07-0067
AUDIT
TAX YEARS: 2001, 2002, 2003
SIGNED 03-11-2010
COMMISSIONERS: R. JOHNSON, D. DIXON, M. CRAGUN
EXCUSED: M. JOHNSON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION** Appeal No. 07-0067 Account No.: ##### Tax Type: Sales Tax Audit Period: 01/01/01 to 05/31/03 Judge: Jensen

Presiding:
R. Bruce Johnson, Commission Chair
Clinton Jensen, Administrative Law Judge

Appearances:
For Petitioner: PETITIONER REP 1, for the Taxpayer
PETITIONER REP 2, for the Taxpayer
For Respondent: RESPONDENT REP 1, Assistant Utah Attorney General
RESPONDENT REP 2, Deputy Director, Sales Tax Auditing
RESPONDENT REP 3, Audit Manager, Sales Tax, Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on July 15, 2009. Based upon the testimony and evidence presented at the Formal Hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. On April 30, 2004, Petitioner PETITIONER (the "Taxpayer") submitted a sales tax refund request to the Taxpayer Services Division of the Utah State Tax Commission. On October 27, 2004, the Taxpayer Services Division refunded sales tax to the Taxpayer in accordance with that refund request.

2. The Auditing Division of the Utah State Tax Commission (the "Division") made an audit of the Taxpayer's sales tax refund request. On December 19, 2006, it issued a Statutory Notice – Sales and Use Tax

(the "Statutory Notice") to the Taxpayer indicating that its audit found that the Taxpayer had requested more of a refund than Utah law allowed.

3. The Statutory Notice indicated that the Taxpayer owed $$$$$ in sales tax, together with $$$$$ in interest on the sales tax amount. The Statutory Notice indicated that the Division had computed interest as of January 1, 2007 and that interest would continue to accrue on any unpaid balance. The Statutory Notice indicated no assessment of penalty.

4. The Taxpayer operates a facility manufacturing (X) products and meets the SIC code requirements for a manufacturing facility located in Utah. In approximately September 2000, it purchased the (X) plant of another (X) manufacturer and moved most of its operations from a plant in CITY 1, Utah (the "CITY 1 Plant") to the newly purchased plant in CITY 2 (the "CITY 2 Plant").

5. The CITY 2 Plant and most of its equipment date to the 1960s. As old as it was, the CITY 2 Plant and its machinery were considerably newer than the CITY 1 plant and its equipment that generally dated to the 1920s.

6. The Taxpayer presented testimony, which the Division did not dispute, indicating that much of the equipment in the CITY 2 Plant was older than similar equipment generally in use in the industry.

7. The Taxpayer's aging equipment was prone to mechanical failure and required regular mechanical work to stay operating.

8. The Taxpayer presented testimony that unexpected mechanical breakdowns of equipment at its CITY 2 Plant were disruptive and expensive. Mechanical failure of one item had the potential of damaging product and shutting down the production line until maintenance crews could make necessary repairs. Unplanned repairs had the potential to be particularly inconvenient and expensive because they often involved overtime labor and special charges for parts that were not always available.

9. To prevent mechanical breakdowns of equipment at its CITY 2 Plant, the Taxpayer followed a regular schedule of taking equipment apart, inspecting it, replacing missing, damaged, or worn items, installing new lubricating oils or grease, and reassembling the equipment with new gaskets. The timing of this schedule depended on various factors such as age of equipment, amount of use, the Taxpayer's expectations and experience indicating how long the equipment would operate without problem, the availability of personnel to work on the equipment, and the ability to take the equipment out of service, if necessary.

10. The sales tax refund request and the Division's audit covered items that were listed in a collection of invoices that the parties have reduced to a listing of invoices. The Taxpayer produced witness testimony that indicated that the Taxpayer did not group its invoices by date or project. The Taxpayer's witness testified that

a few of the items were used to make building repairs, but did not identify which items.

11. The Taxpayer's schedules and other documentation as provided in this case do not distinguish any of the work completed on its equipment as an overhaul as opposed to repairs or maintenance.

