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9 **BOARD OF EQUALIZATION**
10 **STATE OF CALIFORNIA**

12 In the Matter of the Appeals of:

) **REHEARING SUMMARY**

) **PERSONAL INCOME TAX AND**
) **CORPORATION FRANCHISE TAX**
) **APPEALS**

14 **GRANITE ROCK COMPANY¹ AND**

15 **BRUCE W. WOOLPERT AND**

) Case Nos. 420038; 420171; 420181; 420187;
) 420219; 420221; 420222; 420223

16 **ROSE ANN WOOLPERT AND**

17 **BRUCE G. WOOLPERT AND**

18 **MARY E. WOOLPERT AND**

19 **ARTHUR WOOLPERT AND**

20 **MARIANNE WOOLPERT AND**

21 **STEPHEN G. WOOLPERT AND**

22 **ELIZABETH M. WOOLPERT AND**

23 **JOSEPH WOOLPERT AND**

24 **MELISSA E. WOOLPERT**

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27 ¹ This is the tax year and claim for refund amount at issue for appellant-Granite Rock Company (hereafter appellant), which
28 claimed the manufacturer's investment credit (MIC) on its amended return. The MIC was claimed on a 2.5 mile conveyor
belt in use at appellant's site in San Benito County, California.

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<u>Year Ended</u>	<u>Claim For Refund</u>
December 31, 1995 ²	\$72,173.00

Representing the Parties:

For Appellant: David Colker, Representative

For Franchise Tax Board: Daniel V. Biedler, Tax Counsel III

QUESTIONS: (1) Whether appellant's mining activity ended at the point at which it stockpiled crushed, unwashed rock in stockpiles for sale to the public, so that the 2.5 mile conveyor belt at issue was used after appellant's asphalt manufacturing began (a qualified activity for purposes of the Manufacturer's Investment Credit (MIC)); or whether the mining activity ended later, at the point at which the crushed and unwashed rock was washed and transported briefly by rail to appellant's hot plant, so that the 2.5 mile conveyor belt was used as part of its mining activity (which is not a qualified activity)?

(2) Assuming appellant's mining activity ended at the point the crushed, unwashed rock was stockpiled for sale to the public, so that the 2.5 mile conveyor belt was used after asphalt manufacturing began, was its undisputed use removing decanted fines (waste) to the embankment area part of the asphalt manufacturing process, and thus eligible for the MIC?

²The shareholder city/counties of residence, tax years, and claim for refund amounts, are listed below.

For the following related shareholder appeals, only tax year 1995 is at issue:

Case ID Number 420181, *Appeal of Bruce G. and Mary E. Woolpert*. These appellant's reside in Watsonville, Monterey County. (\$239,508.)

Case ID Number 420187, *Appeal of Arthur Woolpert*. This appellant resides in Cupertino, Santa Clara County. (\$2,524.)

Case ID Number 420219, *Appeal of Marianne Woolpert*. This appellant resides in Cupertino, Santa Clara County. (\$6,047.)

Case ID Number 420222, *Appeal of Joseph Woolpert*. This appellant resides in Carmel Valley, Monterey County. (\$4,542.)

Case ID Number 420223, *Appeal of Melissa E. Woolpert*. This appellant resides in Carmel Valley, Monterey County. (\$5,243.)

For the following related shareholders' appeal, tax years 1995 and 1996 are at issue:

Case ID Number 420221, *Appeal of Stephen G. Woolpert and Elizabeth M. Woolpert*, for the years 1995 and 1996.

These appellant's reside in Carmel Valley, Monterey County. (\$302,025.)

For the following related shareholders' appeal, tax years 1995, 1996, and 1997 are at issue:

Case ID Number 420171, *Appeal of Bruce W. Woolpert and Rose Ann Woolpert*. These appellant's reside in Cupertino, Santa Clara County. (\$330,349.)

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1 (3) Whether the claims for refund include costs incurred before the
2 January 1, 1994, effective date of the MIC?

3 Background

4 On November 13, 2008, the Board held an oral hearing in the above appeals and
5 determined that appellant had not shown that it was entitled to the claimed MIC on a 2.5 mile long
6 conveyor belt purchased in 1995 and operating on appellant-Granite Rock Company's Wilson-Aromas
7 Quarry site (hereafter "appellant" and "site," respectively).

8 Appellants then filed a petition for rehearing pursuant to section 19048 of the Revenue
9 and Taxation Code (R&TC), which the Board granted on May 27, 2009. The original hearing summary
10 is incorporated herein with respect to the procedural details of appellants' claims for refunds and
11 respondent's denial of those claims. (The first issue in the original oral hearing, jurisdiction, is no
12 longer in dispute.) Following the briefing in preparation for the rehearing, the Appeals Division
13 requested that the parties participate in a pre-hearing conference pursuant to California Code of
14 Regulations, title 18, section (Regulation) 5443, to clarify the placement and use of the 2.5 mile
15 conveyor belt at the site, as well as to narrow the questions of law raised by appellants' factual
16 assertions with respect to the use of the conveyor belt. Appellant's activities on the site occur in the
17 following order:

- 18 1. Rock extraction (by explosives);
- 19 2. Crushing of large rock;
- 20 3. Movement by conveyor belt (not the belt at issue) to the secondary crushing plant
21 (crushing to smaller rock);
- 22 4. Stockpiling of crushed unwashed rock for sale to the public (in various sizes).

