

09-2874
AUDIT
SIGNED 05-06-2010

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER,

Petitioner,

v.

AUDITING DIVISION OF THE
UTAH STATE TAX COMMISSION,

Respondent.

INITIAL HEARING ORDER

Appeal No. 09-2874

Account No. #####

Tax Type: Sales and Use Tax

Audit Period: 05/01/08 – 05/31/08

Judge: Chapman

Presiding:

Kerry Chapman, Administrative Law Judge

Appearances:

For Petitioner: PETITIONER REP. 1, from PETITIONER
PETITIONER REP. 2, from 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 on May 3, 2010.

PETITIONER (“PETITIONER” or “taxpayer”) is appealing Auditing Division’s (“Division”) assessment of additional sales and use tax for a one-month audit period, specifically May 1, 2008 through May 31, 2008. On September 9, 2009, the Division issued a Statutory Notice – Sales and Use Tax (“Statutory Notice”) to the taxpayer, in which it imposed additional sales and use tax of \$\$\$\$ plus interest of \$\$\$\$ (calculated through October 9, 2009), for a total assessment of \$\$\$\$.

The Division asserts that the taxpayer sold and converted tangible personal property into real property without paying sales and use tax on its purchase of the tangible personal property and without

accruing use tax on its consumption of the property. The audit only concerns that tangible personal property that the taxpayer sold and installed in regards to the construction of the RECREATION CENTER (“Recreation Center”). The Division asks the Commission to find that the taxpayer is liable for the tangible personal property that it sold and converted into real property and to sustain its assessment.

The taxpayer states that it was a subcontractor hired by COMPANY A (“COMPANY A”), the general contractor hired by CITY 1 to construct the Recreation Center. The taxpayer states that it usually accrues and remits use tax on items of tangible personal property that it sells and converts into real property. However, for this particular job, COMPANY A provided PETITIONER with an exception certificate approved by the CITY 1 Attorney to purchase items tax-free under the Utah state and local governments exemption. The letter from COMPANY A to PETITIONER specifically stated:

Please find enclosed with this letter, a form that has been approved by the CITY 1 Attorney for distribution to all subcontractors and suppliers for the [RECREATION CENTER project]. If you are purchasing any materials for use in the execution of your subcontract agreement, we would expect you to copy this information to your suppliers and request that they issue immediate credits for sales tax and that may have already been charged during the course of this project. They should also immediately cease charging sales tax on any future purchase by your company. If your company is the primary supplier of the material we would expect that no sales tax would be charged on any of your invoicing.

Given the circumstances, the taxpayer asks the Commission to find that it is not liable for the assessment at issue.

APPLICABLE LAW

1. Utah Code Ann. §59-12-103(1)(2008)¹ provides that sales and use tax is imposed on certain transactions, as follows in pertinent part:

- (a) retail sales of tangible personal property made within the state;
.....
- (l) amounts paid or charged for tangible personal property if within this state the tangible personal property is:

1 The 2008 version of Utah law is cited, unless otherwise indicated.

- (i) stored;
- (ii) used; or
- (iii) otherwise consumed;

....

2. UCA §59-12-104(2) provides an exemption for sales to certain governmental entities

and specifically addresses whether construction materials are exempt, as follows:

(2) sales to the state, its institutions, and its political subdivisions; however, this exemption does not apply to sales of:

(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 purchased 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; or

....

3. During the audit period, Utah Admin. Rule R865-19S-58 (“Rule 58”) provided, 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.

b. . . . , the contractor or repairman who converts the construction materials, fixtures or other items to real property is the consumer of the personal property whether the contract is performed for an individual, a religious or charitable institution, or a government entity.

....

e. Purchases . . . are assumed to have been made by the contractor and are subject to sales tax.

....

2. If the contractor or repairman purchases all materials and supplies from vendors who collect the Utah tax, no sales tax license is required unless the contractor makes direct sales of tangible personal property in addition to the work on real property.

- a. If direct sales are made, the contractor shall obtain a sales tax license and collect tax on all sales of tangible personal property to final consumers.
- b. 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.

....

4. UCA §59-1-1417 (2009) provides that the burden of proof is upon the petitioner in proceedings before the Commission, with limited exceptions as follows:

In a proceeding before the commission, the burden of proof is on the petitioner except for determining the following, in which the burden of proof is on the commission:

- (1) whether the petitioner committed fraud with intent to evade a tax, fee, or charge;
- (2) whether the petitioner is obligated as the transferee of property of the person that originally owes a liability or a preceding transferee, but not to show that the person that originally owes a liability is obligated for the liability; and
- (3) whether the petitioner is liable for an increase in a deficiency if the increase is asserted initially after a notice of deficiency is mailed in accordance with Section 59-1-1405 and a petition under Part 5, Petitions for Redetermination of Deficiencies, is filed, unless the increase in the deficiency is the result of a change or correction of federal taxable income;
 - (a) required to be reported; and
 - (b) of which the commission has no notice at the time the commission mails the notice of deficiency.

DISCUSSION

PETITIONER purchased tangible personal property tax-free and converted it into real property while completing its contract in regards to the Recreation Center. Pursuant to Section 59-10-103(1) and Rule 58, PETITIONER is required to accrue use tax on tangible personal property. The taxpayer did not accrue and remit use tax on the tangible personal property at issue because of instructions it received directly from COMPANY A and indirectly from CITY 1. Specifically, the taxpayer was instructed that it should not

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include sales and use tax in its bid on the basis that CITY 1 was exempt from taxation pursuant to 59-10-104(2), which provides, in part, that “sales to the state, its institution and political subdivisions” are exempt.

The taxpayer, however, was misinformed when it was told that it would not be required to accrue and remit use tax on its purchases on tangible personal property. First, the taxpayer sold real property to COMPANY A and CITY 1 and, in doing so, was the final consumer of the tangible personal property it converted into real property. Second, Section 59-10-104(2)(a)(ii) specifically provides that the state and local government exemption does not apply to construction materials purchased by a governmental entity unless the governmental entity’s own employees install or convert the materials into real property. In this case, CITY 1’s employees did not convert the tangible personal property at issue into real property. PETITIONER did. As a result, the materials are subject to taxation, and the taxpayer should have accrued and remitted use tax on the materials. For these reasons, the Division’s assessment should be sustained.

Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based upon the foregoing, the Commission sustains the Division’s assessment. 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

Appeal No. 09-2874

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 _____, 2010.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
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.

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