
2 its use was a qualifying use. Petitioner also notes that petitioner's vendors accepted the exemption
3 certificates in good faith, which petitioner argues is evidence that the vendors believed the purchases
4 met the requirements for the partial exemption.

5 There is no dispute that petitioner is a qualified person as defined by Regulation 1533.1,
6 subdivision (b)(6), and that the equipment at issue is qualifying farm equipment and machinery as
7 defined by Regulation 1533.1, subdivision (b)(1). The sole issue in dispute is whether petitioner used
8 the equipment primarily in producing and harvesting agricultural products. It is undisputed that
9 petitioner used the equipment at issue only to process the grapes it grew on its farms into wine.
10 Regulation 1533.1, subdivision (b)(5), explicitly states that, with certain exceptions not relevant here,
11 producing and harvesting activities do not include post-harvesting activities, which include the
12 manufacture of wine, brandy, and brandy spirits. Thus, we find wine manufacturing is not a qualified
13 activity as defined by Regulation 1533.1, subdivision (b)(5), and, since petitioner used the equipment
14 at issue only to manufacture wine, its use of the equipment is not a qualified use. Thus, the partial
15 exemptions were properly disallowed. We reject petitioner's assertion that its activities fell within the
16 exception for sun drying or fruit dehydrating because petitioner used the equipment to extract juice
17 from grapes and allow the juice to ferment into wine; it did not sun dry or dehydrate the fruit. We also
18 are not persuaded that petitioner converted the grapes into wine only to prevent mold. As for
19 petitioner's argument that its vendors and lender believed that petitioner's purchases qualified for the
20 partial farm equipment exemption, the views of third parties are irrelevant to the question of whether
21 petitioner actually used the equipment in a qualifying manner. Accordingly, we find no adjustment is
22 warranted to the disallowed claimed partial exemptions.

23 **RESOLVED ISSUE**

24 Since petitioner did not file returns for the periods July 1, 2005, through June 30, 2006, and
25 July 1, 2007, through June 30, 2009, the NOD's for those periods included penalties for failure to file
26 returns. At the appeals conference, the Department recommended relief of the failure-to-file penalty
27 imposed for the period July 1, 2007, through June 30, 2009, because petitioner did file returns for that
28 period, although the returns were filed late. We concur. Also, we find that petitioner's failure to file a

1 return for the period July 1, 2005, through June 30, 2006, was the result of petitioner's mistaken belief
2 that its July 18, 2005 purchase and subsequent use of the grape press machine qualified for the partial
3 farm equipment exemption. Thus, we find petitioner's failure to file a return for the year ending
4 June 30, 2006, was due to reasonable cause, and we recommend relief of the penalty for that period as
5 well.

6 **OTHER MATTERS**

7 None.

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9 Summary prepared by Deborah A. Cumins, Business Taxes Specialist III

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