23 Appellant's records indicate 12% of the crushed unwashed rock was used in the
24 taxable year to then manufacture asphalt, leaving 88% of the crushed unwashed rock
25 for sale to the public;

- 26 5. Wash plant; receiving the crushed rock into the plant for washing (removal of
27 decanted fines) to achieve an adhesive state according to industry and government
28 standards for asphalt manufacture;

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- 1 6. After cleaning, the crushed, washed rock is then loaded onto railroad cars for a short
- 2 trip (at the same site) to the Hot Plants (asphalt manufacture).
- 3 7. Simultaneous with the washing (step five), waste water is removed to the dewatering
- 4 plant, which separates the water from the “decanted fines”, a.k.a. “applesauce”,
- 5 looking like greenish/gray sludge;
- 6 8. Decanted fines are moved into the “yard” (near the dewatering plant) by front loader
- 7 (the yard fills up daily during washing); then removed from the yard by truck,
- 8 continuously during washing, and placed in drying fields;
- 9 9. Decanted fines are again moved by truck from the drying fields and loaded onto the
- 10 2.5 mile conveyor belt in a mixture of decanted fines and overburden to facilitate
- 11 drying and movement;
- 12 10. A 2.5 mile conveyor belt ride to the embankment area, where (drier) decanted fines
- 13 are deposited onto the embankment area.

14 Following the pre-hearing conference the parties agreed to the following facts:

- 15 1) By 1995, the placement of overburden on the conveyor belt was not done in
- 16 furtherance of appellant’s mining activity; rather, the overburden was used as
- 17 a drying agent to move decanted fines to the embankment area.³
- 18 2) Appellant is not engaged (respondent agrees appellant is not “primarily”
- 19 engaged) in operating sand and gravel pits or dredges (Standard Industrial
- 20 Classification or “SIC” code section 1442) at the site. This is significant in
- 21 that SIC code section 1442, sand and gravel pits or dredges, includes
- 22 “washing” in its description. Respondent qualifies its agreement by alleging
- 23 that appellant washes and screens granite, but otherwise agrees that the
- 24

25
26 ³ Appellants’ description of the mining process in their Appeal Letter may have lead to the understanding at the first oral
27 hearing that the removal of overburden was part of the mining process, a fact that the parties now agree does not apply to the
28 tax year at issue. Specifically, based on the type of mining (going deeper into the earth as opposed to mining a wider area),
overburden was no longer removed in 1995 primarily as part of the mining process. As such, the parties agree that the
placement of overburden on the conveyor belt does not mean that the conveyer belt was used primarily in appellant’s mining
activity.

1 activities described in SIC code section 1442 do not occur at the site.⁴

- 2 3) The removal of decanted fines on the conveyor belt at issue is a natural and
3 necessary step to remove waste from the wash area. Absent the removal of
4 the decanted fines, appellant's washing activity would stop.
- 5 4) The decanted fines waste is continually generated during the specialized
6 washing process that occurs at the site.
- 7 5) The specialized washing that occurs at the site removes fine particles from the
8 aggregate so that the aggregate meets the specific federal, state and industry
9 specifications for binding/adhesion required in the manufacture of hot mix
10 asphalt and ready-mix concrete.

11 There are two main areas of disagreement remaining in this appeal following the
12 prehearing conference. First, the parties do not agree at which point appellant's mining activity ends
13 and the asphalt manufacturing begins, so as to ascertain with which activity the 2.5 mile conveyor belt is
14 associated. Looking to the list of appellant's activities, above, appellants' contend that the mining
15 activity ends at step four, whereas respondent contends that the mining activity ends at step six. Second,
16 assuming the mining activity ceases at the point at which the crushed unwashed rock is stockpiled for
17 sale to the public (so that the conveyor belt is associated with the asphalt manufacturing activity), the
18 parties do not agree whether the conveyor belt is part of the asphalt manufacturing process (and thus
19 qualifies for the MIC), or mere waste removal.

20 Issue 1-Where does appellant's mining process end?

21 *Contentions*

22 *Appellants*

23 Appellants contend that the mining process at the site ends at the point appellant has
24 placed extracted and crushed, unwashed rock into stockpiles of various sizes for sale to the public.

