

04-0634
Audit
Signed 09/12/2005

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,)		
	)	ORDER	
Petitioner,	)	Appeal No.	04-0634
)		
v.	)	Account No.	#####
)		
AUDITING DIVISION	)	Tax Type:	Sales Tax
OF THE UTAH STATE TAX)		
COMMISSION,	)	Tax Year:	2001
)		
Respondent.	)	Judge:	Davis

Presiding:

G. Blaine Davis, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER REPRESENTATIVE

For Respondent: RESPONDENT REPRESENTATIVE 1, Assistant Attorney General
RESPONDENT REPRESENTATIVE 2, from the Auditing Division
RESPONDENT REPRESENTATIVE 3, from the Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to the provisions of Utah Code Ann. §59-1-502.5, on January 25, 2005.

At issue in this case is whether the purchase of a Caterpillar 246 MA3 skid steer qualified for the sales and use tax exemption for sales of tangible personal property used or consumed primarily and directly in farming operations.

The year at issue is 2001.

PETITIONER ("PETITIONER") or ("Petitioner") is a limited liability company that registered in Utah on March 15, 1998 with its principal address in CITY 1, STATE.

In 1998, Petitioner entered into a purchase agreement in which it agreed to purchase approximately ninety-seven acres of land located in CITY 2, Utah. Subsequently, Petitioner sold twenty-two acres for development. houses are now located on that twenty-two acre portion. PETITIONER currently owns approximately seventy-seven acres in CITY 2, Utah.

Petitioner's Purchase and Sale Agreement for the acquisition of the ninety-seven acres states that "[t]he Property is currently zoned agricultural. The Buyer is planning to use the Property for a commercial nursery which may require rezoning of up to two (2) acres."

Petitioner has been a licensed Nurseryman in Utah since 1999 and has purchased over 22,000 seedlings from 1999 to 2003.

Of the seventy-seven acres owned by Petitioner, only three acres are being used to grow the seedlings which it purchased and planted. Another three-acre parcel owned by COMPANY is also being used by Petitioner to grow the seedlings.

On February 22, 2001, Petitioner purchased a Caterpillar 246 MA3 skid steer. Petitioner presented an exemption certificate to the seller indicating that the equipment was exempt from sales tax based on the agricultural exemption.

On April 6, 2004, the Auditing Division ("Respondent") issued a Statutory Notice to Petitioner for Sales and Use Tax in the amount of \$\$\$\$\$, plus interest, on the purchase of the Caterpillar 246 MA3 skid steer.

Petitioner claims that the skid steer was purchased for and has been used "solely for purposes of improving agricultural lands which are used either for 1) raising of cattle for sale as beef, 2) production of agricultural products raised for sale, or 3) raising of nursery trees and shrubs held for future sale to the public." (Feb. 27, 2004 letter.)

However, Petitioner does not own any cattle, it has not sold any agricultural products, and it has not sold any of the seedlings or trees in its possession.

Petitioner did not file a federal Farm Income and Expense Statement (Schedule F) for 1998, 1999, 2000, 2001, and 2002.

In 1998, Petitioner reported miscellaneous income of \$\$\$\$\$ on its Federal Partnership Return. The Income Statement of Petitioner shows that hay sales and pasture rental income made up the miscellaneous income. Petitioner also received income from the sale of water rights and water shares.

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In 2000, no income was reported on the Federal Partnership Return of Petitioner or on its Income Statement. The only expense listed on its Income Statement for 2000 was amortization.

In 2001, the year at issue, Petitioner did not report any income on its Federal Partnership Return. Its yearly Income Statement reports a gain from the sale of water rights and an

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amortization deduction as an expense. The skid steer was not reported on its Federal Tax Return or on its Income Statement, and no depreciation on the skid steer was deducted.

On its 2002 Federal Partnership Return, Petitioner did not report any income. Its yearly Income Statement reports a gain from the sale of water rights and an amortization deduction as an expense. No depreciation on the skid steer was deducted.

APPLICABLE LAW

Utah Code Ann. §59-12-103(1) imposes sales and use tax and provides in relevant part as follows:

(1) A tax is imposed on the purchaser as provided in this part for amounts paid or charged for the following transactions:

(a) retail sales of tangible personal property made within the state.

