
BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,

Petitioner,

v.

AUDITING DIVISION OF THE
UTAH STATE TAX COMMISSION,

Respondent.

INITIAL HEARING ORDER

Appeal No. 08-2017

Account No. #####

Tax Type: Sales and Use

Audit Period: 02/01/2005 – 11/30/2007

Judge: Chapman

Presiding:

Kerry Chapman, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER REP 1, PETITIONER
PETITIONER REP 2, PETITIONER.

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

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to Utah Code Ann. §59-1-502.5 on July 21, 2009.

On September 29, 2008, Auditing Division (“Division”) issued a Statutory Notice to PETITIONER (“PETITIONER” or “taxpayer”) for the audit period February 1, 2005 through November 30, 2007. In the Statutory Notice, the Division assessed additional sales and use tax in the amount of \$\$\$\$\$, plus \$\$\$\$\$ in interest as of October 29, 2008, for a total assessment of \$\$\$\$\$.

The Division imposed sales and use tax on tangible personal property that the taxpayer received and stored at its CITY warehouse prior to converting it into real property at job sites in STATE 1 and STATE 2. The Division sourced the storage or use of the tangible personal property to the taxpayer’s CITY warehouse and calculated the amounts of sales and use tax it imposed with the tax rate applicable to CITY.

The taxpayer makes two challenges to the assessment. First, the taxpayer contends that all real property sales made in STATE 1 and STATE 2 are nontaxable sales made in interstate commerce. As a result, the taxpayer asserts that the Division erroneously imposed sales and use tax on its storage or use of tangible personal property that it converted to real property in these other states. Second, even if it owes sales tax on the tangible personal property it converted to real property, the taxpayer contends that the Division should not have calculated its sales tax liability with the tax rate applicable to its CITY location. The taxpayers assert that the Division should have used the tax rates applicable to its various job sites to calculate the tax due.

APPLICABLE LAW

Utah Code Ann. §59-12-103(1) (2007)¹ provides that a tax is imposed on the purchaser for amounts paid or charged for the following transactions:

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- (l) amounts paid or charged for tangible personal property if within the state the tangible personal property is:
 - (i) stored;
 - (ii) used; or
 - (iii) consumed[.]
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For sales and use tax purposes, UCA §59-12-102 defines the terms “storage” and “use,” as follows:

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- (95) "Storage" means any keeping or retention of tangible personal property or any other taxable transaction under Subsection 59-12-103(1), in this state for any purpose except sale in the regular course of business.
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- (108) (a) "Use" means the exercise of any right or power over tangible personal property under Subsection 59-12-103(1), incident to the ownership or the leasing of that property, item, or service.

¹ All cites refer to the 2007 version of Utah law, unless otherwise indicated.

(b) "Use" does not include the sale, display, demonstration, or trial of that property in the regular course of business and held for resale.

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UCA §59-12-104(61) (2008), which was amended in 2008 with retroactive application to July 1, 2004, provides an exemption from taxation for certain sales of tangible personal property incorporated into real property, as follows:

(61) (a) subject to Subsection (61)(b) or (c), sales of tangible personal property to a person within this state if that tangible personal property is subsequently shipped outside the state and incorporated pursuant to contract into and becomes a part of real property located outside of this state;

(b) the exemption under Subsection (61)(a) is not allowed to the extent that the other state or political entity to which the tangible personal property is shipped imposes a sales, use, gross receipts, or other similar transaction excise tax on the transaction against which the other state or political entity allows a credit for sales and use taxes imposed by this chapter; and

(c) notwithstanding the time period of Subsection 59-12-110(2)(b) for filing for a refund, a person may claim the exemption allowed by this Subsection (61) for a sale by filing for a refund:

(i) if the sale is made on or after July 1, 2004, but on or before June 30, 2008;

(ii) as if this Subsection (61) as in effect on July 1, 2008, were in effect on the day on which the sale is made;

(iii) if the person did not claim the exemption allowed by this Subsection (61) for the sale prior to filing for the refund;

(iv) for sales and use taxes paid under this chapter on the sale;

(v) in accordance with Section 59-12-110; and

(vi) subject to any extension allowed for filing for a refund under Section 59-12-110, if the person files for the refund on or before June 30, 2011[.]

Utah Admin. Rule R865-19S-58 ("Rule 58") provides guidance concerning the sale and use tax responsibilities of real property contractors, as follows in pertinent part:

(1) Sales of construction materials and other items of tangible personal property to real property contractors and repairmen of real property are generally subject to tax if the contractor or repairman converts the materials or items to real property.

