

PRIVATE LETTER RULING

REQUEST LETTER

September 30, 2011

To Contact Writer:
E-MAIL
PHONE NUMBER

VIA HAND DELIVERY

Tax Commission
Attn: Mr. Bruce Johnson, Commission Chair
210 North 1950 West
Salt Lake City, Utah 84134

*RE: Request for Letter Ruling on Sales Tax Exemption for Purchase of Irrigation
Personal Property and Materials for the Irrigation Portion of the PROJECT, COUNTY,
Utah*

(Expedited Ruling Requested)

Dear Commissioners:

This firm represents the COMPANY (“COMPANY”), a mutual non-profit irrigation COMPANY located in COUNTY, Utah. On behalf of COMPANY, we respectfully request an advisory letter ruling on the sales tax exemption for the purchase of irrigation pipe under the “farming operations” exemption of the Utah Sales and Use Tax Act (“the Act”), Utah Code Ann. § 59-12-104(18)(a) (2011).

By way of background, local farmers hold roughly 66.5% of COMPANY shares of stock for irrigation uses, while COMPANY 2 (fka COMPANY 3) holds approximately 26% for industrial uses (power generation), and CITY 2 holds approximately 5% for municipal (irrigation) uses, and CITY 3 holds approximately 2.5% also for municipal (irrigation) uses. See COMPANY Shareholder Roster, attached hereto as Ex. 1. Generally, each share of stock in COMPANY represents an aliquot share of the water delivered under COMPANY’s water rights and contract rights. COMPANY water is critical to the agricultural and industrial economies of COUNTY and neighboring communities.

COMPANY will soon be purchasing a large amount of construction materials and irrigation infrastructure, including approximately DOLLAR AMOUNT worth of 63-inch diameter HDPE piping, for improvement of its irrigation system that will be directly and primarily used in local farming operations. The current COMPANY irrigation system is antiquated. It is still, in large part, an open ditch un-pressurized system. It is in need of updating and pressurization to curb water loss and other irrigation inefficiencies.

Over the last two years, COMPANY has planned, and is now beginning to construct the PROJECT which generally consists of water diversion infrastructure and inlet piping, a 1,200 acre-foot capacity regulating reservoir, and separate pressurized water delivery pipelines – one, serving COMPANY 2’s industrial uses, and the other serving only local irrigators for their farming needs. See PROJECT Schematic, attached hereto as Ex. 2. When completed, the PROJECT will provide the pressurized delivery of irrigation water to local farmers that hold shares of stock in COMPANY. Such deliveries will be made from pipelines exclusive to service of irrigation water for farming operations. There will be no intermediaries. This agricultural portion of the Project will directly serve local farming operations.

COMPANY seeks to confirm the sales tax exemption for its purchase of that percentage of pipe procured for irrigation needs as related to the inlet works (71.5%) and for all that pipe procured for the isolated agricultural delivery system from the regulating reservoir. The total dollar amount to be expended for pipe designated for irrigation use is DOLLAR AMOUNT 2. COMPANY has provided herewith a breakdown and calculation of those pipe costs for the PROJECT that merit a sales tax exemption under the Act. See Ex. 3, attached hereto.

The Act provides an exemption for “sales of tangible personal property . . . used or consumed primarily and directly in farming operations.” Utah Code Ann. § 59-12-104(18)(a) (2011). The language of this section does not require “exclusive use” in farming operations; it instead requires “primary and direct use.” Therefore, under this statutory authority, COMPANY maintains that its purchases of pipe and other personal property and materials for those parts of the PROJECT primarily and directly dedicated for farming use should be exempt from sales tax.

We are aware that in at least one other circumstance, the Commission has confirmed such a sales tax exemption to a mutual irrigation COMPANY for the materials used to construct a water pipeline delivery system used for irrigation purposes. See Private Letter Ruling 06-008, attached hereto as Ex. 4. We also understand that it is unrefuted that “irrigation companies have not paid any taxes in similar situations.” See *id.*

Therefore, COMPANY respectfully requests the Commission advise it as to whether COMPANY is entitled to a sales tax exemption for the pipe procured for the PROJECT under the circumstances described above and as further described in the attached exhibits. COMPANY and this firm stand ready to provide the Commission with any further information it may need on this issue. Please do not hesitate to contact the undersigned or COMPANY’s President, NAME at PHONE 2.