Utah Code Ann. §59-12-104(20) provides for an exemption for personal property used or consumed primarily and directly in farming operations, and states in relevant part as follows:

(20)(a)(i) sales of tangible personal property used or consumed primarily and directly in farming operations, including sales of irrigation equipment and supplies used for agricultural production purposes, whether or not they become part of real estate and whether or not installed by farmer, contractor, or subcontractor, but not sales of:

(A) machinery, equipment, materials, and supplies used in a manner that is incidental to farming, such as hand tools and maintenance and janitorial equipment and supplies;

(B) tangible personal property used in any activities other than farming, such as office equipment and supplies, equipment and supplies used in sales or distribution of farm products, in research, or in transportation; or

(C) any vehicle required to be registered by the laws of this state, without regard to the use to which the vehicle is put;

Utah Administrative Code Rule R865-19S-49(C) provides as follows:

C. The sales and use tax exemption for sales of tangible personal property used or consumed primarily and directly in farming operations applies only to commercial farming operations, as evidenced by the filing of a federal Farm Income and Expenses Statement (Schedule F) or other similar evidence that the farm is operated as a commercial venture.

Effective October 19, 2004, the Commission modified Utah Administrative Code

Rule R865-19S-49, which now reads as follows:

For purposes of the sales and use tax exemption for tangible personal property used or consumed primarily and directly in farming operations, a person is engaged in "farming operations" if that person may deduct farm related expenses under Section 162 or 212, Internal Revenue Code.

To determine whether a person may deduct farm related expenses under Sections 162 or 212 of the Internal Revenue Code, the commission shall consider Treas. Reg. Sections 1.183-1 and 1.183-2.

Utah Admin. Code R865-19S-49(A)(1)-(2) (Effective October 19, 2004).

Under Treas. Reg. Sections 1.183-1 and 1.183-2, whether an expense is deductible under I.R.C. §§162 or 212 depends on whether the activity is engaged in for profit. If an activity is engaged in for profit, the expenses for that activity are deductible under sections 162 or 212; if the activity is not engaged in for profit, then the expenses are not deductible under sections 162 or 212.

Treas. Reg. 1.183-1(i)(1)(ii) provides that:

[i]f for any 2 of 5 consecutive taxable years . . . the gross income derived from an activity exceeds the deductions attributable to such activity which would be allowed or allowable if the activity were engaged in for profit, such activity is presumed . . . to be engaged in for profit.

DISCUSSION

In this matter, Petitioner has offered evidence which substantiates that a portion of the property may ultimately be operated as a commercial farming operation. It has purchased and planted approximately 22,000 tree seedlings, and some of those seedlings have gained significant growth since they were planted. Petitioner did present pictures of those trees, and some of them appear to be between five feet and seven feet tall, although Petitioner has never sold any plants of any kind.

The seedlings which have been planted occupy approximately three acres of land owned by Petitioner, and another three acres of land owned by a related company, and 22,000 trees is clearly more than would be planted for the personal consumption of the owners of the company.

Respondent made a representation that approximately 70% of those seedlings were purchased and planted prior to the date when the skid steer was purchased by Petitioner, but that also means that approximately 6,600 seedlings were planted after the purchase of the skid steer. Also, when small seedlings are planted, they are commonly planted close together. As those seedlings grow, it becomes necessary to "thin" them by increasing the distance between the trees. This is done by removing some of the trees, and then replanting them a further distance from other trees. The skid steer may well have been used to move such trees, and that would be done after the trees had previously been planted. The photographs presented as evidence by Petitioner show that the trees are far enough apart to have sufficient room to grow.

Petitioner does have a license as a Nurseryman, and is therefore authorized to grow plants commercially. Petitioner represented that the skid steer was used exclusively in dealing with the seedlings and in moving hay which was grown on the premises.

Petitioner did not file a federal Farm Income and Expense Statement (Schedule F), but the photographs of the trees, and the invoices for the purchased trees, convinces the Commission that the skid steer may well be used for a commercial farming activity. It is also noted that Respondent did not produce any evidence of the actual usage of the skid steer if it was not used for agricultural activity.

Respondent did argue that the Commission should look at the amendment to Utah Administrative Code, Rule R865-19S-49 as amended effective October 19, 2004. The effective date of the Rule amendment was therefore nearly 2.5 years after the purchase of the skid steer. That amended rule would prevent the acquisition of the skid steer from being exempt because Petitioner would not have shown a profit for 2 out of 5 consecutive years. However, the Commission feels it cannot legally impose upon Petitioner a standard which was not in effect on the date the skid steer was purchased.

DECISION AND ORDER

Based upon the foregoing, the Commission hereby determines that the skid steer was purchased for use in commercial farming operations. The audit assessment made by Respondent is therefore set aside, and the Petition for Redetermination filed by Petitioner is hereby granted. It is so ordered.

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This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2005.

G. Blaine Davis
Administrative Law Judge

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BY ORDER OF THE UTAH STATE TAX COMMISSION.

The Commission has reviewed this case and the undersigned concur in this decision.

DATED this _____ day of _____, 2005.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Palmer DePaulis
Commissioner

Marc B. Johnson
Commissioner

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