

10-0998  
SALES & USE  
TAX YEARS: 2006, 2007, 2008  
SIGNED: 10-12-2012  
COMMISSIONERS: R. JOHNSON, M. CRAGUN  
PARTIAL CONCURRENCE & PARTIAL DISSENT: M. JOHNSON, D. DIXON

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BEFORE THE UTAH STATE TAX COMMISSION

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PETITIONER,

Petitioner,

v.

TAXPAYER SERVICES DIVISION OF THE  
UTAH STATE TAX COMMISSION,

Respondent.

**INITIAL HEARING ORDER**

Appeal No. 10-0998

Account No. #####-1

Tax Type: Sales & Use

Tax Period: 01/01/06 - 04/30/08

Judge: Chapman

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**Presiding:**

Kerry R. Chapman, Administrative Law Judge

**Appearances:**

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

For Respondent: RESPONDENT REP. 1, Assistant Attorney General  
RESPONDENT REP. 2, from Taxpayer Services Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for an Initial Hearing pursuant to the provisions of Utah Code Ann. §59-1-502.5, on June 7, 2011. Post-hearing telephone status conferences were held on July 12, 2011 and October 4, 2011, and the parties submitted post-hearing briefs in October 2011.

On July 28, 2009, PETITIONER (“PETITIONER” or “taxpayer”) filed a request for a refund of sales tax that it had paid on transactions that occurred between January 1, 2006 and April 30, 2008 and that it claimed to be exempt from taxation. PETITIONER specifically asked for a refund of \$\$\$\$ of sales tax that it paid on purchases of machinery, equipment, and replacement parts (collectively referred to as “machinery”) and \$\$\$\$ of sales tax that it paid on purchases of dyed diesel fuel (“fuel”).

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On March 11, 2010, Taxpayer Services Division issued a Statutory Notice, in which it denied the refund request in its entirety. First, the Division determined that the refund request was past the statute of limitations for those transactions that occurred between January 1, 2006 and May 30, 2006, which PETITIONER did not contest at the Initial Hearing.

Second, the Division determined that the machinery that PETITIONER purchased did not qualify for the “manufacturing exemption” provided in Utah Code Ann. §59-12-104(14) (2006). For those transactions that occurred between June 1, 2006 and April 30, 2008 (i.e., those for which a timely refund request was submitted), the amount of sales tax at issue for purchases of machinery totals \$\$\$\$\$.

To qualify for the manufacturing exemption, a taxpayer must meet a number of requirements. For purposes of the Initial Hearing, the Division asserts that PETITIONER has not met two of the requirements, but reserved the right to contest other requirements at a future time. First, the Division asserts that PETITIONER does not meet the requirement of being a “manufacturing facility,” as described in Utah Code Ann. §59-12-102(43) (2006). PETITIONER contends that it qualifies as a “manufacturing facility” under either of two scenarios provided in Section 59-12-102(43). Specifically, PETITIONER contends that it is a “manufacturing facility” either: 1) because it is an establishment described in SIC Codes 2000 to 3999; or 2) because it is a scrap recycler. The Division also contends that PETITIONER does not qualify for the manufacturing exemption because it does meet the requirement that it manufactures an item sold as tangible personal property.

Third, the Division determined that the fuel that PETITIONER purchased did not qualify for the “industrial fuel exemption” provided in Utah Code Ann. §59-12-104(39) (2006). For those transactions that occurred between June 1, 2006 and April 30, 2008 (i.e., those for which a timely refund request was submitted), the amount of purchases of fuel totals \$\$\$\$\$.

PETITIONER contends that its fuel purchases are exempt if the Commission determines that it is an establishment described in SIC Codes 2000 to 3999. However, as previously mentioned, the Division contends that PETITIONER is not an establishment described in SIC Codes 2000 to 3999. PETITIONER concedes that if the Commission finds that it is not an establishment described in SIC Codes 2000 to 3999, its fuel purchases are taxable, even should the Commission determine that it is a “scrap recycler” for purposes of the manufacturing exemption.

APPLICABLE LAW

**I. Manufacturing Exemption.** Utah law provides for a number of sales and use exemptions in Section 59-12-104. Prior to July 1, 2006, Section 59-12-104(14)<sup>1</sup> provided, as follows in pertinent part:

- (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) . . . 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[.]

. . . .