Lastly, due to the imminent delivery of pipe and invoicing for the PROJECT, COMPANY respectfully requests an expedited ruling on this matter.

Thank you for your time and consideration in reviewing this request. We look forward to your response.

Very truly yours,

COMPANY 3

NAME 2

Enclosures

Cc: NAME (w/encl.)

Copies for 3 other Tax Commission Members (w/encl.)

RESPONSE LETTER

November 15, 2011

NAME 2
COMPANY 3
ADDRESS
ADDRESS 2
CITY, STATE ZIP CODE

RE: Private Letter Ruling Request–For Sales Tax Purposes, the Applicability of the Farming Operations Exemption Found in § 59-12-104(18) to Pipe Purchased by a Mutual Nonprofit Irrigation Company.

Dear NAME 2:

You have requested a ruling on behalf of COMPANY (“COMPANY”), a mutual nonprofit irrigation COMPANY located in COUNTY, Utah.

You have explained that the shares of COMPANY are owned as follows:

66.5% by local farmers for irrigation
26% by COMPANY 2 for power generation
5% by CITY 2 for irrigation
2.5% by CITY 3 for irrigation

You also explained that COMPANY will soon purchase a large amount of construction materials and irrigation infrastructure for the PROJECT (“Project”). This Project will serve the local farmers and COMPANY 2, but not the cities.¹ The Project will include installing 14,500 linear feet of 63-inch pipe (“Inlet Pipe”) from a diversion source to a regulating reservoir. The Inlet Pipe part of the Project will serve industrial and agricultural users: 28.5% of the water will be

¹ In a recent phone conversation, you explained that the water for the cities is diverted upstream of the Project.

used by COMPANY 2 for power generation and 71.5% by local farmers for irrigation.² The Project will also include installing 9,850 linear feet of 63-inch pipe from the regulating reservoir to a section of COMPANY's pipeline system serving only farmers for irrigational use ("Agricultural System Pipe"). This part of the Project will only serve the local farmers for irrigation.

You request that the Commission apply the sales tax exemption found in § 59-12-104(18) for farming operations to 71.5% of the purchase price for the Inlet Pipe and to 100% of the purchase price for the Agricultural System Pipe.³ You expect the exempt amount for the piping alone to be DOLLAR AMOUNT 2.⁴ You assert that the piping meets the "primary and direct use" requirement found in the statute and that the statute does not require "exclusive use."

You noted that through Private Letter Ruling ("PLR") 06-008, the Commission previously confirmed the farming operations exemption to a nonprofit mutual irrigation COMPANY for materials used to construct a water pipeline delivery system. You assert that it is still unrefuted that "irrigation companies have not paid any taxes in similar situations."

I. Applicable Law

Utah Code § 59-12-103(1) imposes sales tax for certain enumerated transactions including "(a) retail sales of tangible personal property made within the state."

Utah Code § 59-12-104 list transactions that are exempt from the sales tax, including the farming operations exemption found in § 59-12-104(18), which states:

- (a) (i) except as provided in Subsection (18)(b), sales of tangible personal property or a product transferred electronically **used or consumed primarily and directly in farming operations**, regardless of whether the tangible personal property or product transferred electronically:
 - (A) becomes part of real estate; or
 - (B) is installed by a:
 - (I) farmer;
 - (II) contractor; or
 - (III) subcontractor; or
- (ii) sales of parts used in the repairs or renovations of tangible personal property or a product transferred electronically if the tangible personal property or product transferred electronically is exempt under Subsection (18)(a)(i); and
- (b) notwithstanding Subsection (18)(a), amounts paid or charged for the following are subject to the taxes imposed by this chapter:

² For this ruling, we assume that the local farmers being served by the Project are engaged in farming operations as defined in Utah Admin. Code R865-19S-49(1).

³ In a recent phone conversation, you confirmed that you are not requested a ruling on other personal property and materials that might be used in the Project.

