09-3565
AUDIT
TAX YEARS: 2005, 2006, 2008
SIGNED: 10-14-2010
COMMISSIONERS: R. JOHNSON, B. JOHNSON, D. DIXON, M. CRAGUN
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**INITIAL HEARING ORDER** Appeal No. 09-3565 Account No. ##### Tax Type: Income Audit Period: 10/1/05 -9/30/08 Judge: Phan

Presiding:
Jane Phan, Administrative Law Judge

Appearances:
For Petitioner: PETITIONER REP., CPA
For Respondent: RESPONDENT REP. 1, Assistant Attorney General
RESPONDENT REP. 2, Manager, Manger, COMPANY A
RESPONDENT REP. 3, Senior Auditor
RESPONDENT REP. 4, Auditor

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to Utah Code Sec. 59-1-502.5 on July 28, 2010. Petitioner (the Taxpayer) is appealing an audit deficiency issued by Respondent (the Division) for the audit period from October 1, 2005 through September 30, 2008. For each of the tax years at issue the Division denied enterprise zone credits claimed by the Taxpayer on its Utah Corporation Franchise or Income Tax Returns. The Statutory Notice of Audit Change was issued on November 5, 2009 for all three tax years at issue. The Taxpayer timely appealed the audit. The amount of additional tax due for each tax year is as follows:

Tax Period	Tax	Interest	Penalty	Total[1]
10/1/05 - 9/30/06	$$$$$	$$$$$	$$$$$	$$$$$
10/1/06 - 9/30/07	$$$$$	$$$$$	$$$$$	$$$$$

1 Total listed as of date of Statutory Notice. Interest continues to accrue on the unpaid balance.

10/1/07 – 9/30/08	$$$$$	$$$$$	$$$$$	$$$$$

APPLICABLE LAW

Enterprise Zone Credits are provided at Utah Code 63-38f-413(1) (2006)[2] as follows:

> Subject to the limitations of Subsections (2) through (4), the following nonrefundable tax credits against a tax under Title 59, Chapter 7, Corporate Franchise and Income Taxes, or Title 59, Chapter 10 Individual Income Tax Act, are applicable in an enterprise zone: . . . (g) an annual investment tax credit of 10% of the first $250,000 in investment, and 5% of the next $1,000,000 qualify investment in plant, equipment, or other depreciable property.

That section also provides that businesses engaged in retail trade and public utilities may not claim the credit. Utah Code Sec. 63-38f-413(5) provides:

> The tax credits under Subsections (1)(a) through (g) may not be claimed by a business entity engaged in retail trade or by a public utilities business.

A further qualification for the credit is located at Utah Code Ann. §63-38f-412 (2006) which provides that to qualify for an enterprise zone credit, a business must meet residency requirements as follows:

> The tax incentives described in this part are available only to a business entity for which at least 51% of the employees employed at facilities of the business entity located in the enterprise zone are individuals who, at the time of employment, reside in the county in which the enterprise zone is located.

"Business entity" is defined at Utah Code Sec. 63-38f-402 (2006) as follows:

> "Business entity" means an entity: (a) including a claimant, estate, or trust; and (b) under which business is conducted or transacted.

Utah Admin. Rule R865-9I-37 (2006) clarifies the retail sales criteria would not eliminate qualification for the credit if the sales were de minimis as follows:

> E. A business firm that conducts non-retail operations and is engaged in retail trade qualifies for the credits under Section 9-2-413 if the retail trade operations constitute a de minimis portion of the business firm's total operations.

The burden of proof in on the Petitioner in these proceedings pursuant to Utah Code Sec. 59-1-1417 (2009) which provides:

> In a proceeding before the commission, the burden of proof is on the petitioner . . .

2 The law was revised in 2006, but the change between 2005 and the 2006 provisions did not appear substantive regarding the issue presented by the parties in this appeal.