12. In its internal records, the Taxpayer described the majority of the items in its refund request as "Repairs & Maintenance," although it infrequently categorized some items in other categories such as "Truck Repair & Maint." and "Operating Supplies."[1]

13. The Taxpayer presented testimony of the reconfiguration of what its witness called a "(X)." The Taxpayer purchased a piece of machinery to (WORDS REMOVED) into place. The machine proved to give unsatisfactory results, however, because the (X) did not stay in place when the filled (X) were transported to higher altitudes. To remedy this problem, the Taxpayer reconfigured the machine to (X) and (X) a different style of (WORDS REMOVED). While the purchase of this machine predated the audit period, the Taxpayer's witness indicated that he was fairly certain that the reconfiguration took place in the audit period. The Taxpayer's witness was unable to provide data such as the date of the reconfiguration, the costs involved, and which items in the refund request would relate to the reconfiguration.

14. In addition to parts and supplies for equipment, the Taxpayer's refund requests included gasses such as ammonia, argon, acetylene, oxygen, and propane. The items also included charges for the rental of propane tanks.

15. The Taxpayer used ammonia gas as a (WORDS REMOVED) in its plant. Although the ammonia did not wear out, the Taxpayer provided testimony that it had to replenish ammonia in its (X) systems from time to time.

16. The Taxpayer used argon as a shielding gas for welding. The argon did not become a part of the welded items, but was nevertheless necessary in the welding process. The Taxpayer used oxygen and acetylene as expendable gasses to torch-cut ferrous metals.

17. The Taxpayer purchased propane and rented propane tanks for its forklifts. The Taxpayer provided testimony that it used forklifts and pallet jacks to move both raw materials and finished product but the primary use of its pallet jacks and forklifts was for raw materials. The Taxpayer did not use forklifts within its (X) manufacturing facility out of concern for possible product contamination.

18. (PARAGRAPH REMOVED)

19. The Taxpayer presented information that the Commission granted a given percentage of the refund

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[1] The Taxpayer's invoices listed items categorized as "Equipment," including a forklift, an electric pallet jack used in the warehouse, and a piece of equipment referred to as a recording thermometer. These items are not at issue in this

request of another taxpayer in another case. The other taxpayer had no ties to the Taxpayer in this case and did not manufacture (X). Nevertheless, the Taxpayer argued that to be equitable, the Commission would be required to grant the same percentage of the Taxpayer's refund request.

APPLICABLE LAW

1. For transactions that would otherwise be subject to sales and use tax, Utah law provides for a number of exemptions from taxation in Utah Code Ann. §59-12-104. The Utah Legislature has adopted a statute that exempts certain sales of tangible personal property used in a manufacturing facility from sales tax. For the years at issue, Section 59-12-104 (2003)[2] provided, in pertinent part:

> The following sales and uses are exempt from the taxes imposed by this chapter:
> . . . .
> (14)(a) the following purchases or leases by a manufacturer on or after July 1, 1995:
> (i) machinery and equipment:
> (A) used in the manufacturing process;
> (B) having an economic life of three or more years; and
> (C) used:
> (I) to manufacture an item sold as tangible personal property; and
> (II) in new or expanding operations in a manufacturing facility in the state; and
> (ii) subject to the provisions of Subsection (14)(b), normal operating replacements that:
> (A) have an economic life of three or more years;
> (B) are used in the manufacturing process in a manufacturing facility in the state;
> (C) are used to replace or adapt an existing machine to extend the normal estimated useful life of the machine; and
> (D) do not include repairs and maintenance;
> . . . .
> (42) sales of natural gas, electricity, heat, coal, fuel oil, or other fuels for industrial use;

2. For purposes of the manufacturing exemption and during the periods at issue, Utah Admin. Rule R865-19S-85 (2003)[3] provides:

appeal because the Division agreed with the Taxpayer's refund request for these pieces of equipment.