Beginning July 1, 2006 and in effect for the remainder of the period at issue, Section 59-12-104(14) provided, as follows in pertinent part:

- (14) (a) . . . . amounts paid or charged on or after July 1, 2006, for a purchase or lease by a manufacturing facility . . . , for the following:
  - (i) machinery and equipment that:

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<sup>1</sup> All cites are to the 2006 version of Utah law, unless otherwise indicated. In SB 31 (2006), the Legislative substantively amended Section 59-12-104(14). The changes pertinent to this appeal, which affected manufacturing facilities described as establishments in SIC Codes 2000 to 3999 and as scrap recyclers, became effective on July 1, 2006.

- (A) is used:
  - (I) for a manufacturing facility other than a manufacturing facility that is a scrap recycler described in Subsection 59-12-102(43)(b):
    - (Aa) in the manufacturing process; and
    - (Bb) to manufacture an item sold as tangible personal property; or
  - (II) for a manufacturing facility that is a scrap recycler described in Subsection 59-12-102(43)(b), to process an item sold as tangible personal property; and
- (B) has an economic life of three or more years; and
- (ii) normal operating repair or replacement parts that:
  - (A) have an economic life of three or more years; and
  - (B) are used:
    - (I) for a manufacturing facility in the state other than a manufacturing facility that is a scrap recycler described in Subsection 59-12-102(43)(b), in the manufacturing process; or
    - (II) for a manufacturing facility in the state that is a scrap recycler described in Subsection 59-12-102(43)(b), to process an item sold as tangible personal property; . . . .

Throughout the period at issue, “manufacturing facility” is defined in UCA §59-12-102(43)<sup>2</sup>, as follows in pertinent part:

- (43) For purposes of Section 59-12-104, "manufacturing facility" means:
  - (a) 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; [or]
  - (b) a scrap recycler if:
    - (i) from a fixed location, the scrap recycler utilizes machinery or equipment to process one or more of the following items into prepared grades of processed materials for use in new products:
      - (A) iron;
      - (B) steel;
      - (C) nonferrous metal;
      - (D) paper;
      - (E) glass;
      - (F) plastic;
      - (G) textile; or
      - (H) rubber; and
    - (ii) the new products under Subsection (60)(b)(i) would otherwise be made with nonrecycled materials; or
  - (c) a cogeneration facility as defined in Section 54-2-1.

Utah Admin. Rule R865-19S-85 (“Rule 85”) provides guidance in determining whether an item

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<sup>2</sup> The numbering changed for the subsequent years, but the language remained intact.

qualifies for the manufacturing exemption. Rule 85 was amended during the period at issue in this appeal, with the amendments becoming effective on November 11, 2006. Until November 11, 2006, Rule 85 provided, as follows in pertinent part:<sup>3</sup>

A. Definitions:

1. "Establishment" means an economic unit of operations, that is generally at a single physical location in Utah, where qualifying manufacturing processes are performed. If a business operates in more than one location (e.g., branch or satellite offices), each physical location is considered separately from any other locations operated by the same business.
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.
3. "Manufacturer" means a person who functions within a manufacturing facility.
4. a) "New or expanding operations" means:
  - (i) the creation of a new manufacturing operation in this state; or
  - (ii) the expansion of an existing Utah manufacturing operation if the expanded operation increases production capacity or is substantially different in nature, character, or purpose from that manufacturer's existing Utah manufacturing operation.b) The definition of new or expanding operations is subject to limitations on normal operating replacements.  
c) A manufacturer who closes operations at one location in this state and reopens the same operation at a new location does not qualify for the new or expanding operations sales and use tax exemption without demonstrating that the move meets the conditions set forth in A.4.a). Acquisitions of machinery and equipment for the

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<sup>3</sup> The amendments to Rule 85 involved the removal of all references to the terms "new or expanding operations" and "normal operating replacements," which the Legislature had removed from Section 59-12-104(14) effective July 1, 2006. Except for these changes, the revised version of Rule 85 that became effective on November 11, 2006 and the prior version of Rule 85 are the same.

new location may qualify for the normal operating replacements sales and use tax exemption if they meet the definition of normal operating replacements in A.5.

5. "Normal operating replacements" includes:
  - a) new machinery and equipment or parts, whether purchased or leased, that have the same or similar purpose as machinery or equipment retired from service due to wear, damage, destruction, or any other cause within 12 months before or after the purchase date, even if they improve efficiency or increase capacity.
  - b) if existing machinery and equipment or parts are kept for backup or infrequent use, any new, similar machinery and equipment or parts purchased and used for the same or similar function.