Generally, tax exemption or tax credit statutes are strictly construed against the taxpayer. *See Parson Asphalt Prods., Inc. v. State Tax Comm'n,* 617 P.2d 397, 398 (Utah 1980)("[s]tatutes which provide for exemptions should be strictly construed, and one who so claims has the burden of showing his entitlement to the exemption"). Tax credit statutes, like tax exemptions, "are to be strictly construed against the taxpayer." *MacFarlane v. State Tax Comm'n,* 2006 UT 18, ¶11. "While we recognize the general rule that statutes granting credits must be strictly construed against the taxpayer, the construction must not defeat the purposes of the statute. The best evidence of that intent is the plain language of the statute." (Citations omitted.) *See id. at* ¶19.

DISCUSSION

Although there are a number of qualifications for the enterprise zone credit, the only issue in dispute at the hearing was whether or not the Taxpayer was disqualified from taking the credit because the Taxpayer had a small amount of retail trade in its overall operations. Utah Code Sec. 63-38f-413(6) provides that a business entity may not claim the credits if it is engaged in retail trade. It was undisputed that the Taxpayer was primarily engaged in (PORTION REMOVED) which was not considered retail trade. It performed this construction for COMPANY B and other customers. However, for each year at issue in addition to the site construction, the Taxpayer also leased equipment such as (PORTION REMOVED) to COMPANY B at COMPANY B's request. The Taxpayer's representative indicated that this was done to accommodate COMPANY B who was a major customer of the (PORTION REMOVED) construction. The leasing of equipment is retail trade. The Taxpayer collected sales tax on the equipment rentals, filed sales tax returns and remitted the tax amount based on those rentals. It was undisputed that for each of the tax years at issue the amount of the rentals were less than 5% of the Taxpayers total operations. The parties agreed that the break out between the equipment rentals and construction operations were as follows:

Tax Year Ending	Retail Sales (Rentals)	Total Sales	Percentage of Retail
9/30/06	$$$$$	$$$$$	2.6730%
9/30/07	$$$$$	$$$$$	4.7019%
9/30/08	$$$$$	$$$$$	3.9265%

The Taxpayer argued that the retail sales were a de minimis portion of its overall operations. The Taxpayer's representative pointed out that for each of the years the retail sales were less than 5% of the total operations. He stated that he had spoken with one state tax auditor who told him de minimis was now defined as less than 10% and another auditor, AUDITOR A, who said that something over 5% would not be de minimis. He also noted that there had been two private letter rulings discussing de minimis, although neither

was dealing with the requirement for the enterprise zone credit.[3] He requested that the Commission issue an interpretation of de minimis for purposes of the enterprise zone credit that is based on a percentage of total revenue. It was his position that giving a specified percentage would be the only way for tax preparers to know how to advise their clients.

Although the Division acknowledged that the retail sales constituted less than 5% of the total sales for each year, the Division argued that the retail sales were not de minimis. The Division pointed out that even though small in percentage to the total, the retail sales were a high dollar amount, more than $$$$$ for the 2006 year and nearly $$$$$ for the 2007 year. It was the Division's position that de minimis should not be determined based on a specified percentage but should be determined based on a totality of the facts including the dollar amount of the retail sales and even how integral the retail sales were to the primary business. In this case the Division did not think $$$$$ in retail sales could be de minimis and asked that the audit be upheld.

The Division also pointed out that the statuary definition of "de minimis" for purpose of the bundled transactions provisions in the Sales Tax Act has no application to the enterprise zone credit provision. The Taxpayers representative had relied on Private Letter Ruling 09-005 which involved a sales tax exemption related to bundled transactions. The Sales and Use Tax Act currently provides a definition of de minimis as it relates to bundled transactions for purposes of determining sales tax liability. The definition is found at Utah Code Sec. 59-12-102(15)(e) and provides that up to 10% of a bundled transaction would be de minimis. The Division points out that this definition is for sales tax purposes and does not apply to provisions of the Enterprise Zone Act. It was the Division's position that the Commission had not previously issued a ruling on the definition of de minimis for the purposes of the enterprise zone credit, but argued against adopting the bright line test based on the percentage of the retail sales to the total operations that was requested by the Taxpayer. It was the Division's position that the determination of de minimis should be based on the totality of all the facts.