[2] The Commission cites the 2003 version of the Utah Code for ease of reference in this decision. Although the applicable statutory provisions remained substantially the same throughout the audit period, some of the subsections were renumbered over this period. Subsequent to the audit period, in 2006, the manufacturing exemption was substantially revised regarding replacement parts.

[3] Utah Admin. Rule R865-19S-85 as revised in 2002. The rule remained the same in 2002 and 2003. For ease of reference, the Commission cites to the 2003 rule. The Commission does not consider the revision to materially

A. Definitions:
2. "Machinery and equipment" means:
a) electronic or mechanical devices incorporated into a manufacturing process from the initial stage where actual processing begins, through the completion of the finished end product, and including final processing, finishing, or packaging of articles sold as tangible personal property. This definition includes automated material handling and storage devices when those devices are part of the integrated continuous production cycle; and
b) any accessory that is essential to a continuous manufacturing process. Accessories essential to a continuous manufacturing process include: (i) bits, jigs, molds, or devices that control the operation of machinery and equipment; and (ii) gas, water, electricity, or other similar supply lines installed for the operation of the manufacturing equipment, but only if the primary use of the supply line is for the operation of the manufacturing equipment.

B. The sales and use tax exemptions for new or expanding operations and normal operating replacements apply only to purchases or leases of tangible personal property used in the actual manufacturing process.
1. The exemptions do not apply to purchases of real property or items of tangible personal property that become part of the real property in which the manufacturing operation is conducted.
2. Purchases of qualifying machinery and equipment or normal operating replacements are treated as purchases of tangible personal property under R865-19S-58, even if the item is affixed to real property upon installation.

. . .

C. Machinery and equipment or normal operating replacements used for a non-manufacturing activity qualify for the exemption if the machinery and equipment or normal operating replacements are primarily used in manufacturing activities. Examples of non-manufacturing activities include:
1. research and development;
2. refrigerated or other storage of raw materials, component parts, or finished product; or
3. shipment of the finished product.

3. Utah Code Ann. Section 59-12-102(30) (2003) defines industrial use, in pertinent part, as follows:

"Industrial use" means the use of natural gas, electricity, heat, coal, fuel oil, or other fuels:
. . . .
(c) in manufacturing tangible personal property at an establishment described in SIC Codes 2000 to 3999 of the 1987 Standard Industrial Classification Manual of the federal Executive Office of the President, Office of Management and Budget;

4. A taxpayer must maintain appropriate records to establish that a purchase is exempt. Utah Admin. Rule R865-19S-85(F) provides as follows:

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affect the decision for the portion of the audit period in the 2001 tax year.

> The manufacturer shall retain records to support the claim that the machinery and equipment or normal operating replacements are qualified for exemption from sales and use tax under the provisions of this rule and Section 59-12-104.

DISCUSSION

In this matter there was little disagreement between the parties regarding the facts. The Taxpayer, however, argued for a different interpretation of the law from the position taken by the Division in its Statutory Notice. The issues at the hearing involved the interpretation of the Manufacturers' Exemption at Utah Code Sec. 59-12-104(14). Both refund and audit periods at issue occurred prior to the 2006 revision to the Manufacturers' Exemption, which did change the law substantively. The Commission, however, must apply the substantive law in effect during the audit period. Additionally, in applying the facts to the applicable law, the Commission must consider that the issues presented in this matter are tax exemption issues.

A. Normal Operating Replacements

Most of the items described in the Taxpayer's refund request are normal operating replacement parts and supplies. However, not all normal operating replacements receive Utah's manufacturing exemptions. To receive a tax exemption for normal operating replacements, a taxpayer has to show that the claimed items "(A) have an economic life of three or more years; (B) are used in the manufacturing process in a manufacturing facility in the state; (C) are used to replace or adapt an existing machine to extend the normal estimated useful life of the machine; and (D) do not include repairs and maintenance." Utah Code Ann. §59-12-104 (14)(a)(ii) (2003). Because the four subparts of this subsection are joined with the conjunctive "and," a taxpayer must prove all four elements to receive the exemption. Additionally, the Commission notes that this subsection is part of an exemption statute. It is a well-settled principal of law[4] that tax exemption statutes are narrowly construed against the taxpayer.

