

07-0737
Audit
Signed 06/23/2008

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,

Petitioner,

vs.

AUDITING DIVISION OF THE UTAH
STATE TAX COMMISSION,

Respondent.

**FINDINGS OF FACT, CONCLUSIONS OF
LAW AND FINAL DECISION**

Appeal No. 07-0737

Account No. #####

Tax Type: Sales Tax

Audit Period: 1/03 – 12/06

Judge: Phan

Presiding:

Pam Hendrickson, Commission Chair

Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER REPRESENTATIVE

For Respondent: RESPONDENT REPRESENTATIVE 1, Assistant Attorney General
RESPONDENT REPRESENTATIVE 2, Deputy Director, Auditing Division
RESPONDENT REPRESENTATIVE 3, Manager, Sales Tax Auditing

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on March 26, 2008, on an appeal filed by Petitioner pursuant to Utah Code Sec. 59-1-501. Petitioner is appealing a sales and use tax audit deficiency. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. Petitioner is appealing a portion of the deficiency issued by Respondent from a Sales and Use Tax Audit for the period of January 1, 2006 through December 31, 2006. The Amended Sates and Use Tax

Audit at issue in this matter was date February 27, 2008. The parties had resolved all issues involving Schedule 1 of the audit prior to the Formal Hearing. At the Formal Hearing, Petitioner contested only Schedule 2 of the Amended Audit.

2. Schedule 2 of the Amended Audit indicated that Petitioner owed sales tax for unreported taxable construction material purchases totaling \$\$\$\$\$. This results in approximately \$\$\$\$\$ in sales tax, plus the interest accruing thereon. No penalties were assessed with the audit.

3. The parties did not dispute the material facts. PETITIONER (Petitioner) is a Construction Company, organized in 1994.¹ COMPANY A (“COMPANY A”) was formed by PETITIONER REPRESENTATIVE, the principal of Petitioner to act as the developer in acquiring the property and building the charter school. Neither Petitioner, nor COMPANY A, were qualified as non-profit entities. COMPANY B, (“COMPANY B”) was organized on January 23, 2004, as a Non-Profit Corporation² for the purposes of operating a charter school.

4. On March 22, 2004, the COMPANY B entered into a Lease With Option to Purchase Agreement with COMPANY A.³ Pursuant to that agreement, COMPANY A was to purchase the land in CITY upon which the school building would be constructed and the COMPANY B would lease the property from COMPANY A with an option to purchase. They lease was for a term that could be up to thirty years. The option to purchase the property indicated that COMPANY B could purchase the property “on or before the five (5) year anniversary of the commencement date . . .”⁴

5. Also on March 22, 2004, COMPANY A, the COMPANY B and Petitioner entered into an

1 Respondent’s Exhibit 2.

2 Respondent’s Exhibit 3.

3 Petitioner’s Exhibit 6.

4 Petitioner’s Exhibit 6, Sec.14.01

Agreement for Development, Construction Management, and General Contractor Services.⁵ Pursuant to this agreement COMPANY A would purchase the land, Petitioner would construct the building and COMPANY B would then, upon completion of the construction, lease the building with the option to purchase.

6. As outlined in the agreements, COMPANY A did acquire the land, Petitioner constructed the building and the COMPANY B was operational as a charter school by the beginning of the school year in September 2004.

7. Petitioner was the entity that had purchased the construction materials necessary to complete the building of the school. Petitioner did not pay sales tax on these purchases and it is these purchases that are indicated on Schedule 2 of the audit as unreported taxable construction material purchases totaling \$\$\$\$\$.

8. All throughout the period of time when Petitioner purchased the construction materials and the construction of the school building, the land under the building was owned by COMPANY A.

9. Petitioner's representative explained that the transaction had to be structured in the manner it was due to the way the school would receive financing.

APPLICABLE LAW

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. . . . (c) sales of the following for commercial use: (i) gas; (ii) electricity; (iii) heat; (iv) coal; (v) fuel oil; or (vi) other fuels; . . . (g) amounts paid or charged for services or repairs or renovations of tangible personal property; . . . (Utah Code Ann. Sec. 59-12-103(1) (2002)⁶.)

2. The following sales and uses are exempt from the taxes imposed by this chapter: . . . (2) sales to the state, its institutions, and its political subdivisions; however, this exemption does not apply to sales of :

⁵ Petitioner's Exhibit 5.