---

3 The Taxpayer cited to Private Letter Rulings 09-005 and 94-006. Advisory Opinion 94-006 was issued by the Commission on May 13, 1994. In that letter the Commission interpreted "de minimis" as used in Admin. Rule R865-19S-85(Involving the manufactuere's exemption for machinery & equitpment). The letter stated "[a] use factor in excess of 5 percent with be considered more than de minimis." However, a subsequent Advisory Opinion in 94-006 was issues on June 6, 1994 in which the Commission stated "In summary, it appears that the definition in Black's Law Dictionary is as clear as we could find. It says de minimis things are "very small or trifling matters." While I am sure you would prefer the certainty of a percentage, this term is not susceptible of easy, universal definition, therefore, the Commission has used it sparingly and cannot elaborate further." In Private Letter Ruling 09-005, the issue was whether a plan that included payroll services and a software tool was a bundled transaction.

Upon review of the evidence and information presented by the parties at the hearing, the Division should have allowed the enterprise zone credits at issue. The legislature provided the credits to business entities that conducted or transacted business, had employees working in a facility of the business located in the enterprise zone and of which 51% resided within the County in which the zone was located. See Utah Code Sec. 63-38f-402 and 63-38f-412. However, the legislature specified that the credits "may not be claimed by a business entity engaged in retail trade." Utah Code Sec. 63-38f-413(5). "Retail Trade" was not defined in the Enterprise Zone Act. The Tax Commission adopted a rule that clarifies "retail trade." Utah Admin. Rule R865-9I-37(E) (2006) stated that a business firm that conducts non-retail operations and is engaged in retail trade could qualify for the credits "if the retail trade operations constitute a de minimis portion of the business firm's total operations." Although the rule specifically discusses the retail sales as a portion of the businesses' total operations, the Division's argument that $$$$$ in sales or $$$$$ in sales is a significant dollar amount its own right and therefore, not de minimis, is not misplaced. However, it is clear from the rule that the portion of the retail sales to the firm's total operations is relevant in determining when a business qualifies for the credit if the other requirements have been met.

Neither side was able to submit case law or a prior Tax Commission decision that delineated a percentage below which would be de minimis or even a definition for purposes of this provision. The Commission concludes that retail sales comprising less than 5% of a business' total operations, is generally a strong indication that a business is not engaged in retail trade for purposes of Utah Code Sec. 63-38f-413(5). Nonetheless, to qualify for the enterprise zone credit other criteria should be considered, and the determination of whether sales were de minimis should not be made solely on the basis of the percentage of total operations. There may be situations where sales of less than 5% are not de minimis, or situations where sales of over 5% are de minimis.

Given the large dollar amount of the retail sales for this Taxpayer, the single issue of the percentage of retail sales to construction income is insufficient in and of itself to determine whether the business is engaged in retail trade. In this case, the Taxpayer leased the property only to a single customer, COMPANY B, in support of its construction activities; it was not a stand-alone retail operation. The Commission concludes that when these two factors are considered together - the proportion of sales and the nature of the sales - the level of retail operations and sales is de minimis with respect to the Taxpayer's qualifying business activity.

However, for purposes of the sales tax liability at issue in that ruling the term "de minimis" was defined by statute at Utah Code Sec. 59-12-102(15)(e) to be 10% or less of the seller's total sales price.

Jane Phan
Administrative Law Judge

ORDER

On the basis of the foregoing, the Commission orders the Division to amend the audit to allow the enterprise zone credits in accordance with this decision for all three tax years. 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

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.

JKP/09-3565.int