25 _____

26 ⁴ Following the prehearing conference respondent initially agreed that appellant was not engaged in operating sand and gravel
27 pits or dredges (with the qualifications noted above); however, this agreement was not reflected in the stipulation filed with
28 the Board Proceedings Division on February 10, 2010. Respondent may wish to clarify its position with respect to whether it
believes appellant is engaged in operating sand and gravel pits or dredges (so that washing is part of appellant's mining
process) at the oral hearing.

1 Appellants contend that washing is not part of this type of mining (hard rock mining), and the SIC codes
2 for hard rock mining reflect this in that they do not include “washing” in their description. The
3 unwashed, crushed rock is relatively clean and can be (and is) sold in its unwashed form. In contrast,
4 sand and gravel mining produces a much dirtier product (containing dirt and roots) that has to be washed
5 in order to be saleable. Thus, appellants contend, the SIC codes for sand and gravel mining include
6 “washing” (whereas the SIC code for gabbro⁵ mining does not.) Appellants further contend that the
7 asphalt manufacturing process begins at the point at which inputs are entered into the manufacturing
8 process; i.e., unwashed aggregates (crushed rock) are removed from stockpiles, received into the wash
9 plant, and washed as required for asphalt production. Accordingly, appellant’s activities from the point
10 the unwashed rock is received into the wash plant and forward (including the use of the 2.5 mile
11 conveyor belt), are part of asphalt manufacturing, a qualified activity.

12 *Respondent*

13 Respondent appears to contend that the mining process is not completed until after the
14 washing of the crushed rock and transportation to the “hot plants”, so that the use of the 2.5 mile
15 conveyor belt is part of the mining process, not a qualified activity for purposes of the MIC.
16 Specifically, respondent contends that: “appellant’s mining activity includes all ‘milling’ or
17 ‘beneficiating’ of granite.” Respondent contends that “beneficiating” of granite means “washing” of
18 granite, noting that the 2001 publication from the Geological Society of Engineering, Geology Special
19 Publication Number 17, called “Aggregates, Sand and Gravel, and Crushed Rock Aggregates for
20 Construction Purposes”, describes beneficiating in detail as including “washing and screening.”
21 Respondent also refers to the descriptions of “beneficiating” in the introduction to the SIC’s Division B
22 (mining) and the North American Industry Classification System (NAICS) Sector 21, which talk
23 generally about mining and discuss washing. Respondent acknowledges that the SIC and NAICS
24 sections describing “crushed and broken granite mining in quarrying” further describe beneficiating as
25 solely “grinding and pulverizing” (not washing), but nevertheless applies the description of beneficiating
26

27
28 ⁵ Appellant’s clarified at the prehearing conference that the type of rock mined is specifically identified as “gabbro,” so that
SIC code section 1429 is the correct applicable SIC code section to appellant’s mining activity. The SIC code sections for
1423 (granite) and 1429 (gabbro) are otherwise substantially similar.

1 as described in Special Publication Number 17 with respect to “Aggregates, Sand and Gravel, and
2 Crushed Rock Aggregates for Construction Purposes,” and the Division B and Sector 21 introductions’
3 references to washing, to appellant’s hard rock mining. Respondent also contends that “[j]ust as
4 significantly, the washing of aggregate for use in asphaltic and Portland cement concrete occurs before
5 the beginning, and therefore outside, of the process for manufacturing of those products” and finds no
6 support for the position that asphalt manufacture includes the washing of aggregate. Respondent notes
7 that it does not appear that other asphalt plants wash crushed rock.

8 Respondent further notes that the Environmental Protection Agency (EPA) lists
9 appellant’s site under the following SIC code sections:

- 10 - 1423 (Crushed and Broken Granite),
- 11 - 1442 (Construction Sand and Gravel),
- 12 - 2951 (Asphalt Paving Mixtures and Blocks) and
- 13 - 3295 (Minerals and Earths, Ground or Otherwise Treated)

14 as well as NAICS sections:

- 15 - 212321 (Construction Sand and Gravel Mining),
- 16 - 212399 (All Other Nonmetallic Mineral Mining) and
- 17 - 212313 (Crushed and Broken Granite Mining and Quarrying)

18 Respondent initially agreed that appellant is not “primarily” engaged in construction sand and gravel
19 mining (SIC code section 1442 and NAICS section 212321, which describe washing as part of the
20 mining process) (and should further clarify if that is still its position), but contends that the washing that
21 appellant does at the wash plant is part of the mining process. In this regard, at the prehearing
22 conference, the Appeals Division requested that respondent address the fact that, according to
23 appellant’s records, for 1995, 12% of the crushed unwashed rock was sent to the wash plant for asphalt
24 manufacturing, whereas 88% of the crushed unwashed rock apparently remained in stockpiles for sale to
25 the public, seeming to indicate that the mining process was complete. Respondent contends that, to the
26 contrary, the washing is another step in beneficiating (mining), regardless of the interim sale of
27 unwashed, crushed rock to the public.