⁴ The DOLLAR AMOUNT 2 amount equals 71.5% of 14,500 ft. Inlet Pipe @ \$237.64 per ft. plus 100% of 9,850 ft. Agricultural System Pipe @ \$237.64 per ft.

- (i) (A) subject to Subsection (18)(b)(i)(B), the following if **used in a manner that is incidental** to farming:
 - (I) machinery;
 - (II) equipment;
 - (III) materials; or
 - (IV) supplies; and
- (B) tangible personal property that is considered to be used in a manner that is incidental to farming includes:
 - (I) hand tools; or
 - (II) maintenance and janitorial equipment and supplies;
- (ii) (A) subject to Subsection (18)(b)(ii)(B), tangible personal property or a product transferred electronically if the tangible personal property or product transferred electronically is **used in an activity other than farming**; and
- (B) tangible personal property or a product transferred electronically that is considered to be used in an activity other than farming includes:
 - (I) office equipment and supplies; or
 - (II) equipment and supplies used in:
 - (Aa) the sale or distribution of farm products;
 - (Bb) research; or
 - (Cc) transportation; or
- (iii) a vehicle required to be registered by the laws of this state during the period ending two years after the date of the vehicle's purchase . . .

(Emphasis added.)

The current language of the farming operations exemption is similar to the exemption's language in 2006; the current statute was only revised to include products transferred electronically.

II. Analysis

In general, the purchase of the Project's pipe would be subject to Utah sales and use tax under § 59-12-103(1) unless the purchase meets an exemption. As you have requested, we will consider whether the Project's purchase of pipe meets the farming operations exemption found in § 59-12-104(18).

Agricultural System Pipe. The farming operations exemption requires the "sales of tangible personal property or a product transferred electronically [to be] used or consumed primarily and directly in farming operations" and to not be "used in a manner that is incidental to farming" or "used in an activity other than farming." In Private Letter Ruling ("PLR") 06-008, the Commission found that piping purchased by a mutual nonprofit irrigation COMPANY for a new water system serving only farmers met the exemption. In that PLR, the Commission stated:

We see no real distinction from an individual farmer constructing an irrigation system on his or her own land. In such a case the Commission would consider that system to be a direct part of the farming operation. Where you have

a group of farmers constructing a system with separate pipelines leading to different agricultural operations, we do not find a substantive difference in principle from an individual farmer. In contrast, were an individual farmer to construct an irrigation system that also delivered water to non-agricultural users, that system would be subject to sales tax.

Other contributing, but not dispositive, factors include the fact that NON PROFIT ORGANIZATION does not make commercial sales of water to non-shareholders, the nature of the ownership, and your unrefuted representation that irrigation companies have historically not paid any taxes in similar situations.

This exemption only applies to the purchase of construction materials for pipelines and other items used in the agricultural system, as well as to any otherwise taxable labor for the installation of personal property (labor for installation related to real property is not taxable). It does not apply to purchases of machinery or equipment used to construct the system. Nor would it apply to materials used for any part of the company's system that is not used solely for agricultural purposes.

The Agricultural System Pipe part of COMPANY's Project is very similar to the project in PLR 06-008; both involve mutual nonprofit irrigation companies constructing irrigation systems to deliver water to agricultural users only. The purchase of the Agricultural System Pipe would qualify for the farming operations exception based on the analysis provided in PLR 06-008.

Inlet Pipe. The purchase of the Inlet Pipe presents a different issue because the Inlet Pipe will serve an industrial user, not just agricultural users. Although PLR 06-008 did not involve an industrial user, the Commission warned:

[W]ere an individual farmer to construct an irrigation system that also delivered water to non-agricultural users, that system would be subject to sales tax.

....

[The exemption] would [not] apply to materials used for any part of the company's system that is not used solely for agricultural purposes.

....

[The conclusions of PLR 06-008] may or may not be applicable to other water companies, depending on such factors as . . . if the construction of a water system includes non-agricultural uses.

You have argued that the Inlet Pipe meets the "primary and direct use" requirement, partly because the statute does not require "exclusive use." We agree.