Applying Utah Code Section 59-12-104(14), the Commission looks first to the plain language of the statute.[5] The Commission gives the terms of the statute their ordinary meaning. When interpreting a statute the Commission must assume that each term included in the statute was used advisedly. See *MacFarlane v. Utah*

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[4] See *Union Pacific R.R. v. Auditing Div.*, 842 P.2d 876, 880 (Utah 1992); *Parsons Asphalt Prods., Inc. v. State Tax Comm'n*, 617 P.2d 397, 398 (Utah 1980); *SF Phosphates LTD v. Auditing Div,.* 346 Utah Adv. Rep. 18 (Utah 1998); and *MacFarlane v. Utah State Tax Comm'n*, 2006 UT 25 (2006).

[5] In *Hart v. CITY 2 County Comm'n*, 945 P.2d 125, 138 (Utah 1996) (citations omitted) the Court stated, "the primary rule of statutory interpretation is to give effect to the intent of the legislature in light of the purposes the statute was meant to achieve, and the best evidence of the legislature's intent is the plain meaning of the statute. In *Hercules, Inc. v. Utah State Tax Comm'n.*, 21 P.3d 231 (Utah Ct. App. 2000) the court indicated that if a statute fails to define a word, one would use the dictionary definition or usual meaning. In *MacFarlane v. Utah State Tax Comm'n*, 2006 UT 25 (2006) the Court stated, "In undertaking statutory construction, "we look first to the plain language of a statute to determine its meaning. Only when there is ambiguity do we look further." (citation omitted) Moreover, "when examining the plain language we must assume that each term included

State Tax Comm'n, 2006 UT 25 (2006). Further, where the Legislature has not specifically defined a word, the Commission considers its ordinary or dictionary definition. *See Hercules, Inc. v. Utah State Tax Comm'n*., 21 P.3d 231 (Utah Ct. App. 2000). Instead of phrasing the exemption to encompass all replacement part purchases that extended the useful life, the Legislature placed the limitation that the item purchased must "adapt" the existing machine to extend the useful life and not for repairs or maintenance.[6]

Webster's II New Revised University Dictionary defines "adapt" as follows: "To adjust to a specified use or situation." It is clear that in drafting the statute in this manner the Legislature did not provide the exemption merely for items used to replace a broken part with the same part, but instead the exemption applies to items used to replace a part, which may or may not be broken, with something that would result in an adjustment to the machine that would extend is useful life. Webster's II New Revised University Dictionary defines "repair" as to "restore to sound condition after damage . . . [to] fix."

With one possible exception, the Taxpayer did not provide evidence that would support a finding that these parts were used to adapt machinery to extend its useful life. These parts were not used, or at least it was not shown that they were "used to replace or adapt an existing machine." The testimony for many of these items was that parts were purchased in advance and to have on hand when the equivalent part in the machine broke down. Then Petitioner's employees would replace the broken part. If the parts were installed in a piece of machinery because the equivalent part in the machine no longer functioned and without its function the machine, or component of the machine in which it was used, would no longer operate, replacing the broken part is a repair. The Commission notes that the evidence presented was that several of the machines in which the parts at issue had been installed had already exceeded their economic life. Therefore, the taxpayer argues that any replacement of parts would generally extend its useful life. Replacement of the same parts on a newer piece of equipment, however, would not extend its useful life. We reject this distinction. The "extension of useful life" language must be read in conjunction with the clear legislative decision to continue to tax "repairs and maintenance." Replacing the tires on a pickup trick does not extend the useful life of the truck, in our view, whether the truck is three years old or fifty years old. It is a repair of the truck. Rebuilding the engine on a truck, however, will normally extend its useful life, whether the truck is three years old or fifty years old. " A repair or preventative maintenance action does not replace a machine. Nor does it extend "the normal useful life." Thus, the evidence does not show that any of the purchases in question are other than normal operating

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in the [statute] was used advisedly." (Citations omitted).