28 *Appellant’s Response*

In response, appellants contend that respondent is straining to add a washing activity to
hard rock mining when such activity is not stated in the applicable SIC code (1429). Appellants add that

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1 the writers of the SIC knew very well the types of mining activities that included washing and stated
2 “washing” in those SIC codes (i.e., construction sand and gravel mining, 1442). In addition, the
3 processing of the unwashed aggregate is the first step in a separate activity (manufacturing asphalt).

4 *Applicable Law*

5 The MIC provides an income tax credit to any qualified taxpayer for specified qualified
6 costs paid or incurred on or after January 1, 1994, for qualified property placed into service in this
7 state. (Rev. & Tax. Code, § 23649, subd. (a)(1); Cal. Code Regs., tit. 18, § 23649-1, subd. (a).) The
8 Board has held that the MIC should be interpreted liberally in favor of taxpayers (see *Appeal of Save*
9 *Mart Supermarkets & Subsidiary (Save Mart)* 02-SBE-002, Feb. 6, 2002; *Appeal of California Steel*
10 *Industries, Inc.* 2003-SBE-001A, July 9, 2003), and that California Code of Regulations, title 18, section
11 (Regulation) 23649-3 (“qualified taxpayer”) was invalid under the MIC statute insofar as it incorporated
12 the entire SIC Manual “establishment” classification system, whereas the Legislature only incorporated
13 specific SIC Codes. (*Appeal of Save Mart Supermarkets & Subsidiary, supra.*) Accordingly, the Board
14 in *Save Mart* granted a MIC claim for refund because the taxpayer, supermarkets with an on-site bakery
15 and meat department, were indisputably engaged in, and described in, a statutorily identified SIC Code
16 (2051, bakery and meat products), even though due to the retail nature of the supermarkets, under the
17 SIC Manual “establishment” classification system, the taxpayer would be treated as non-manufacturing.
18 Because R&TC section 23649 referenced specific SIC codes but not the SIC Manual, the Board found
19 that an activity described in a particular SIC Code was enough to qualify a taxpayer for the MIC,
20 regardless of whether the unincorporated SIC Manual would have treated the activity as manufacturing.

21 R&TC Section 23649, subdivision (d), defines “qualified property” as follows:

22 “(1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue
23 Code for use by a qualified taxpayer in those lines of business described in Codes 2011 to
24 3999, inclusive, of the Standard Industrial Classification (SIC) Manual published by the
United States Office of Management and Budget, 1987 edition, that is primarily used for
any of the following:

- 25 (A) For the manufacturing, processing, refining, fabricating or recycling of property,
26 beginning at the point at which any raw materials are received by the qualified taxpayer
and introduced into the process and ending at the point at which the manufacturing,
27 processing, refining, fabricating, or recycling has altered tangible personal property to its
completed form, including packaging, if required . . .”(Emphasis added).

28 Regulation 23649-2(e) provides that “manufacturing” means:

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1 . . . the process of converting or conditioning property by changing the form composition,
2 quality, or character of the property for ultimate sale at retail or for use in the
manufacturing of a product to be ultimately sold at retail . . . ”

3 Further, “process” is defined by Regulation 23649-2(l) as follows:

4 “The term "process" shall mean the period beginning at the point at which any raw
5 materials are received by the qualified taxpayer and introduced into the manufacturing,
6 processing, refining, fabricating, or recycling activity of the qualified taxpayer and
7 ending at the point at which the manufacturing, processing, refining, fabricating, or
8 recycling activity of the qualified taxpayer has altered tangible personal property to its
9 completed form, including packaging, if required. Raw materials will be considered to
10 have been introduced into the process when the raw materials are stored on the same
11 premises where the qualified taxpayer's manufacturing, processing, refining, fabricating,
12 or recycling activity is conducted . . .” (Emphasis added.)

13 In addition, “processing” is defined in Regulation 2364902, subdivision (m), as meaning:

14 “. . . the process of physically applying the materials and labor necessary to modify or
15 change the characteristics of property.”

16 The Standard Industrial Classification (SIC) system was replaced by the North American
17 Industry Classification System (NAICS) starting in 1997. The classifications (with respect to mining)
18 are substantially similar (with the NAICS sections providing more detail). The SIC codes at issue in this
19 appeal, including their industry group, are as follows:

20 **1423 Crushed and Broken Granite** (Division B, Mining; Industry Group 142: Crushed And Broken
21 Stone, Including Riprap)

22 Establishments primarily engaged in mining or quarrying crushed and broken granite, including related
23 rocks, such as gneiss, syenite, and diorite.

- 24 • Diorite, crushed and broken-quarrying
- 25 • Gneiss, crushed and broken-quarrying
- 26 • Granite, crushed and broken-quarrying
- 27 • Syenite, except nepheline: crushed and broken-quarrying

28 **1429 Crushed and Broken Stone, Not Elsewhere Classified** (Division B, Mining; Industry Group
142: Crushed And Broken Stone, Including Riprap)

Establishments primarily engaged in mining or quarrying crushed and broken stone, not elsewhere
classified.

