STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

CALIFORNIA STATE BOARD OF EQUALIZATION

APPEALS DIVISION BOARD HEARING SUMMARY

In the Matter of the Claims for Refund Under the Sales and Use Tax Law of: NEW NGC, INC., fka National Gypsum Company[1] Claimant	Account Number SR Z OHB 99-309892 Case ID's 485164, 547426 Charlotte, North Carolina

Type of Business: Manufacturer of building products

Claim periods: 04/01/05 – 03/31/08 (Case ID 485164)
10/07/07 – 12/31/08 (Case ID 547426)

Item	Claimed Refund
Claimed overpayments of tax and tax reimbursement[2] paid with respect to purchases of specific products	$227,599 (Case ID 485164)[3] $114,451 (Case ID 547426)

Claimant filed two claims for refund of alleged overpayments of use tax and of sales tax reimbursement paid to vendors related to purchases of specific materials. Claimant asserts that those purchases are not subject to tax because the materials are not used primarily in the manufacturing process but instead are incorporated into the manufactured property sold by claimant.

This matter was scheduled for Board hearing in December 2015, but was postponed at claimant's request due to a scheduling conflict.

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[1] Since the D&R was issued, claimant's name has been changed to New NGC, Inc.

[2] Claimant contends that it erroneously paid sales tax reimbursement to vendors with respect to some of the purchases of the materials at issue. The implication is that claimant is requesting a refund of such sales tax reimbursement. We note that a claim for refund must be filed by the person that actually paid the tax to the Board. Thus, claimant may not claim a refund of sales tax reimbursement that it paid to vendors (each vendor would be required to file a claim for refund of overpaid tax). However, if claimant's arguments were to succeed on the merits, claimant would be entitled to a deduction for tax paid on purchases that were later resold. (See Cal. Code of Regs., tit. 18, § 1701.) The distinction between a claim for refund of sales tax reimbursement and a deduction for tax-paid purchases resold does not alter our analysis of the merits of the claims for refund. Further, claimant does not specify, and we do not know, the portion of the claimed overpayment that represents sales tax reimbursement and the amount that represents use tax paid directly to the Board by claimant. Accordingly, throughout the summary, we will describe our analysis of whether the transactions at issue are subject to tax, and we will not refer to the terms use tax, tax reimbursement, or tax-paid purchases resold.

[3] The first claim for refund (Case ID 485164) was filed for a total overpayment of $276,623, and the second claim for refund (Case ID 547426) was filed for a total overpayment of $120,767. In addition to the claimed overpayments of tax on purchases of certain materials, the claims also asserted that claimant had made duplicate tax payments. The Sales and Use Tax Department found that claimant had made duplicate payments, with a total overpayment of $55,340.12, which occurred during both periods. A refund of $66,930.29 ($55,340.12 tax and $11,590.17 interest) was issued May 30, 2012, and the remaining amount in dispute is $342,060 ($397,400 - $55,340.12 = $342,059.88). The remaining amounts in dispute are $227,599 for Case ID 485164 and $114,451 for Case ID 547426. These corrected amounts were provided by claimant's representative on January 5, 2016.

Issue: Whether there is any overpayment of tax with respect to claimant's purchases of five specific materials, which it alleges were physically incorporated into its manufactured product. We find that the transactions at issue were subject to tax and that there is no overpayment.

Claimant is a manufacturer of fully integrated building products, including gypsum wallboards. Claimant has two locations in California, one plant that produces wallboard and another plant that produces wallboard and interior finishing products.

Claimant has filed two claims for refund of tax related to its purchases of five specific materials (naphthalene sulfonate, tartaric acid, potassium sulfate, alcohol ethoxy sulfate, and Versenex). With respect to those purchases, claimant either paid sales tax reimbursement to its vendors or paid use tax directly to the Board. Claimant now contends that its purchases of those five materials were not subject to tax because the materials were physically incorporated into a manufactured article (wallboard). According to claimant, in order to produce a quality wallboard, it adds the raw materials at issue and that those materials, which remain in the wallboard, are part of the board core and play a key role in giving finished wallboard various desired qualities.