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 nonmanufacturing activity qualify for the exemption if the machinery and equipment or normal operating replacements are primarily used in manufacturing activities. Examples of nonmanufacturing 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.

D. Where manufacturing activities and nonmanufacturing activities are performed at a single physical location, machinery and equipment or normal operating replacements purchased for use in the manufacturing operation are eligible for the sales and use tax exemption for new or expanding operations or for normal operating replacements if the manufacturing operation constitutes a separate and distinct manufacturing establishment.

1. Each activity is treated as a separate and distinct establishment if:
  - a) no single SIC code includes those activities combined; or
  - b) each activity comprises a separate legal entity.
2. Machinery and equipment or normal operating replacements used in both manufacturing activities and nonmanufacturing activities qualify for the exemption for new or expanding operations or for normal operating replacements only if the machinery and equipment or normal operating replacements are primarily used in manufacturing activities.

E. 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.

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## **II. 1987 Standard Industrial Classification Manual ("SIC Manual").**

**A. SIC Code Assignment.** The basis of SIC Code assignment is explained on page 15 of the SIC Manual, as follows in pertinent part: “Each operating establishment is assigned an industry code on the basis of its primary activity, which is determined by its principal product or group of products produced or distributed, or services rendered. . . .”

**B. DIVISION D - Manufacturing.** The SIC Manual provides guidance for the manufacturing division on page 67, as follows:

The manufacturing division includes establishments engaged in the mechanical or chemical transformation of materials or substances into new products. These establishments are usually described as plants, factories, or mills and characteristically use power driven machines and materials handling equipment. Establishments engaged in assembling component parts of manufactured products are also considered manufacturing if the new product is neither a structure nor other fixed improvement.

. . . .

The new product of a manufacturing establishment may be finished in the sense that it is ready for utilization or consumption, or it may be **semifinished** to become a raw material for an establishment engaged in further manufacturing. For example, the product of the copper smelter is the raw material used in electrolytic refineries; refined copper is the raw material used by copper wire mills; and copper wire is the raw material used by certain electrical equipment manufacturers.

. . . .

Manufacturing production is usually carried on for the wholesale market, for interplant transfer, or to order for industrial users, rather than for direct sale to the domestic consumer. (Emphasis added.)

**C. Major Group 29 and SIC Code 2951.** Major Group 29 (Petroleum Refining and Related Industries) “includes establishments primarily engaged in petroleum refining, manufacturing paving and roofing materials, and compounding lubricating oils and greases from purchased materials. . . .”

The establishments included in SIC Code 2951 (Asphalt Paving Mixtures and Blocks) are described as “[e]stablishments primarily engaged in manufacturing asphalt and tar paving mixtures; and paving blocks made of asphalt and various compositions of asphalt or tar with other materials. Establishments primarily engaged in manufacturing brick, concrete, granite, and stone paving blocks are classified in Major Group 32.” Among the activities listed under SIC Code 2951 are “asphalt and asphaltic mixtures for paving, not made in

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refineries,” “asphalt paving blocks, not made in petroleum refineries,” “asphaltic concrete, not made in petroleum refineries,” “road materials, bituminous: not made in petroleum refineries,” and “tar and asphaltic mixtures for paving, not made in petroleum refineries.”

**D. Major Group 32 and SIC Code 3295.** The description for Major Group 32 (Stone, Clay, Glass, and Concrete Products) provides:

This major group includes establishments engaged in manufacturing flat glass and other glass products, cement, structural clay products, pottery, concrete and gypsum products, cut stone, abrasive and asbestos products, and other products from materials taken principally from the earth in the form of stone, clay, and sand. When separate reports are available for mines and quarries operated by manufacturing establishments classified in this major group, the mining and quarrying activities are classified in Division B, Mining. When separate reports are not available, the mining and quarrying activities, other than those of Industry 3295, are classified herein with the manufacturing operations.

If separate reports are not available for crushing, grinding, and other preparation activities of Industry 3295, these establishments are classified in Division B, Mining.

Establishments included in SIC Code 3295 (Minerals and Earths, Ground or Otherwise Treated) are described as follows:

Establishments operating without a mine or quarry and primarily engaged in processing, grinding, pulverizing, or otherwise preparing clay, ceramic, and refractory minerals; barite; and miscellaneous nonmetallic minerals, except fuels. These minerals are the crude products mined by establishments of Industry Groups 145 and 149, and by those of Industry 1479 mining barite. Also included are establishments primarily processing slag and preparing roofing granules. The beneficiation or preparation of other minerals and metallic ores, and the cleaning and grading of coal, are classified in Division B, Mining, whether or not the operation is associated with a mine.