....

(2) The sale of real property is not subject to sales tax, nor is the labor performed on real property. For example, the sale of a completed home or building is not subject to the tax, but sales of materials and supplies to contractors for use in building the home or building are taxable transactions as sales to final consumers.

(a) The contractor or repairman who converts the personal property to real property is the consumer of tangible personal property regardless of the type of contract entered into - whether it is a lump sum, time and material, or a cost-plus contract.

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(3) (c) The contractor must accrue and remit tax on all merchandise bought tax-free and converted to real property. Books and records must be kept to account for both material sold and material consumed.

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Although repealed on January 1, 2009, Utah Admin. Rule R865-12L-6 (“Rule 6”) provided guidance during the audit period for purposes of determining the place where a transaction takes place, as follows in pertinent part:

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E. Purchases subject to use tax are defined as those purchases made by ultimate consumers for their own storage, use, or consumption in Utah when the merchandise is shipped from outside Utah direct to the purchaser in Utah and on which the vendor did not charge Utah use tax. Local use tax applies to purchases subject to use tax, as defined above, that are stored, used, or consumed in a county that has adopted the uniform local tax law.

F. Taxpayers having one or more places of business in Utah shall report all purchases subject to use tax, as defined above, according to the location of the place of business at which the tangible personal property is initially delivered. If initially delivered within a county that has adopted the uniform local tax law, local use tax applies, regardless of whether the goods are later transferred to a different location.

Utah Admin. Rule R865-19S-44 (Rule 44”) provides guidance concerning sales made in interstate commerce, as follows:

A. Sales made in interstate commerce are not subject to the sales tax imposed. However, the mere fact that commodities purchased in Utah are transported beyond its boundaries is not enough to constitute the transaction of a sale in interstate commerce. When the commodity is delivered to the buyer in this state, even though the buyer is not a resident of the state and intends to transport the property to a point outside the state, the sale is not in interstate commerce and is subject to tax.

B. Before a sale qualifies as a sale made in interstate commerce, the following must be complied with:

1. the transaction must involve actual and physical movement of the property sold across the state line;
2. such movement must be an essential and not an incidental part of the sale;

3. the seller must be obligated by the express or unavoidable implied terms of the sale, or contract to sell, to make physical delivery of the property across a state boundary line to the buyer;
- C. Where delivery is made by the seller to a common carrier for transportation to the buyer outside the state of Utah, the common carrier is deemed to be the agent of the vendor for the purposes of this section regardless of who is responsible for the payment of the freight charges.
- D. If property is ordered for delivery in Utah from a person or corporation doing business in Utah, the sale is taxable even though the merchandise is shipped from outside the state to the seller or directly to the buyer.

APPLICABLE FACTS

1. The taxpayer is a real property contractor that installs exterior siding. The taxpayer does business in 18 states and has warehouses in 11 states.
2. One of the taxpayer's warehouses is located in CITY, Utah. This is the taxpayer's only business location in Utah.
3. The only activities that occur at the CITY warehouse are "warehousing" and "back office" operations. There is no showroom at the CITY warehouse and potential customers do not visit the facility. All sales and presentations occur in the homes of the taxpayer's customers. The taxpayer has a business license in most jurisdictions in which it makes in-home presentations. In addition, the taxpayer states that its customers have a three business day right of rescission because sales do not occur at the taxpayer's facility.
4. The taxpayer purchases materials from various manufacturers and distributors, some of which are shipped to its CITY warehouse. When materials arrive at the warehouse, they are counted, reconciled to the shipping documents and stocked.
5. Materials are stored at the CITY warehouse prior to being delivered to various job sites.

6. When a contract is entered into, personnel at the CITY warehouse prepare a “charge sheet” for the materials needed to fulfill the contract based on information prepared by the sales representative. The contract is assigned to one of the taxpayer’s installation crews, which gathers the appropriate materials from the CITY warehouse. The installation crews transport the materials to the job sites and install the materials at the job sites.

7. The taxpayer has not accrued and paid Utah sales and use tax on the materials used in performing its various contracts.

8. The taxpayer has paid tax to STATE 1 and STATE 2 on the materials used to perform contracts completed in those states. STATE 1 and STATE 2 each allow a credit against the taxes due to those states for any sales and use taxes imposed by Utah on the same transaction.