[6] Because the Commission finds the statutes at issue to be unambiguous, the Commission declines the Taxpayer's request to consider legislative history or statutes predating the audit period. *See Brinkerhoff v. Forsyth*, 779 P.2d 685, 686 (Utah 1989) ("Where statutory language is plain and unambiguous, this Court will not look beyond the same to divine legislative intent.

replacements incident to repairs and maintenance.[7] The testimony indicated that some of the repairs may have been major overhauls that did, in fact, extend the useful life of the equipment. The witnesses, however, were unable to identify which expenditures would so qualify.

The Taxpayer did present testimony that it had adapted its (X) machine to (WORDS REMOVED) than the machine previously handled. As an action to "adjust to a specified use or situation," this is an adaptation. Thus if the Taxpayer's records allowed separation of the costs for this adaptation, the new parts would likely qualify for the manufacturing exemption. From the evidence presented at hearing, the Commission is unable to make this finding. At hearing, the Taxpayer's representative was critical of the Division for not organizing the Taxpayer's records to demonstrate qualification for various exemptions. This criticism misapprehends the record-keeping requirements of Utah law. The Taxpayer has not cited any law that would burden the Division with organizing taxpayer records. Rather, Utah Admin. Rule R865-19S-85(F) requires a manufacturer to "retain records to support the claim that the machinery and equipment or normal operating replacements are qualified for exemption from sales and use tax under the provisions of this rule and Section 59-12-104." While parts for the Taxpayer's adaptation of its (X) machine may have qualified for a manufacturing exemption, the Taxpayer's record keeping does not provide the Commission a basis to grant the exemption. *See Tummurru Trades, Inc. v. Utah State Tax Comm'n*, 802 P.2d 715, 718 (Utah 1990) (Commission required to deny exemption when taxpayer does not adequately document claims).

The Taxpayer made an argument that another taxpayer unrelated to the Taxpayer in this case made a refund request and received a given percentage of its claim as a refund. The Taxpayer then argued that equity required that the Taxpayer receive the same percentage as the unrelated taxpayer received in response to its unrelated claim. The Taxpayer provided no reason why an unrelated entity making an unrelated claim should receive the same percentage of its refund claim as another taxpayer.

B. Non-fuel Gasses

The Taxpayer clamed tax exemption for the purchase of various gasses that were not used as fuels. These gasses include argon and oxygen. The Taxpayer indicated that it consumed these gasses in making repairs to its equipment, but made no claim that it used these gasses as fuels. Thus, the Commission finds that these gasses may be analyzed under the same criteria as parts used in the repair processes. These gasses do not replace or adapt machines and are thus not exempt under the manufacturing exemption.

Rather, we are guided by the rule that a statute should generally be construed according to its plain language.")

[7] The Commission declines the Taxpayer's invitation to strain the language of Utah Code Ann. §59-12-104(14) to find that parts themselves are "machines." This ruling is consistent with case law requiring strict construction of exemption statutes. *See* cases cited *supra* note 4.

The Taxpayer uses ammonia gas as a refrigerant. The Taxpayer testified that ammonia lasts more than three years. We do not believe, however, that ammonia gas is "machinery or equipment" or a "part," within the meaning of the statute, or "an electronic or mechanical device" within the meaning of the rule, We do hold, however, for the Taxpayer's future guidance, that the (X) equipment was part of the manufacturing process. In this case, the evidence shows that (X) at very low temperatures is necessary to harden the products to provide greater product quality in storage. The additional hardening is part of the manufacturing, whereas mere storage of the product, after it was fully hardened would probably not be part of the manufacturing process. See Utah Admin. Rule R865-19S-85(A) (2)(a)(2003) "[machinery and equipment] includes material handling and storage devices when those devices are part of an integrated continuous production cycle. . ."

