

02-1734
TAX TYPE: SALES AND USE TAX
TAX YEAR: 2002
DATE SIGNED: 6-30-2003
COMMISSIONERS: P. HENDRICKSON, P. DEPAULIS, M. JOHNSON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,	:	
	:	Formal Hearing Decision and Order
Petitioner,	:	
	:	Appeal No. 02-1734
v.	:	
	:	Acct. No. #####
Auditing Division of the Utah State Tax Commission,	:	Tax Type Sales & Use Tax
	:	
Respondent.	:	

Presiding:
 Irene Rees, Administrative Law Judge

Appearances:
 For Petitioner: REPRESENTATIVE-1 FOR PETITIONER and
 REPRESENTATIVE-2 FOR PETITIONER, Legal Counsel for
 Petitioner, with REPRESENTATIVE-3 FOR PETITIONER,
 REPRESENTATIVE-4 FOR PETITIONER,
 REPRESENTATIVE-5 FOR PETITIONER, and
 REPRESENTATIVE-6 FOR PETITIONER.

For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant
 Attorney General
 RESPONDENT

STATEMENT OF THE CASE

This matter came before the Commission in a Formal Hearing on April 30, 2003. At issue is whether Petitioner's purchases of construction materials for installation and conversion to real property are exempt from sales and use tax pursuant to Utah Code section 59-12-104 (2) (a) (ii).

FINDINGS OF FACT

1. Prior to DATE, the COMPANY-1 ("COMPANY-1") owned and operated a hydro-electric generating facility and distribution system. COMPANY-1 operated as an electric utility in Utah County.

2. Changes in federal law established preferences for sales of power to municipalities and other public corporations or agencies. As a private entity, COMPANY-1 did not qualify for preferential sales. To remedy this situation and to guarantee preferential assignments of power into the future, the Utah County Commission created the PETITIONER (“PETITIONER”) pursuant to Utah Code Ann. §17A-2-301 et. seq. PETITIONER is a political subdivision of the State of Utah.

3. In DATE, PETITIONER obtained authorization from the Public Service Commission to operate an electrical utility distribution system in late DATE. Thereafter, PETITIONER purchased COMPANY-1’S electric distribution system, while COMPANY-1 retained ownership of the hydro-electric generating facilities.

4. In DATE, PETITIONER and COMPANY-1 entered a Distribution System Operation Agreement. Under this agreement, COMPANY-1 furnished employees and services so that the PETITIONER could operate its distribution system. Initially a 10-year agreement, the contract remains in effect today.

5. Over the years, increases of workload have required the dedication of full time employees to repair, maintain and install new and existing distribution equipment. However, there is no dispute that PETITIONER and COMPANY-1 continue to share employees, including the line crew supervisor, the accountant and her supervisor. All employees are on the COMPANY-1 payroll, and PETITIONER reimburses COMPANY-1 for personnel and other expenses.

APPLICABLE LAW

Utah Code Ann. §59-12-104 (2) (a) (ii) exempts from sales tax:

Construction materials purchased by the state, its institutions, or its political subdivisions which are installed or converted to real property by employees of the state, its institutions, or its political subdivisions

DISCUSSION

COMPANY-1, a private, non-profit entity, has a long-standing operation in conjunction with the COMPANY-2. COMPANY-1 sells water to various canal companies and operates a hydro-electric generation facility. Until the mid-1980’s, COMPANY-1 operated as an electric

utility, serving parts of Utah County. COMPANY-1 purchased additional power from other sources as necessary to meet the needs of its customers.

In DATE, the Utah County Commission established PETITIONER to take advantage of changes in the federal law extending preferences for the sale of power to public entities. As a private entity, COMPANY-1 was not entitled to preference within this system and the Association anticipated that it could not continue to meet its customers' demand. PETITIONER is a public entity, established pursuant to Utah Code Ann. §17A-2-301 et. seq. There is no dispute that PETITIONER is a political subdivision of the State of Utah.