- Basalt, crushed and broken-quarrying

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- 1 • Boulder, crushed and broken-quarrying
- 2 • Dolomitic marble, crushed and broken-quarrying
- 3 • Gabbro, crushed and broken-quarrying
- 4 • Ganister, crushed and broken-quarrying
- 5 • Grits mining (crushed stone)
- 6 • Marble, crushed and broken-quarrying
- 7 • Mica schist, crushed and broken-quarrying
- 8 • Onyx marble, crushed and broken-quarrying
- 9 • Quartzite, crushed and broken-quarrying
- 10 • Riprap quarrying, except limestone or granite
- 11 • Sandstone, except bituminous: crushed and broken-quarrying
- 12 • Serpentine, crushed and broken-quarrying
- 13 • Slate, crushed and broken-quarrying
- 14 • Trap rock, crushed and broken-quarrying
- 15 • Verde'antique, crushed and broken-quarrying
- 16 • Volcanic rock, crushed and broken-quarrying

17 **1442 Construction Sand and Gravel** (Division B, Mining; Industry Group 144: Sand And Gravel)

18 Establishments primarily engaged in operating sand and gravel pits and dredges, and in washing,
19 screening, or otherwise preparing sand and gravel for construction uses.

- 20 • Common sand mining
- 21 • Construction sand mining
- 22 • Gravel mining
- 23 • Pebble mining

24 **2951 Asphalt Paving Mixtures and Blocks** (Division D; Industry Group 295: Asphalt Paving And
25 Roofing Materials)

26 Establishments primarily engaged in manufacturing asphalt and tar paving mixtures; and paving blocks
27 made of asphalt and various compositions of asphalt or tar with other materials. Establishments
28 primarily engaged in manufacturing brick, concrete, granite, and stone paving blocks are classified in

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1 Major Group 32.

- 2 • Asphalt and asphaltic mixtures for paving, not made in refineries
- 3 • Asphalt paving blocks, not made in petroleum refineries
- 4 • Asphaltic concrete, not made in petroleum refineries
- 5 • Coal tar paving materials, not made in petroleum refineries
- 6 • Composition blocks for paving
- 7 • Concrete, bituminous
- 8 • Mastic floor composition, hot and cold
- 9 • Road materials, bituminous: not made in petroleum refineries
- 10 • Tar and asphalt mixtures for paving, not made in petroleum refineries

11 The NAICS codes referenced in this appeal are:

12 **21232 Sand, Gravel, Clay, and Ceramic and Refractory Minerals Mining and Quarrying**

13 This industry comprises (1) establishments primarily engaged in developing the mine site and/or mining,
14 quarrying, dredging for sand and gravel, or mining clay, (e.g., china clay, paper clay and slip clay) and
15 (2) preparation plants primarily engaged in beneficiating (e.g., washing, screening, and grinding) sand
16 and gravel, clay, and ceramic and refractory minerals. (Emphasis added.)

17 **212319 Other Crushed and Broken Stone Mining and Quarrying**

18 This U.S. industry comprises: (1) establishments primarily engaged in developing the mine site and/or
19 mining or quarrying crushed and broken stone (except limestone and granite); (2) preparation plants
20 primarily engaged in beneficiating (e.g., grinding and pulverizing) stone (except limestone and granite);
21 and (3) establishments primarily engaged in mining or quarrying bituminous limestone and bituminous
22 sandstone. (Emphasis added.)

23 The introduction to Division D (manufacturing) of the SIC provides that there are also
24 some manufacturing-type activities performed by establishments which are primarily engaged in
25 activities covered by other divisions, and are, thus, not classified as manufacturing. One of those
26 examples is mining; which is described as including:

27 “The dressing and beneficiating of ores; the breaking, washing, and grading of coal; the
28 crushing and breaking of stone; and the crushing, grinding, or otherwise preparing of
sand, gravel, and nonmetallic chemical and fertilizer minerals other than barite are
classified in Mining.”

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2 Likewise the introduction to Division B (Mining) provides that:

3 “This division includes all establishments primarily engaged in mining. The term mining
4 is used in the broad sense to include the extraction of minerals occurring naturally: solids,
5 such as coal and ores; liquids, such as crude petroleum; and gases such as natural gas.
6 The term mining is also used in the broad sense to include quarrying, well operations,
7 milling (e.g., crushing, screening, washing, flotation), and other preparation customarily
8 done at the mine site, or as a part of mining activity.”