**III. Industrial Fuel Exemption.** Section 59-12-104(39) provides a sales and use tax exemption for “sales of natural gas, electricity, heat, coal, fuel oil, or other fuels for industrial use[.]”

Section 59-12-102(37) defines “industrial use” to mean, as follows in pertinent part:

(37) "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;

(d) by a scrap recycler if:



(i) from a fixed location, the scrap recycler utilizes machinery or equipment to process one or more of the following items into prepared grades of processed materials for use in new products:

- (A) iron;
- (B) steel;
- (C) nonferrous metal;
- (D) paper;
- (E) glass;
- (F) plastic;
- (G) textile; or
- (H) rubber; and

(ii) the new products under Subsection (37)(d)(i) would otherwise be made with nonrecycled materials; . . .

. . . .

Utah Admin. Rule R865-19S-35(D) (“Rule 35”) provides guidance in determining whether a purchase of fuel qualifies for the industrial fuel exemption, as follows in pertinent part:

. . . .

C. If a firm has activities that are commercial and industrial and all fuels are furnished at given locations through single meters, the predominant use of the fuels shall determine taxable status of the fuels.

D. Fuel oil and other fuels must be used in a combustion process in order to qualify for the exemption from sales tax for industrial use of fuels pursuant to Section 59-12-104.

**IV. Burden of Proof.** UCA §59-1-1417 (2012) provides that the burden of proof is generally upon the petitioner in proceedings before the Commission, with limited exceptions as follows:

(1) 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:

- (a) whether the petitioner committed fraud with intent to evade a tax, fee, or charge;
- (b) 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
- (c) 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:
  - (i) required to be reported; and
  - (ii) of which the commission has no notice at the time the commission mails the notice of deficiency.

(2) Regardless of whether a taxpayer has paid or remitted a tax, fee, or charge, the commission or a court considering a case involving the tax, fee, or charge shall:

- (a) construe a statute imposing the tax, fee, or charge strictly in favor of the taxpayer; and

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(b) construe a statute providing an exemption from or credit against the tax, fee, or charge strictly against the taxpayer.

### DISCUSSION

PETITIONER is typically contracted by other entities to ( WORDS REMOVED ). PETITIONER owns ( EQUIPMENT LISTED ), and PETITIONER provides its own employees to operate its machinery. Under its contracts, PETITIONER is paid by the ( PRODUCT ) manufacturers a “cost per ton ( PROCESSED ).”

Where an entity operates both a ( MACHINE ) and the ( PLANT ), the Commission has found the entire operation to be a manufacturing facility whose machinery and equipment can qualify for the manufacturing exemption. In *USTC Appeal No. 97-1342* (Findings of Fact, Conclusions of Law, and Final Decision Feb. 26, 1999), the Commission determined that the ( EQUIPMENT ) and ( PLANT ) operated by a ( CONTRACTOR ) that consumed 75% to 80% of the ( PRODUCT ) it manufactured in its ( BUSINESS ) and that sold the remaining 20% to 25% of the ( PRODUCT ) it manufactured to third parties qualified for the manufacturing exemption.

When an entity operating its own ( MACHINE ) and ( PLANT ) needs another ( MACHINE ), it hires PETITIONER to bring in its portable machinery and equipment to perform this portion of the manufacturing process. PETITIONER can tear down, move, and set up its machinery and equipment at a ( PLANT ) in a few days. PETITIONER proffers that the ( PLANTS ) at which it is contracted to ( PROCESS ) old ( PRODUCT ) are permanent in nature and that its ( MACHINES ) are “semi-permanently” affixed at the ( PLANT ) while its contract is in place.

PETITIONER uses its excavating equipment to remove the old ( PRODUCT ) from ( X ) and dump it into a pile next to the ( PLANT ). PETITIONER uses its ( PROCESSING ) machinery to ( PROCESS ) the ( PRODUCT ) to a grade and quality that is fit to be used in the ( PLANT ). PETITIONER does not own the old ( PRODUCT ) being ( PROCESSED ). It is owned by the other entities.

PETITIONER uses its excavators, loaders, and ( MACHINES ) to excavate and ( PROCESS PRODUCT ) approximately 80% of the time. For 10% of the time, the machinery is used to ( WORDS REMOVED ). PETITIONER sells any steel recovered with this process. For the remaining 10% of the time, PETITIONER excavates and ( PROCESSES ) other types of ( PRODUCT ) that do not contain ( X ).