DISCUSSION

Are the Materials at Issue Subject to Utah Taxation? The taxpayer argues that the materials at issue are not subject to taxation because they are sold in interstate commerce as part of the contract to provide and install siding on homes. The taxpayer also argues that its materials are held for sale in the regular course of business and, as a result, do not meet the definitions of “storage” or “use,” as found in Section 59-12-102.

The Commission disagrees. The taxpayer and its customers enter into real property contracts. The taxpayer does not enter into contracts for the sale of tangible personal property. Accordingly, the materials on which the Division imposed Utah sales and use tax were not held for sale in the regular course of business. The materials are stored or used by the taxpayer in order for it to consume the materials when performing its real property contracts. Furthermore, the Utah Supreme Court has clarified that such materials are subject to Utah sales and use tax, even though a taxpayer converts the materials to real property in a state outside of Utah.

In (*X*). v. *Utah State Tax Comm'n*, 802 P.2d 715 (Utah 1990), one of the issues considered by the Utah Supreme Court concerned the taxation of materials stored in Utah and used by a real property contractor to construct real property outside of Utah. The court found that the taxpayer, as a real property contractor, was the consumer of the materials. The Court stated that “[t]he act of taking the items out of inventory for use in a construction contract is a retail sale for the purpose of sales tax because the contractor is the ultimate consumer.” The Court determined that the circumstances did not qualify as a sale in interstate commerce. The Court reconfirmed this position in (*X*). v. *State Tax Comm'n*, 839 P.2d 303 (Utah 1992), stating that “[e]ven if a real property contractor incorporates the materials into real property in another state, the purchase in Utah of those materials is still taxable.”

In the present case, the taxpayer owns the materials stored at its CITY warehouse. In addition, the taxpayer converts the materials to real property. Whether the materials are converted into real property in Utah or another state, the taxpayer consumes them. Under these circumstances, the Commission finds that the taxpayer owes Utah sales and use tax on the materials that were stored at its CITY warehouse and that it converted into real property.

Section 59-12-104(61) provides an exemption from taxation in certain cases where a real property contractor consumes tangible personal property when performing a real property contract outside of Utah. The Commission notes that such an exemption would be unnecessary if, as the taxpayer argues, the materials used in such contracts are nontaxable sales in interstate commerce. Regardless, the exemption is not applicable in the present case. Section 59-12-104(61)(b) provides that the exemption is not allowed when the state in which the tangible personal property is converted to real property allows a credit for Utah sales and use tax that is due. The Division asserts that STATE 1 and STATE 2, the two states in which the taxpayer converted the materials at issue into real property, allow such a credit. The taxpayer did not contest the Division’s assertion.

Should CITY's Tax Rate Be Used to Calculate the Tax Due on the Materials? The taxpayer contends that the Division erred when it used the tax rate applicable to its CITY warehouse to calculate the tax it owes on the materials it consumed. The taxpayer contends that the tax rates of the locations at which the installation took place should be used instead. As an example, the taxpayer states that the tax rate used for a vending machine sale is the tax rate of the location where the vending machine is located, not the warehouse where the vendor stores the vending items.

The Commission disagrees with the taxpayer. Rule 6(E), (F) clarifies that items delivered to Utah and stored or used by the purchaser are subject to use tax where the items are originally delivered. There is no question that the materials at issue in this case were delivered to the taxpayer at its CITY warehouse, as it is the taxpayer's only business location in Utah. Accordingly, the Division properly used the tax rate for the CITY warehouse when it calculated the taxpayer's liability in this matter.

DECISION AND ORDER

Based upon the foregoing, the Commission finds that the taxpayer owes Utah sales and use tax on the tangible personal property that it stored at its CITY warehouse and converted into real property in STATE 1 and STATE 2. In addition, the Commission finds that the Division properly used the tax rate applicable to the taxpayer's CITY warehouse when calculating the taxpayer's tax liability. Accordingly, the Commission sustains the Division's assessment and denies the taxpayer's appeal. 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

Appeal No. 08-2017

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 _____, 2009.

Kerry Chapman
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 _____, 2009.

Pam Hendrickson
Commission Chair

R. Bruce Johnson
Commissioner

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Notice: If a Formal Hearing is not requested as discussed above, failure to pay the balance resulting from this order within thirty (30) days from the date of this order may result in a late payment penalty. If the Petitioner decides not to seek a Formal Hearing and wishes to discuss payment options, he may contact Taxpayer Services Division at (801) 297-2200.

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