9 *Staff Comments*

10 It appears that appellant is engaged in SIC Industry Group 142, Crushed and Broken
11 Stone. Appellants have clarified that section 1429 (substantially similar to 1423) is the correct
12 classification because the rock being mined at the site is gabbro (not granite). These SIC sections do not
13 include washing as a description of this type of hard rock mining. Respondent’s argument appears to be
14 that because washing is a common element in other types of mining, that appellant’s mining process
15 should be considered to include washing that occurs after the aggregate is stockpiled for sale.
16 Respondent notes that the term “beneficiating” is used generally to describe mining and that the term
17 often includes “washing.”

18 “Beneficiating” is defined by Webster’s Revised Unabridged Dictionary, published 1913
19 by C. & G. Merriam Co. as: “(Mining) to reduce (ores).” In the sand and gravel context, NAICS section
20 21232 describes “beneficiating” as washing, screening, grinding; whereas in the hard rock context,
21 NAICS section 212319 describes “beneficiating” as grinding and pulverizing. Thus, the meaning of the
22 term “beneficiating” would not appear to necessarily include washing unless, in the context of the
23 particular mining in question, washing is a step in “reducing the ore.” As appellants note, washing is not
24 a step in hard rock mining; the crushed, unwashed rock is relatively clean and stockpiled for sale without
25 washing. In addition, the SIC section for mining gabbro (1429) does not specify washing. As such, it
26 appears that appellant’s activity mining gabbro may not include washing, so that the mining activity may
27 be found to be concluded prior to the sending of the crushed rock to the wash plant for washing.

28 Likewise, in the introduction to Division B (mining), the SIC manual describes mining
“in the broad sense” to include quarrying, well operations, milling (e.g., crushing, screening, washing,
flotation), and other preparation customarily done at the mine site, or as a part of mining activity. The

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1 parties should address whether this broad description necessarily entails that appellant's mining process
2 includes washing.

3 With respect to when the asphalt manufacturing process begins, the description of asphalt
4 manufacturing in SIC section 2951 gives no indication as to the activities included in asphalt
5 manufacturing. Instead, R&TC section 23649, subdivision (d)(1)(A), describes the point at which
6 manufacturing begins as the point at which any raw materials are received by the qualified taxpayer and
7 introduced into the manufacturing process. Furthermore, raw materials are considered to have been
8 introduced into the process when the raw materials are stored on the same premises where the qualified
9 taxpayer's manufacturing activity is conducted. Thus it appears the Board could find that the asphalt
10 manufacturing activity appellant's conduct at the site began at the point it received the crushed,
11 unwashed rock from its on-site stockpiles into its wash plant (step five, above).

12 Respondent may wish to discuss the relevance of the general descriptions of mining in
13 the SIC Division B introduction and the industry publications it relies on, which generally reference
14 washing, as compared to the specific SIC code applicable to appellant (which appears to be section
15 1429), which does not reference washing. Respondent should also address the more specific NAICS
16 section 212319, which describes mining or quarrying "other" crushed and broken stone and preparation
17 plants primarily engaged in "beneficiating" as including "grinding and pulverizing stone" (not washing).

18 Finally, the parties should be prepared to address whether applying SIC section
19 descriptions from other types of mining, or from the general discussions of mining in the introductions
20 to Division B or NAICS Sector 21, is consistent with the holding in *Save Mart*, where the Board found
21 that the appellant need only demonstrate that it was engaged in an activity described in Codes 2011 to
22 3999 of the SIC Manual in order to qualify for the MIC, and that the MIC should be interpreted liberally
23 in favor of taxpayers.

24 **Question 2: Is the 2.5 mile conveyor belt used in manufacturing?**

25 *Contentions*

26 Appellants contend that the movement of the decanted fines is an integrated part of its
27 asphalt manufacturing activity. Respondent agrees that without the continuous removal process (during
28 washing), that the washing activity would cease. Accordingly, appellants contend the removal process

1 is necessary and integral to the washing done in asphalt manufacturing; further, the removal is not
2 something that occurs after the asphalt manufacturing is completed.

3 Appellants cite the *Appeal of California Steel Industries, Inc.* 2003-SBE-001A, decided
4 July 9, 2003, for the proposition that the Board has previously found that property used to remove
5 wastes created by a manufacturing process qualifies for the MIC. (There, the issue was whether
6 payments to independent contractors for construction of qualified property, a “pickle line,” represented
7 capitalized labor costs directly allocable to the construction of qualified property and thus qualified for
8 the MIC. The pickle line, used in the production of hot rolled steel, removed impurities from the hot
9 rolled coiled steel using a wash and rinse process utilizing an acid solution.)

10 Appellants also provide a letter written to Mr. Woolpert, appellant’s President and CEO,
11 from the California Manufacturers Technology Association (CMTA), regarding this appeal and the issue
12 with respect to whether a conveyor belt used to transport waste generated in a manufacturing process
13 qualifies for the MIC. The Policy Director and Corporate Counsel for that association indicates that the
14 CMTA was involved with the legislative effort to enact the MIC and, in their opinion, the activity of
15 processing waste created in a manufacturing process is part of the manufacturing process itself as such
16 waste processing activities are clearly necessary and integral to the overall manufacturing effort.

