

# CALIFORNIA BOARD OF EQUALIZATION DECIDES NEW MIC CASES

By Chris Micheli

## **Introduction**

In addition to other cases previously reviewed (e.g., *Appeal of Sierra Pacific Industries* and *Appeal of Costco*), the California State Board of Equalization (BOE) has decided two other Manufacturers' Investment Credit (MIC) cases this year. As with prior MIC appeals to the BOE, the taxpayers in these two cases were successful in their appeals. The first decision – which dealt mainly with who qualified for the MIC – is consistent with two prior cases decided by the five-member board. The second decision – which is another case dealing with types of assets that qualified for the MIC – provides additional guidance on qualifying assets and the manufacturing process.

## **Overview of the MIC**

The now-expired MIC provided an income tax credit of 6% to any qualified taxpayer for qualified costs paid or incurred on or after January 1, 1994 (and prior to January 1, 2004), for qualified property placed into service in California. (See Revenue & Taxation Code § 23649(a)(1); California Code of Regulations, Title 18, § 23649-1(a).)

CRTC Section 23649(c)(1) provides that a “qualified taxpayer” means any taxpayer “engaged in those lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.”

In addition, CRTC Section 23649(d) provides that “qualified property” means “(1) [t]angible personal property that is defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification (SIC) Manual . . . that is primarily used . . . (A) [f]or the manufacturing, processing, refining, fabricating, or recycling of property, 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, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.”

Regulation Section 23649-2(e) defines the term “manufacturing” as 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, and includes any improvement to tangible personal property that result in a greater service life or greater functionality than that of the original property.

## **Safeway/Vons Decision**

The first case resulted in a "summary decision" in favor of Safeway/Vons in its MIC appeal. Although not a published decision (as such, it cannot be cited as precedent by other taxpayers), this determination is consistent with the BOE's previous decisions involving Save Mart Supermarkets and Costco. The Safeway/Vons decision was released at the beginning of the year.

The amount at issue in the Safeway/Vons appeal was \$3.2 million for Safeway and \$1.25 million for Vons. The taxpayers maintained full-service bakery and meat

processing departments at most of their store locations in California. Baking activities are "described in" Standard Industrial Classification (SIC) Manual Code 2051, while meat processing activities are described elsewhere in Division D of the SIC Manual ("Manufacturing"), which is a requirement of the MIC statute.

According to the decision by the BOE, the California Franchise Tax Board (FTB) failed to specify how this taxpayer's claimed property or activities differed from the qualified property and the qualified taxpayer in the BOE's landmark *Save Mart* decision (*Appeal of Save Mart Supermarkets & Subsidiary* (2002-BOE-002), decided February 6, 2002, (*Save Mart*)).

However, the FTB did cite one piece of property as not being qualified for the MIC (the "meat box" - a type of refrigerator) because "most of the time it is used for storing prepackaged lunchmeat." The taxpayer did not rebut this contention.

Under the BOE's summary decision, the taxpayer was engaged in the same lines of business of meat processing and baking as the taxpayer in the *Save Mart* decision. According to the BOE's decision, the taxpayer's claimed property was qualified, except for the meatbox. This property was used primarily to store prepackaged lunchmeat, which is not part of the manufacturing process. The BOE also held that Safeway/Vons was a qualified taxpayer for purposes of claiming the MIC. This is the same holding from the *Save Mart* and *Costco* decisions.

By way of background, the taxpayer is a California-based corporation with grocery stores located throughout the State of California. They maintain full-service bakery and meat processing departments at most store locations. The taxpayer successfully argued that its bakery and meat department operations are substantially identical to those for which *Save Mart* was determined to be a qualified taxpayer, and that the BOE's decision in *Save Mart* should be applied in this case as well.

The BOE reiterated its position that activities of a full-service bakery and a meat processing department operating within a grocery store served to qualify the grocery store as a qualified taxpayer for purposes of the MIC. "This is the only instance in which the BOE has addressed the qualified taxpayer issue. We therefore observe that, although our *Save Mart* opinion serves as a precedent in other matters involving the same facts (i.e., other grocery stores with meat and bakery departments), its application under other facts (i.e., with respect to delicatessens and restaurants, among other things) has not been decided by this Board."

Regarding whether the taxpayers' use of the "meatbox" property was primarily for manufacturing or processing meat, the BOE held that it appears undisputed by the taxpayer that this property was used primarily to store prepackaged lunchmeat. "Accordingly, we conclude that the meat box property does not constitute qualified property and should be removed from the allowable MIC calculation."

There are several remaining taxpayers' appeals to be resolved under the *Save Mart* decision. Those cases are expected to be completed by mid-2007.

### **Granite Construction Decision**

This decision was rendered by the BOE after its hearing on November 20, 2006. The taxpayer is one of the largest civil contractors in the United States and builds roadways, highways, tunnels, bridges, mass transit facilities, and airports. The taxpayer also manufactures "finished aggregate product" in its "rock plant" for sale to end-users

and for its own use in manufacturing asphaltic concrete (hot asphalt), and (to a lesser extent) ready-mixed concrete, in its “hot plant.”

The FTB conceded that the taxpayer was a qualified taxpayer engaged in qualified activities with respect to its “hot plant,” and that the hot plant assets are qualified property. In dispute before the BOE at its November hearing was the taxpayer’s rock plant assets used to produce aggregate.

The taxpayer’s hot plants and rock plants are located adjacent to each other at various sites in California and conducted as stand-alone operations at other sites. Where adjacent, the rock plants are connected to the hot plants by a conveyor belt that delivers some of the prepared aggregate to the hot plants. The aggregate that is used to manufacture asphalt and concrete (where the rock plants and hot plants are adjacent) is conveyed from the rock plant to the hot plant by a conveyor belt.

The taxpayer argued that the rock plant assets are integral to the process of manufacturing asphalt and concrete, and that the manufacturing process of asphalt and concrete begins when the raw aggregate materials are introduced to the rock plant. Also, Granite contended that the rock plant is part of its overall asphalt and concrete manufacturing processes, which are qualified manufacturing activities, described in Standard Industrial Classification (SIC) Codes 2951 and 3273.

The FTB argued that the taxpayer was engaged in three, distinct activities: (1) the qualified activity of manufacturing asphaltic concrete (as described in SIC Code 2421); (2) the manufacture of ready mixed concrete (Portland cement); and (3) the unqualified activity of mining/extraction of raw materials and production of aggregate at the rock plants (which FTB contended is properly described in SIC Code 1442, a code section outside of Division D of the SIC Manual).

According to the FTB, because the taxpayer’s rock plant activity is described in a code section outside of Division D, the taxpayer was not using the claimed property in a qualified activity and, thus, the rock plant assets do not qualify for the MIC. FTB further alleged that the taxpayer’s mining/extraction and rock plant activities are separate, unqualified activities described in a SIC Code outside of Division D that are unrelated to the qualified activity of manufacturing asphalt and concrete.

Nonetheless, the BOE ruled 3-2 that Granite’s “rock plant” assets were primarily used in a qualified manufacturing activity and were therefore properly claimed by the taxpayer for the 6% tax credit. This decision was rendered on a verbal motion and also is not a published decision.

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