**I. Manufacturing Exemption.**

The parties disagree on whether PETITIONER qualifies for the manufacturing exemption on its purchases of machinery. A taxpayer must meet a number of requirements found in Section 59-12-104(14) in order to qualify for this exemption. For the Initial Hearing, only two of those requirements are at issue, specifically whether PETITIONER is a “manufacturing facility” and whether PETITIONER’s machinery is used to manufacture or process “an item sold as tangible personal property.”<sup>4</sup>

**A. Manufacturing Facility.** The parties disagree on whether PETITIONER is a “manufacturing facility,” as defined in Section 59-12-102(43). Section 59-12-102(43) provides three scenarios under which an entity can qualify as a “manufacturing facility.” PETITIONER claims that it qualifies under either of two of the scenarios. First, PETITIONER claims that it meets the requirements of a “scrap recycler” and, as a result, qualifies as a manufacturing facility under Section 59-12-102(43)(b). Second, PETITIONER claims that it is “an establishment described in SIC Codes 2000 to 3999” and, as a result, also qualifies as a manufacturing facility under Section 59-12-102(43)(a).

i. Scrap Recycler. Section 59-12-104(43)(b)(i) lists eight specific items that an entity may “process . . . into prepared grades of processed materials for use in new products” in order to qualify as a “scrap recycler.” An entity cannot qualify as a “scrap recycler” if it only recycles items that are not included on

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<sup>4</sup> For example, for those transactions that occurred prior to July 1, 2006, the requirements to qualify for the exemption included a showing that the machinery was used in “new or expanding operations” or that the machinery qualified as “normal operating replacements.” For purposes of the Initial Hearing, the Division did not assert that PETITIONER’s machinery was not used in new or expanding operations or was not normal operating replacements. This specific requirement of the exemption was eliminated effective July 1, 2006.

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the list. ( SENTENCE REMOVED ). Of these items, the “steel” ( X ) that PETITIONER extracts from ( WORDS REMOVED ) is the only item that PETITIONER processes for which it can qualify as a “scrap recycler.”

To qualify as a manufacturing facility under the “scrap recycler” scenario, PETITIONER must show that it utilizes its machinery to process the steel “into prepared grades of processed materials for use in new products.” PETITIONER proffered no evidence to show that it processes the steel it recovers from the ( WORDS REMOVED ) into prepared grades of processed materials for use in new products. Accordingly, it has not shown that it is a scrap recycler that qualifies as a “manufacturing facility” under Section 59-12-102(43)(b).

ii. Establishment Described in SIC Codes 2000 to 3999. PETITIONER also contends that it qualifies as a “manufacturing facility” under Section 59-12-102(43)(a) because it is an establishment described in SIC Codes 2000 to 3999. The Commission’s decision in *Appeal No. 97-1342* establishes that the various ( PLANTS ) at which PETITIONER ( PROCESSES PRODUCTS ) qualify as “manufacturing facilities” because they are establishments described in SIC Code 2951 (i.e., establishments primarily engaged in manufacturing ( PRODUCT ) and ( MATERIALS )).

Prior to July 1, 2006, Section 59-12-104(14)(a)(i)(C) requires machinery to be “used . . . in a manufacturing facility” in order to qualify for the exemption. Effective July 1, 2006, Section 59-12-104(14) was amended to provide that the machinery for which an exemption was sought must not only be purchased or leased by a “manufacturing facility,” but must also be “used . . . for a manufacturing facility. . . .” Under either of these statutes, PETITIONER itself must be a “manufacturing facility” in order to satisfy the requirements of the exemption. PETITIONER is not a manufacturing facility due to its equipment being located and operated at a ( PLANT ). PETITIONER is a separate establishment from the ( PLANTS ). As such, it must be

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considered independently for purposes of the manufacturing exemption before any other determination can be made.

**PETITIONER's Economic Activity is Manufacturing.** The first issue facing the Commission is to determine if a SIC Code is applicable to PETITIONER itself. Neither party made a persuasive argument as to the appropriate SIC Code. Nevertheless, page 67 of the SIC Manual describes the manufacturing division of the SIC codes and provides that the manufacturing of one product can be the raw material for manufacturing another product. In addition to this guidance, the SIC Manual further provides a list of activities for “numerous borderline cases between manufacturing and other divisions of the classification system,” recognizing that distinctions between the classifications are not always clear.