17 Appellants also contend that the examples in Regulation 23649-5, regarding activities
18 performed after manufacturing is completed (such as building shelves to hold finished goods, example
19 nine), are not applicable to the facts here because the removal of the decanted fines is integral to actually
20 making the asphalt; it is part of the processing of the inputs. Accordingly, it should be treated as part of
21 the manufacturing activity. Appellants also note that the Board has previously held that the MIC should
22 be liberally construed in favor of taxpayers, and that to the extent this case poses a close question with
23 respect to whether the conveyor belt should qualify for the MIC, the case should be decided in favor of
24 appellants. (Citing *Appeal of Save Mart Supermarkets & Subsidiary*, 02-SBE-002, Feb. 6, 2002.)

25 Respondent notes that Regulation 23649-5 does not contain an example addressing the
26 disposal of waste; instead, the examples addressing waste do so in the context of reusing the waste in the
27 manufacturing process. Respondent notes that here, in contrast, the waste is being removed from the
28 manufacturing process and is not being reintroduced into the manufacturing process. Respondent

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1 further contends that, because the 2.5 mile conveyor belt handles only “post-processing” material it
2 cannot be determined to be used in a qualified activity. Respondent cites Regulation 23649-2(n), which
3 defines “qualified activity” as:

4 “The term “qualified activity” shall mean an activity engaged in by a qualified taxpayer
5 that involves manufacturing, processing, refining, fabricating, recycling, research and
6 development, or pollution control and shall also include the maintenance, repairing
7 measuring, or testing of any qualified property.”

8 Respondent further contends that the decanted fines carried to the embankment area by
9 the conveyor belt have no economic value and are waste; they have no further value to the
10 manufacturing process. Thus, respondent contends, the disposal of the decanted fines via the 2.5 mile
11 conveyor belt is separate from, and outside of, the process of producing saleable aggregate. Further, the
12 transport for disposal is essentially the same as transporting within a warehouse for storage. Respondent
13 also cites example nine of Regulation 23649-5, wherein a camera manufacturer fabricated shelving to
14 store manufactured cameras following the completion of its manufacturing process. In that example, the
15 shelving is not qualified property since it was not used in the manufacturing process (camera
16 manufacturing, a qualified activity), but rather was used for storage (which is a nonqualified activity).

17 Respondent also cites Regulation 23649-5, subdivision (d), which specifically excludes
18 specific property from being qualified property, including facilities used for warehousing purposes,
19 which is:

20 “[a]ny property used for warehousing purposes after the completion of the manufacturing
21 process. Thus, for example, a manufacturer of engine components that stores its finished
22 products in a separate warehouse building prior to shipment and thereafter uses forklifts
23 and other heavy equipment to move the inventory within the warehouse building shall not
24 treat the forklifts and other heavy equipment as qualified property.”

25 Respondent contends that the 2.5 mile conveyor belt at issue here is like “other heavy equipment” used
26 to transport material for storage, and thus cannot be qualified property.

27 *Applicable Law*

28 As noted above, Regulation 23649-2(e) provides that “manufacturing” means:

“ . . . the process of converting or conditioning property by changing the form composition,
quality, or character of the property for ultimate sale at retail or for use in the
manufacturing of a product to be ultimately sold at retail . . . ”

Further, “process” is defined by Regulation 23649-2(l) as follows:

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1 “The term "process" shall mean the period beginning at the point at which any raw
2 materials are received by the qualified taxpayer and introduced into the manufacturing,
3 processing, refining, fabricating, or recycling activity of the qualified taxpayer and
4 ending at the point at which the manufacturing, processing, refining, fabricating, or
5 recycling activity of the qualified taxpayer has altered tangible personal property to its
6 completed form, including packaging, if required. . .”

5 In addition, “processing” is defined in Regulation 23649-2, subdivision (m), as meaning:

6 “. . . the process of physically applying the materials and labor necessary to modify or
7 change the characteristics of property.”

8 Regulation 23649-5 sets forth many examples with respect to what constitutes qualified
9 property, i.e., property that is used in the manufacturing process. None of the examples address the
10 issue here directly, i.e., whether property used to remove manufacturing waste, during manufacturing,
11 that is required to be removed for manufacturing to continue, constitutes qualified property. Examples
12 9, 10, and 11, address post-manufacturing activity and waste that is reused in the manufacturing process:

13 Example 9

14 C, a qualified taxpayer, manufactures cameras in Milpitas. The employees of C fabricate and assemble
15 shelving to be used to store the manufactured cameras following completion of C’s manufacturing
16 process. Assume that the costs of fabricating the shelving, including the labor costs, are properly
17 capitalized by C. Although C has “fabricated” the shelving, the shelving is not qualified property since
18 it is not used in C’s manufacturing process, which is a qualified activity, but is rather used for storage,
19 which is a nonqualified activity.

