

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

**440.1015**

In the Matter of the Claim )  
for Refund Under the Sales ) DECISION AND RECOMMENDATION  
and Use Tax Law )  
)  
R--- C--- CO., INC. ) No. SY – XX XXXXXX  
)  
Claimant )

The above entitled matter came on regularly for hearing on September 13, 1972 in San Bernardino, California. James E. Mahler, Hearing Officer.

Appearing for Petitioners: G. S--- W---  
Director of Taxes  
  
G. W. H---  
Assistant Tax Manager  
  
J--- W. F---  
Chief Chemist  
  
Appearing for the Board: William E. Phaender  
Audit Supervisor

Claim

Claimant seeks a refund under Section 6012(a)(1) of the Revenue and Taxation Code of sales tax in the amount of \$XX,XXX for the period January 1, 1975, through March 31, 1977.

Contention

Approximately ten percent of the coal purchased by petitioner is incorporated into cement and resold.

Summary

Claimant is a corporation engaged in the manufacture and sale of cement. It uses numerous raw materials in the manufacture of cement, including shale, clays, iron ore and

limestone. These materials are crushed into small particles and mixed in batches of 30,000 tons. The mix is then put into a ball mill and reduced to a powder called "kiln feed".

The next stage of the process uses a rotary kiln, which is 330 feet long and constructed on a slope. The kiln feed is placed in the higher end of the kiln and, as the kiln rotates, the feed corkscrews toward the lower end. Heat is applied which causes chemical reactions in the feed and produces a lava-like substance called "clinker". Later the clinker is mixed with gypsum to form cement.

Normally claimant burns coal to produce heat in the rotary kiln. The coal is crushed into powder, blown into the kiln and ignited. Most of the coal is consumed or evaporates in the process, but the inorganic elements, primarily silica, alumina and ferric oxide, remain in the form of ash called "fly ash". Approximately 98 percent of the fly ash is absorbed by and remains in the clinker, while the remainder escapes from the kiln mixed with various gasses. Claimant has submitted evidence to show that about ten percent of the coal it used during the period of the refund claim, measured by weight, was composed of the fly ash elements.

The presence of fly ash has a considerable effect on the clinker, increasing the amounts of silicon dioxide, aluminum oxide and other elements. Claimant desires these chemicals in the finished cement, but not in excessive amounts. In order to insure that the finished cement has the proper chemical balance, therefore, claimant takes account of the fly ash when mixing the raw materials for kiln feed. When fuels other than coal are used, claimant must take steps to retain the proper chemical balance and compensate for the absence of ash. This is usually done by decreasing the amount of limestone and increasing the amount of shale in the kiln feed, but claimant states that it sometimes also purchases fly ash for direct introduction into the clinker.

Claimant's contract with its coal supplier specifies that the ash content of the coal shall not exceed 15 percent by weight. If it does, claimant has the right to receive liquidated damages. The contract does not specify any minimum ash content.

#### Analysis and Conclusions

Sales and Use Tax Regulation 1525 provides:

- (a) Tax applies to the sale of tangible personal property to persons who purchase it for the purpose of use in manufacturing, producing or processing tangible personal property and not for the purpose of physically incorporating it into the manufactured article to be sold. Examples of such property are machinery, tools, furniture, office equipment, and chemicals used as catalysts or otherwise to produce a chemical or physical reaction such as the production of heat or the removal of impurities.

- (b) Tax does not apply to sales of tangible personal property to persons who purchase it for the purpose of incorporating it into the manufactured article to be sold, as, for example, any raw material becoming an ingredient or component part of the manufactured article.

It has been suggested that claimant does not desire the fly ash to remain in the clinker, but simply leaves it there because it would be too expensive to remove. The fact that claimant's agreement with its coal supplier does not specify a minimum ash content supports this view. It is clear, however, that the fly ash has a beneficial effect on the clinker by increasing the amounts of certain chemicals. That claimant desires and intends these chemicals to be in the clinker is demonstrated by the fact that, when fuels other than coal are burned, the amounts of other raw materials must be adjusted to provide those chemicals. It is therefore concluded that claimant purchases coal for dual purposes, namely, that the organic elements will be burned to provide heat while the inorganic elements or fly ash will be incorporated into the finished product.

When such dual purposes are present, the issue becomes whether the intervening use (see Safeway Stores, Inc. v. State Board of Equalization, 148 Cal. App. 2d 299) of the materials is made before incorporation in the final product. When the use in question is made as part of a single process which also results in the material being incorporated in a final product, the use is not seen as such an intervening use as to impose tax.

In this case it is arguable that the fly ash or inorganic elements of the coal are not used at all, since only the organic elements of the coal burn to provide heat. Even assuming that the fly ash is somehow used, however, the use is a simultaneous part of a single manufacturing process which also introduces the fly ash into the clinker. Since any such use would not be sufficient to impose tax, claimant is entitled to a refund of tax paid with respect to the fly ash.

The question remains as to how the refund should be measured. Since claimant purchases coal for a lump sum price, the price must be allocated between the fly ash and the other elements of the coal.

Claimant argues that the refund should be measured by 10 percent of the price it paid for coal during the refund period, since the fly ash comprises ten percent of the coal by weight. This assumes that the price claimant paid for coal was divided equally between the fly ash and the other elements. Since fly ash normally sells for about one-half the price of coal, however, this position cannot be accepted.

Normally, where taxable and nontaxable items are purchased for a lump sum price, the Board allocates the price on the basis of fair market value. In this case, therefore, the refund should be measured by the fair market value of the fly ash which claimant purchased

(approximately equal to ten percent of the coal purchased) and on which it paid tax or tax reimbursement during the refund period.

The record does not reveal the fair market value of fly ash during the refund period. Claimant should submit evidence on this point to the San Bernardino audit staff, and also evidence of the amount of tax or tax reimbursement it paid on coal purchases. The audit staff will examine this evidence and adjust the refund claim accordingly. If claimant and the audit staff cannot agree on the fair market value of the fly ash, the evidence will be forwarded to this office for further review and a supplemental ruling.

Recommendation

The San Bernardino audit staff is to determine the measure of the refund in accordance with the foregoing on the basis of evidence to be submitted by claimant. Grant the claim as adjusted.

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James E. Mahler, Hearing Officer

2/14/79  
\_\_\_\_\_  
Date

REVIEWED FOR AUDIT:

\_\_\_\_\_  
Principal Tax Auditor

February 28, 1979  
\_\_\_\_\_  
Date