⁶ Statutes in the Sales and Use Tax Act and Administrative Rules have been both revised and renumbered since the

(a) construction materials except: (i) construction materials purchased by or on behalf of institutions of the public education system as defined in Utah Constitution Article X, Section 2, provided the construction materials are clearly identified and segregated and installed or converted to real property which is owned by institutions of the public education system; and (ii) construction materials purchase 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; . . . (Utah Code Ann. 59-12-104(2) (2004).)

3. A sale is considered made to the state, its department and institutions, or to its political subdivisions if the purchase is paid for directly by the purchasing state or local entity. If an employee of a state or local entity pays for a purchase with his own funds and is reimbursed by the state or local entity, that sale is not made to the state or local entity and does not qualify for the exemption. (Utah Admin. Rule R865-19S-42(B) (2002).)

CONCLUSIONS OF LAW

1. Petitioner's purchases of the construction materials are considered retail sales of tangible property under Utah Code Sec. 59-12-103 and are subject to sales tax unless they qualify for a specific sales tax exemption.

2. As the Division correctly noted, sales tax exemptions are narrowly construed against the taxpayers. The Division cites to *Parson Asphalt v. Utah State Tax Commission*, 617 P.2d 397, 398 (Utah 1980). See also *Gull Labs, Inc. v. Utah State Tax Comm'n*, 936 P.2d 1082 (Ct. App. 1997) and *Eaton Kenway*, 906 P.2d at 886. It is clear that the Commission may not expand a statutory exemption beyond the express statutory terms as were adopted by the Utah Legislature.

3. Utah Code Section 59-12-104(2) provides an exemption for sales to the state, its institutions

period at issue. In this order the Commission cites to the statutes and rules in affect during the relevant period.

and political subdivisions. However, as noted by Respondent there is an exception to this exemption for purchases of construction materials made by or on behalf of the public education system. Additional requirements must be met for these purchases of construction material to qualify for the exemption. The Legislature has specifically made the exemption from sales tax more stringent for these types of purchases. The specific requirements that must be met are set out at Subsection (2)(a)(i) of Utah Code 59-12-104(2).

4. Petitioner argues it should receive the exemption on the purchases of the construction material under Utah Code Sec. 59-12-104(2), because charter schools are part of the public education system and should be considered institutions of the states. He cites to Utah Code Sec. 53A-1a-503.5 in support of this position. The Commission reaches no conclusion on this contention. Regardless of whether the COMPANY B is deemed a public school and entity of the state, the purchases at issue do not qualify for the exemption on other grounds.

5. Utah Code Sec. 59-12-104(2)(a)(i) indicates that the materials must be installed or converted to real property which is owned by institutions of the public education system. COMPANY B did not own the real property at the time the construction materials were converted to real property. Therefore, the transactions do not qualify for this exemption.

6. Petitioner argued that the COMPANY B should be considered the owner of the property due to the Lease Option Agreement. The Commission disagrees. A lessee, even one with a lease option, is not the owner of the property. The owner is the party that has legal title to the property. The Commission recently considered the question of whether a party other than the legal title owner could be deemed the owner for a property tax exemption for use for charitable purposes. That decision is *Utah State Tax Commission, Initial Hearing Decision, Appeal No. 07-1067*. Further, Utah courts have looked at the question of ownership in *University of Utah v. Salt Lake County and Picker x-Ray*, 547 P.2d 207 (Utah 1976); and *Salt Lake County v.*

Tax Comm'n ex rel. Greater Salt Lake Recreational Facilities, 596 P.2d 641, 643 (Utah 1979). These decisions support that the owner is the holder of legal title. Certainly Petitioner did not provide any case law or statutory support for its position that the lessee, or a lessee with an option, could be considered the owner for purposes of the sales tax exemption.

7. The Commission understands that Petitioner and COMPANY B may have been unable to organize the transaction in a manner where the charter school owned the land at the time of the commencement of construction and also that charter schools in general may have similar challenges. However, it is up to the Legislature to determine if the exemption should be expanded in a manner that would encompass this type of transaction.

DECISION AND ORDER

Based upon the foregoing, the Tax Commission denies Petitioner's appeal. It is so ordered.

DATED this _____ day of _____, 2008.

Jane Phan
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 _____, 2008.

Appeal No. 07-0737

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
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. Sec. 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 Sec. 59-1-601 et seq. and 63-46b-13 et seq.

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