20 Example 10

21 J, a qualified taxpayer, manufactures aquariums in Whittier. As part of J’s manufacturing process, J
22 uses specialized equipment which recycles used Styrofoam packing material by converting it into plastic
23 parts that J then uses in manufacturing the aquariums. The specialized recycling equipment is primarily
24 used in recycling, a qualified activity, so that it is treated as qualified property.

25 Example 11

26 Assume the same facts as in example 10, except that J does not use postconsumer waste but instead
27 converts its own manufacturing waste (generated by the construction of plastic aquarium parts) into
28 finished aquarium parts. J may include as qualified property the equipment used to convert the waste

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1 resulting from J's manufacturing process into aquarium parts.

2 *Staff Comments*

3 Should the Board determine that appellant's mining activity ceased at the point at which
4 it stockpiled crushed, unwashed rock for sale to the public, so that the use of the 2.5 mile conveyor belt
5 was not associated with mining, but rather with asphalt manufacturing, the Board then needs to
6 determine whether the 2.5 mile conveyor belt was used to manufacture asphalt, and therefore qualified
7 property. Thus, the question is whether the 2.5 mile conveyor belt was used in the process of converting
8 or conditioning property by changing the form composition, quality, or character of the property for
9 ultimate sale at retail or for use in the manufacturing of a product to be ultimately sold at retail? In this
10 regard, appellants will need to demonstrate that the use of the 2.5 mile conveyor belt to remove the
11 decanted fines waste product out of the site and to the embankment area is part of the process of
12 physically applying the materials and labor necessary to modify or change the characteristics of property
13 (crushed rock, among other things) into asphalt.

14 Appellants may wish to discuss the fact that the description of their activity
15 manufacturing asphalt diverges after step five, i.e., the newly washed, crushed rock is dropped into
16 railroad cars for transportation to the hot plant (where the manufacturing process continues), whereas the
17 waste water containing decanted fines is diverted to the dewatering plant, the decanted fines (or
18 applesauce) is moved to the "yard" by front loader, then by truck to the drying fields, and again by truck
19 to the 2.5 mile conveyor belt with the ultimate destination of the embankment area.

20 Respondent may wish to address the fact that the removal of the decanted fines via the
21 2.5 mile conveyor belt is done during the manufacturing process (not after), and is necessary for the
22 washing of aggregate to continue.

23 Staff notes that this is a matter of first impression for the Board and that respondent
24 requested (during the prehearing conference) that the Board issue a formal opinion in this appeal.

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1 **Question 3: Whether the claims for refund include costs incurred before the January 1, 1994,**
2 **effective date of the MIC?**

3 *Background*

4 Upon review of appellant's conveyor belt system appropriation report, respondent
5 identified a total of 123 invoices in the amount of \$2,885,484 paid prior to January 1, 1994, and
6 disallowed this amount as unqualified costs.

7 *Contentions*

8 Previously, appellants contended that they had already removed the pre-January 1, 1994,
9 invoices from their third claim for refund, citing specifically that the claimed MIC on their third
10 amended return was based on qualified costs of \$15,609,680, and not the previously claimed costs of
11 \$17,783,941. Thus, appellants contend they already removed from their claim for refund \$2,885,484 of
12 costs paid prior to January 1, 1994. (See appellants Reply Brief from the briefing for the first oral
13 hearing in this appeal, Exhibits J and K.) The parties were asked at the prehearing conference to address
14 whether this issue was resolved based on appellants' adjustment to their third claim for refund removing
15 the pre-January 1, 1994 invoices from the claim amount. While appellants thought the matter was
16 resolved (and did not raise this issue in their briefing on rehearing), respondent included this issue in its
17 reply brief on petition for rehearing. At the prehearing conference, respondent was not yet able to
18 indicate whether it agreed or disagreed that the remaining claim for refund (arising from the third claim
19 for refund) still contained costs incurred prior to January 1, 1994.

20 *Applicable Law*

21 R&TC Section 23649, subdivisions (a) (2) and (b) (1)(A), provide that the only "qualified
22 costs" for purposes of the MIC are costs "paid or incurred on or after January 1, 1994."

23 *Staff Comments*

24 It appears that appellants have already removed the disputed costs incurred prior to
25 January 1, 1994, from their third claim for refund. Respondent should be prepared to discuss at the oral
26 hearing whether it agrees that the pre-January 1, 1994 costs have been removed; if not, respondent
27 should be prepared to explain why it believes that the modified claim for refund, based on \$15,609,680
28 of qualified costs, still contains pre-January 1, 1994 costs. Respondent should reference appellants'

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1 exhibit K (from its reply brief for the first oral hearing), which appellants contend do not include any
2 pre-1994 invoices, to identify which of the disallowed 123 invoices are still included in the third claim
3 for refund.

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