The Sales and Use Tax Department (Department) has reviewed the claims and the supporting documentation, and it concludes that the materials were purchased for use in the manufacturing process. Consequently, the Department finds that tax applies to claimant's purchase and use of the materials because claimant has consumed the materials in the manufacturing process. Thus, the Department recommends that the claims for refund be denied.

Claimant explains that a gypsum wallboard is a panel made of gypsum plaster pressed between two thick sheets of paper. The process of making gypsum wallboard involves a dynamic stucco hydration process. Gypsum is formed when water reacts with stucco. According to claimant, the key elements to producing quality wallboards are the complete hydration of stucco to gypsum, modifying and controlling crystal morphology, and board core structure. Claimant has explained the benefits to the quality of gypsum that are provided by each of the five materials at issue, with specific details and descriptions presented by its principal scientist, Dr. Gopal Sethuraman.

We will briefly summarize the use of each of the materials, as described by claimant. Naphthalene sulfonate, is added as a raw material to disperse solid particles to maintain a

homogeneous slurry and to enable the stucco to hydrate completely prior to the drying process. It also improves the wetting property of paper that helps the paper-to-core bond. Tartaric acid is added as an ingredient to the slurry and subsequently chemisorbs to the crystal surface. Potassium sulfate (potash) is added to increase the super saturation of the slurry mix. Alcohol ethoxy sulfate is a foaming agent, which claimant uses to make a lower weight wallboard. Versenex is a chelating agent that complexes or bonds with positively charged metal ions to form a stable complex or molecule. Thus, according to Dr. Sethuraman's testimony, each of the five materials is used in the manufacturing process. In addition, it is undisputed that each material, in some form, remains in the manufactured product.

Tax applies to the sale of tangible personal property (TPP) to persons who purchase it for use in manufacturing, producing or processing an article. (Cal. Code Regs., tit. 18, § 1525, subd. (a).) On the other hand, tax does not apply to sales of TPP to persons who purchase it for the purpose of physically incorporating it into the manufactured article to be sold. (Cal. Code Regs., tit. 18, § 1525, subd. (b).) When TPP is purchased for a dual purpose, both for use in the manufacturing process and for incorporation into the manufactured article to be sold, the purchaser's primary purpose for the raw materials determines the application of tax. (*Kaiser Steel Corp. v. State Bd. of Equalization* (1979) 24 Cal.3d 188, 193.) Therefore, the pertinent inquiry in this matter is whether the materials at issue were purchased for use in manufacturing the wallboard or, alternatively, were purchased for the purpose of being incorporated into the wallboard sold.

Addressing naphthalene sulfonate, claimant used the product during the manufacturing process to disperse the slurry mix and prevent lumping, so that cockles and blisters would not form on the face and back paper of the wallboard. In addition, claimant's incorporation of the naphthalene sulfonate into the wallboard had the effect of increasing the wallboard's dry strength. However, claimant's description indicates that the benefits to the finished wallboard result from the use of the naphthalene sulfonate and its electric repulsion property during the manufacturing process, and that the result of that process enables complete hydration of stucco, improving the wetting property of the paper that helps in the paper-to-core bond, forms a new crystalline structure, and increases the dry strength of the wallboard. Accordingly, the crystalline structure that remains in the finished wallboard is a result of or by-product of the use of the naphthalene sulfonate during the manufacturing process.

Regarding the tartaric acid, claimant used this product during the manufacturing process by adding it as an ingredient to the slurry mix so that it would chemisorb to the gypsum crystal surface during the stucco hydration process, produce a structural modification, and thereby increase the tensile and compressive strength of the gypsum crystals. Also, the incorporation of the tartaric acid into the wallboard during the manufacturing process had the effect of improving its resistance to sagging because the tartaric acid forms an amorphous coating on the surface of the gypsum crystal, and causes the crystals to be needle-shaped, which improves the wallboard's tensile and compressive strength. From claimant's description, we find that the benefits to the finished wallboard result from the use of the tartaric acid during the manufacturing process.

Claimant used the potash during the manufacturing process by adding it as an ingredient to the stucco during hydration, thereby increasing the saturation of the slurry mix and increasing the stucco hydration rate. Claimant's incorporation of the potash into the wallboard had the effect of changing the morphology of the gypsum crystals to help improve moisture resistance and increase the strength of the finished wallboards. Thus, claimant's description indicates that the benefits to the finished wallboard stem from the use of the potash during the manufacturing process, and the result of that process enabled an increase to the super-saturated state of the slurry, an improved nucleation[4] rate and set time, and a resulting wallboard with improved moisture resistance and greater strength.

