

05-1526  
Audit  
Signed 12/05/2006

BEFORE THE UTAH STATE TAX COMMISSION

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PETITIONER,	)	
	)	<b>ORDER</b>
Petitioner,	)	
	)	Appeal No. 05-1526
v.	)	Account No. #####
	)	
AUDITING DIVISION OF	)	Tax Type: Sales Tax
THE UTAH STATE TAX	)	Tax Period: 02/01/02 – 01/31/05
COMMISSION,	)	
	)	
Respondent.	)	Judge: Robinson

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**Presiding:**

R. Spencer Robinson, Administrative Law Judge

**Appearances:**

For Petitioner: PETITIONER REPRESENTATIVE

For Respondent: RESPONDENT REPRESENTATIVE 1, Assistant Attorney General  
RESPONDENT REPRESENTATIVE 2

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 August 1, 2006. Petitioner is appealing an audit deficiency of additional sales tax and interest relating to engineering services offered by Petitioner in connection with the sale of drilling fluids. Respondent sent a Preliminary Notice on August 15, 2005. Respondent issued a Statutory Notice September 22, 2005. Petitioner filed a Petition for Redetermination on October 20, 2005. The amount of additional tax at issue is \$\$\$\$\$, along with interest that continues to accrue.

APPLICABLE LAW

Utah Code Ann. §59-12-103

- (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. §59-12-102

- (50)
- consideration:
- (a) “Purchase price” and “sales price” mean the total amount of consideration:
    - (i) valued in money; and
    - (ii) for which tangible personal property or services are:
      - (A) sold;
      - (B) leased; or
      - (C) rented.
  - (b) “Purchase price” and “sales price” include:
    - (i) the seller’s cost of the tangible personal property or services sold;
    - (ii) expenses of the seller, including:
      - (A) the cost of materials used;
      - (B) a labor cost;
      - (C) a service cost;
      - (D) interest;
      - (E) a loss;
      - (F) the cost of transportation to the seller; or
      - (G) a tax imposed on the seller
    - (iii) a charge by the seller for any service necessary to complete the sale;
    - (iv) a delivery charge; or
    - (v) an installation charge.

DISCUSSION

Petitioner sells drilling fluid products to customers engaged in drilling for oil and natural gas. Petitioner also offers engineering services in connection with the sale of the drilling

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fluids. Petitioner collected and remitted sales tax on the sale of drilling fluids. In those cases where it also provided engineering service, it stated the cost of the engineering service separately and did not assess sales tax on the engineering service.

Petitioner does not require customers purchasing drilling fluids to also use Petitioner's engineering service. Customers may use Petitioner's engineering service, obtain engineering service from another provider, or not use engineering services. Petitioner asserted Respondent made the assessment on 131 invoices issued to nine of Petitioner's customers. Of those invoices, 28% listed charges for engineering services. Petitioner stated only 3% of the total invoices in the audit listed engineering services.

Petitioner argues engineering services are independent from the sale of drilling fluids. Petitioner maintains that because the engineering service is not necessary to the sale of drilling fluids, engineering service is not taxable.

Petitioner also argues that Utah law lists taxable services in §59-12-103. Engineering service is not listed. Petitioner argues this means engineering services are not taxable.

Respondent asserts the question of whether the services were necessary to the sale has no bearing on the outcome. Respondent argues the engineering services were part of retail sales. Respondent maintains because the engineering services were part of retail sales, sales tax is due on the entire transaction.

Respondent also contends the list of services in §59-12-103 as subject to sales tax is not exclusive. Respondent states any of the listed services is subject to tax, regardless of

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whether it is associated with the sale of tangible personal property. Respondent holds that any service that is a part of retail sale is taxable as part of the entire transaction.

In making a determination on this issue, the Commission considers whether the engineering services are required in order to purchase the drilling fluids. If a buyer cannot purchase the drilling fluids without also purchasing the engineering services, the services are considered to be necessary to complete the sale of the drilling fluids. In that case, the cost of the engineering services is part of the purchase price and subject to sales tax.

If the engineering services are optional and not necessary to complete the sale of the drilling fluids, the taxability of each component of the transaction is considered on its own merits. In this case, engineering services were purchased, at most, 28% of the time drilling fluids were purchased. This is sufficient to establish the engineering services are optional and not necessary to complete the sale of the drilling fluids.

BJ-Titan Services v. State Tax Commission, 842 P.2d 822 (1992) is helpful. In BJ-Titan, the Supreme Court, while saying it was a close decision, deferred to the Commission's determination the sale of tangible personal property relating to cementing services was taxable.

The Court said,

The value to the customer lies in the combination of materials and services, neither having much value without the other; materials comprise on average 30 percent of the charge to a customer; well operators acquire possession, if not ownership, of the cement; BJ-Titan apparently has the ability to charge separately for the materials and services, although it has not done so in practice; and such materials are not typically sold without the services.

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In this case, in at least 72% of the transactions, the value was in the materials only, not a combination of materials and services. The materials and services have separate values. Well operators acquire ownership of the drilling fluids. Petitioner charges separately for drilling fluids and engineering services, and the drilling fluids are typically sold without the engineering services.

The facts in this case are readily distinguished from those in BJ-Titan. Because of the distinctions, it does not appear the Court would sustain a finding that the engineering services are taxable.

#### DECISION AND ORDER

Based on the forgoing, Petitioner's appeal in this matter is granted. The audit is abated. It is so ordered.

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

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2006.

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R. Spencer Robinson  
Administrative Law Judge

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 \_\_\_\_\_, 2006.

Pam Hendrickson  
Commission Chair

R. Bruce Johnson  
Commissioner

Marc B. Johnson  
Commissioner

D'Arcy Dixon Pignanelli  
Commissioner

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