In PLR 06-008, there was no non-agricultural use. Thus, the statements in the letter are merely dicta. We believe that ruling stands for the proposition that an irrigation system, owned by a third party and not located on any farm or ranch, is, nevertheless used "directly" in

agriculture. Although that conclusion may be debatable, we find it to be reasonable and we will not reverse it.⁵

The Inlet Pipe is a part of the same system as the Agricultural System Pipe. If one part of the system is directly used in agriculture, the Inlet Pipe, through which the agricultural water must pass, is also directly used in agriculture.

Having found that the system, including the Inlet Pipe, is used directly in agriculture, we must apply the second criteria of the statute, i.e., is it used “primarily in agriculture.” We find that it is. COMPANY’s piping is primarily used in farming operations. A common definition of “primarily” is “essentially; mostly; chiefly; principally: *They live primarily from farming.*” Webster’s New Universal Unabridged Dictionary 1537 (2003). Black’s Law Dictionary did not include a legal definition for primarily that would clearly apply to the farming operations exemption language. However, the Merriam Webster Dictionary of Law includes the following definition: “of first rank, value, or importance.” Merriam Webster 381 (1996). For COMPANY’s Project, 71.5% of the water traveling through the Inlet Pipe and 100% of the water traveling through the Agricultural System Pipe will be for agricultural use. For the Inlet Pipe, there is no evidence suggesting that either the agricultural use or the industrial use has priority over the other. Based on these facts, the Inlet Pipe and Agricultural System Pipe are mostly, chiefly, and principally used for irrigation for farms.

Furthermore, COMPANY’s piping is not “used in a manner that is incidental to farming”; the Project’s irrigation piping is not of the same nature as “hand tools . . . or maintenance and janitorial equipment and supplies,” which are specifically listed in § 59-12-104(18)(b)(i)(B).

⁵ Both the history and practice of agriculture and irrigation in Utah demonstrate the close relationship between the two. And both the framers of our Constitution and our lawmakers have given great deference to irrigation. See generally Utah Constitution, Article XIII, Sections 3(1)(i) and (j), and 2(a)(iii). Accordingly, we believe it appropriate to limit our ruling to irrigation. Normally, purchases of goods and services by persons who are supplying farmers may be used “indirectly” in farming, but will not be considered used “directly” in farming and will fail to qualify for the exemption.

Similarly, COMPANY's piping is not "used in an activity other than farming" because the Project's irrigation piping is not of the same nature as "office equipment and supplies; or . . . equipment and supplies used in . . . the sale or distribution of farm products [,] research [,] or transportation," which are specifically listed in § 59-12-104(18)(b)(ii)(B).

We believe both of these provisions are intended to address the type of property involved and the nature of their use, including their use by a farmer. Thus, janitorial equipment and supplies are not used directly in agriculture, even though used 100% by a farmer. Similarly, the office equipment that a farmer uses to keep track of his farming operations is not used "directly" in agriculture, even though used 100% by a farmer to account his farming operations. To use either of these provisions to disallow an exemption for qualifying agricultural equipment just because it was used for a non-agricultural use 20 or 30% of the time would effectively write "primarily" out of the statute. It is an axiom of statutory construction that, where possible, each word must be given effect.⁶

III. Conclusion

As explained above, the Agricultural System Pipe qualifies for the farming operations exception. The Inlet Pipe also qualifies because, although the Inlet Pipe will deliver 28.5% of the water to COMPANY 2 for industrial use, it is used "primarily" directly in farming.

This ruling is based on current law and could be changed by subsequent legislative action or judicial interpretation. Also, our conclusions are based on the facts as described. Should the facts be different, a different conclusion may be warranted. If you feel we have misunderstood the facts as you have presented them, you have additional facts that may be relevant, or you have any other questions, you are welcome to contact the Commission.

For the Commission,

R. Bruce Johnson
Commissioner

RBJ/aln
11-003

⁶ We recognize that you have only asked for an exemption for 71% of the purchase price of the Inlet Pipe. Though that is a reasonable result, and certainly in accord with the "spirit" of the exemption, we find no statutory support for proration. The Inlet Pipe is either used primarily for agriculture or it is not. Because we have found that it is, it qualifies for 100% of the exemption.