C. Fuel Gasses

The Taxpayer argued that two of the gasses it uses are exempt as fuels for industrial use. The Taxpayer maintains that it consumes acetylene and propane to manufacture (X) products.

For purposes of exemption of fuels under Utah Code Ann. Section 59-12-104(42) (2003), Utah Code Ann. Section 50-12-102(30) (2003) defines "[i]ndustrial use" as the use of fuel "in manufacturing tangible personal property at an establishment described in SIC Codes 2000 to 3999 of the 1987 Standard Industrial Classification Manual of the federal Executive Office of the President, Office of Management and Budget." We note that the "industrial use" requirement for fuels is broader than the exemption for machinery and equipment. Both exemptions require use of the property to manufacture personal property. The machinery and equipment exemption, however, contains an additional requirement that the machinery and equipment must be "used in the manufacturing process." Rule 85 on machinery and equipment makes the clear distinction between manufacturing and non-manufacturing activities at a single plant. Rule 35, on industrial fuel, makes a distinction between commercial, industrial and residential fuel. It does not make the same kind of fine distinctions that are made in Rule 35. Applying these statutes, the Taxpayer uses fuels. It meets SIC codes to be considered a manufacturer. Thus, a determination of whether the Taxpayer's use of fuel gasses is industrial use depends on whether the Taxpayer has demonstrated that it uses the fuels 1) "in manufacturing tangible personal property;" and, 2) at a manufacturing establishment meeting SIC codes for a manufacturing facility. The Taxpayer provided testimony that it used the propane to handle materials at a qualifying facility. The fuel was thus used for an industrial use, even though it was not used in the manufacturing process itself. It was certainly not used in a commercial or residential use. Accordingly, we believe the propane is exempt. Propane tanks are not combusted and are not, therefore, exempt as fuels. The Taxpayer used acetylene in repairing equipment. We understand acetylene to be a fuel used in cutting and welding. It is certainly

"combusted" as required by Rule 35. There is no allegation that the acetylene was used in a commercial or residential activity. Thus, the acetylene would come under the definition of "other fuels for industrial use" and is exempt under Utah Code Ann. §59-12-104(42).

CONCLUSIONS OF LAW

1. In Utah Code Sec. 59-12-104 (14)(a)(ii) the Legislature provided a statutory definition of "normal operating replacements." Pursuant to the definition the item must have an economic life of three or more years, be used in the manufacturing process in a manufacturing facility, be used to replace or adapt an existing machine to extend the normal estimated useful life of the machine and that the purchase not be for repairs and maintenance. It is the Commission's conclusion that the factual evidence available did not support the position that the items the Taxpayer claimed to be normal operating replacements were anything more than repairs and maintenance.

2. For the same reasons as Conclusion of Law number 1, The Taxpayer's use of non-fuel gasses does not qualify for the statutory definition of "normal operating replacements" as set forth in Utah Code Sec. 59-12-104 (14)(a)(ii).

3. For purposes of exemption of fuels under Utah Code Ann. Section 59-12-104(42) (2003), Utah Code Ann. Section 50-12-102(30) (2003) defines "[i]ndustrial use" as the use of fuel "in manufacturing tangible personal property." The Taxpayer's use of propane and acetylene qualifies as industrial use of fuel as set forth in Utah Code Ann. Section 50-12-102(30) (2003) and exemption from sales tax under Utah Code Ann. §59-12-104(42).

4. The Taxpayer has provided no legal basis for its assertion that it should receive the same percentage of its refund claim as a different manufacturer operating in an unrelated business received on its claim.

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Clinton Jensen
Administrative Law Judge

DECISION AND ORDER

On the basis of the foregoing, the Commission denies the Taxpayer's appeal in this matter with regard to requested sales tax exemption for normal operating replacements and non-fuel gasses, and grants the Taxpayer's requested exemption for propane and acetylene used as combustible gasses in industrial processes. It is so ordered.

DATED this _____ day of ______________________, 2010.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
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.

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