In November of DATE, COMPANY-1 entered an "Operation Agreement" with the PETITIONER. Under this agreement, PETITIONER purchased the electric distribution system (including power poles, distribution lines, meters, etc). COMPANY-1 retained ownership of the hydro-generation facilities and all equipment to service the generation and distribution facilities. By the terms of the contract, COMPANY-1 agreed to provide equipment and employees to PETITIONER. PETITIONER agreed to reimburse COMPANY-1 for expenses related to the operation of its distribution system. PETITIONER purchases its power from COMPANY-1 and other suppliers.

PETITIONER and COMPANY-1 are separate legal entities with separate oversight Boards. Nevertheless, they operate in close conjunction with one another to maximize economies of scale. Petitioner testified that in the early years of its contractual arrangement with COMPANY-1, PETITIONER could not justify the expense of installing its own full time administrative and operations staff. Over time, PETITIONER'S customer base has grown, and additional staff has been dedicated to PETITIONER'S work and PETITIONER has acquired some of its own equipment (trucks, for instance). Yet PETITIONER and COMPANY-1 continue to realize a financial benefit in pooling their resources. For instance, Petitioner testified that line crew employees are dedicated solely to PETITIONER, but the line crew supervisor, the staff accountant and the general manager function in the same or a similar capacity for both COMPANY-1 and PETITIONER. With regard to the employees, all employees are carried on COMPANY-1'S payroll. They are considered a single pool of employees for purposes of insurance and pension benefits. The Boards confer with one another concerning wage and benefit issues. COMPANY-1 maintains the only withholding and workers compensation accounts, it is responsible for payroll related taxes, and it issues W-2s to all employees. PETITIONER has no payroll, but COMPANY-1 regularly bills PETITIONER for all employee expenses attributed to PETITIONER'S work.

The nature of the employment relationship is the crucial issue in this case. For the tax period at issue here, the line crew installed construction materials to repair or expand PETITIONER distribution facilities. Under section 59-12-104 (2) (a) (ii) of the Utah Code, PETITIONER was entitled to buy the construction materials tax free if the materials were installed by PETITIONER employees. In the course of auditing PETITIONER, the Division determined that the construction materials were purchased tax free, but because they were installed by COMPANY-1'S employees, sales tax should have been paid on these purchases.

Petitioner raises three arguments in support of its claim for exemption. First, although the line crew employees are on COMPANY-1'S payroll, PETITIONER reimburses COMPANY-1 for all employee compensation, benefits, and other expenses associated with these employees. Second, the term "employee" is not defined in the sales tax provisions. It is, therefore, reasonable to look to related laws for guidance. Petitioner directs attention to the body of workers compensation law and to Title 58, Chapter 59 of the Utah Code, which consider various factors beyond payroll accounting to determine whether a worker is an "employee." Finally, Petitioner argues that the purpose of the restriction on this exemption is to protect against a situation where a tax-exempt entity will structure its deal with a third-party or independent contractor to allow the contractor to take advantage of an exemption to which it is not otherwise entitled. Because there was no independent contractor involved in these transactions, the assessment, in effect, unnecessarily penalizes a public entity.

Respondent essentially argues that PETITIONER was established only to ensure a preferential purchasing position to buy additional power to meet the needs of customers who rely on COMPANY-1 and PETITIONER for power. PETITIONER is a separate legal entity that owns property and other assets, but it has no payroll and it has no employees. The line crew employees at issue here are COMPANY-1 employees, and at most, PETITIONER'S Board has input into, but no authority over, employee issues. The Commission agrees. The plain language of the statute requires installation of the construction materials by PETITIONER'S own employees. The line crew is part of COMPANY-1'S pool of employees. That PETITIONER reimburses COMPANY-1 for the costs associated with the use of those employees does not change that fact.

PETITIONER arranged its affairs to minimize its cost of doing business, which certainly makes sense. However, the tax liability is a consequence of PETITIONER'S arrangement with COMPANY-1. We cannot read the tax code otherwise.

DECISION AND ORDER

This Commission sustains the assessment.

BY ORDER OF THE COMMISSION:

DATED this _____ day of _____, 2003.

Administrative Law Judge

The undersigned Commissioners have reviewed this matter and concur in this decision.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Palmer DePaulis
Commissioner

Marc B. Johnson
Commissioner

NOTICE OF APPEAL RIGHTS: You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63-46b-13. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §§59-1-601 and 63-46b-13 et. seq.