Claimant used the alcohol ethoxy sulfate during the manufacturing process by adding it to the slurry. Claimant's incorporation of this foaming agent generated bubbles, and, by controlling the volume and density of the foam added to the slurry, claimant was able to decrease the weight of the wallboard and increase its core strength. Thus, the benefits to the finished wallboard result from the use of the alcohol ethoxy sulfate during the manufacturing process, through control over the volume and density of the product added to the slurry.

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[4] "Nucleation" is the initial process that occurs in the formation of a crystal from a solution, a liquid, or a vapor, in which a small number of ions, atoms, or molecules become arranged in a pattern characteristic of a crystalline solid, forming a site upon which additional particles are deposited as the crystal grows. (http://www.britannica.com/EBchecked/topic/421892/nucleation.)

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

Claimant used the Versenex during the manufacturing process as a chelating agent to bond with calcium, which helped reduce lump formation by controlling the rate of nucleation without affecting the stucco hydration rate. Claimant's incorporation of the Versenex as an ingredient had the effect of improving the wallboard's core strength because it modified the crystal morphology of the gypsum, which improved the paper-to-core bond of the finished wallboard and prevented cockles and blisters from appearing on the finished wallboard. Hence, claimant's description indicates that the benefits to the finished wallboard resulted from the use of the Versenex during the manufacturing process.

Although each of these five materials remain in the finished wallboard in some form, there is no evidence that any of the materials is an essential ingredient in the finished wallboard. Instead, the evidence establishes that the benefit from the use of each material occurs as a result of its use in the manufacturing process and not in its remaining presence in the finished wallboard. Accordingly, we find that petitioner has used the materials at issue, that its consumption of the TPP is subject to tax, and that there is no overpayment of tax. We are not persuaded otherwise by various annotations cited by claimant, which we find to be distinguishable from the facts of this case. In addition, we reject claimant's assertion in its Request for Reconsideration that we have relied on sources that are not pertinent or that we have disregarded the presentation of claimant's expert, Dr. Sethuraman. In fact, we have used the information provided by Dr. Sethuraman to describe claimant's use of each of the materials at issue. Based on the information he provided, we have concluded that claimant's primary purpose for its purchase of each of the materials was for use in the manufacturing process. The question to be answered with respect to each material is whether the material itself is an essential ingredient in the finished wallboard or whether the material itself provided a benefit as a result of its presence in the finished wallboard. We find there is no evidence that the presence of the materials at issue provided a benefit in the finished wallboard or that the primary purpose for claimant's purchase of the materials was for incorporation into the finished product.

OTHER MATTERS

The disputed portions of the claims for refund in this matter consist of alleged overpaid use tax and (essentially) alleged unclaimed tax-paid purchases resold (TPPR) deductions (see Cal. Code Regs., tit. 18, § 1701, subd. (a)). From abundant caution we note that any deduction from a sales or use tax

STATE BOARD OF EQUALIZATION
SALES AND USE TAX APPEAL

liability is limited to the amount of the reported liability. In other words, a deduction cannot exceed the reported liability and will not result in a refund. (See, for illustration, Business Taxes Law Guide annotation 545.0070 (2/2/1982).) Here we note that the vast majority of claimant's sales during the periods at issue appear to be sales for resale, and its reported sales and use tax liability is comparatively low in relation to claimant's total sales. Therefore, if claimant prevails on the merits of this appeal, it will receive a refund of use tax paid to the Board or to permitized out-of-state vendors during the applicable periods, but there may be very little remaining liability from which to deduct claimant's TPPR deductions. As noted above in footnote 2, we are unable to ascertain either the portion of the claimed overpayments that represents TPPR deductions, or the portion that represents use tax paid directly to the Board (or to permitized out-of-state vendors). Accordingly, if claimant prevails on the merits of this appeal, we recommend a reaudit to allow the Department to verify and refund the amount of any overpaid use tax, and to compute and verify the amount of any allowable TPPR deductions, limited by the amount of any tax liability that remains after the refund of use tax.

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