The Commission finds that the production of ( PROCESSED PRODUCT ) most closely falls within the manufacturing division of the SIC codes. Much like raw copper that is smelted or produced from copper ore, ( PROCESSED PRODUCT ) is a “semifinished” product or the raw material used in ( PLANTS ) to produce ( PRODUCT ). Further indirect support for this position is provided in the mining division of the SIC Manual, which on page 48 addresses mining of nonmetallic minerals, stating in relevant part:

Establishments primarily engaged in crushing, pulverizing, or otherwise treating earths, rocks, and minerals mined in Industry Group 145 or 149 . . . are classified in Manufacturing, Industry 3295.

Group 149 includes native asphalt and asphalt rock mining.

Based on an analysis of various provisions of the SIC Manual in their entirety, the Commission concludes that SIC Code 2951, Asphalt Paving Mixtures and Blocks, best describes the economic activity of PETITIONER. In the alternative, SIC Code 3295 would be applicable. This classification describes establishments primarily engaged in “crushing, grinding, [or] pulverizing . . . minerals [which] are the crude products mined by establishments of Industry Groups 145 and 149[.]”

**PETITIONER is a Manufacturing Facility.** Having found that PETITIONER's activity falls either under SIC Code 2951 or SIC Code 3295, the Commission finds that it qualifies as a manufacturer, as well as a manufacturing facility. Because this falls within the parameters of Section 59-12-102(43)(a) as "an establishment described in SIC Codes 2000 to 3999," PETITIONER is statutorily defined as a manufacturing facility.

**B. Item Sold as Tangible Personal Property.** Second, even if PETITIONER meets the "manufacturing facility" requirement, the Division asserts that PETITIONER does not meet another of the requirements necessary to qualify for the manufacturing exemption. The Division contends that PETITIONER does not meet the requirement that it manufacture an item sold as tangible personal property.

For the exemption in effect prior to July 1, 2006, an entity must use the qualifying machinery to "manufacture" an item sold as tangible personal property, regardless of which scenario under which the entity qualifies as a "manufacturing facility." Section 59-12-104(14)(a)(i)(C)(I). For the exemption in effect beginning July 1, 2006, an entity must also use the qualifying machinery to "manufacture" an item sold as tangible personal property, if it qualifies as a "manufacturing facility" because it is an establishment described in SIC Codes 2000 to 3999. Section 59-12-104(14)(a)(i)(A)(I)(Bb).<sup>5</sup> Because PETITIONER qualifies as a manufacturing facility under the scenario of an establishment described under SIC Codes 2000 to 3999, it must show that it uses the machinery at issue to manufacture an item **sold** as tangible personal property. Accordingly, PETITIONER must show that the ( PROCESSED PRODUCT ) it manufactures is sold as tangible personal property.

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<sup>5</sup> For the law in effect July 1, 2006, if an entity qualifies as a manufacturing facility because it is a scrap recycler, it must show that it uses its machinery to "process" instead of "manufacture" an item sold as tangible personal property. Section 59-12-104(14)(a)(i)(A)(II). Earlier, the Commission determined that PETITIONER was a "manufacturing facility" because it met the "establishment described in SIC Codes 2000 to 3999" scenario, but not the "scrap recycler" scenario. As a result, PETITIONER must show that it "manufactures" instead of "processes" an item **sold** as tangible personal property.

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In *Appeal No. 97-1342*, the Commission found that a ( PLANT ) that consumed 75% to 80% and sold the remaining 20% to 25% of the ( PRODUCT ) it manufactured satisfied the requirement that it manufactured an item sold as tangible personal property. It is not disputed that the ( PRODUCT ) chunks produced by PETITIONER are themselves tangible personal property. In this matter, however, PETITIONER has not provided any information to show that it sells the ( PROCESSED PRODUCT ) that it produces. In fact, PETITIONER admitted that it is paid by the ( PLANTS ) on a “cost per ton ( PROCESSED ).” Accordingly, PETITIONER has not shown that it meets this specific requirement of the manufacturing exemption. Because PETITIONER has not met all requirements necessary to qualify for the manufacturing exemption, its request for a refund of the sales tax it paid on its machinery purchases should be denied.

## **II. Industrial Fuel Exemption.**

PETITIONER contends that the fuel it purchases to operate its machinery qualifies for the industrial fuel exemption. Section 59-12-104(39) provides a sales and use tax exemption for “sales of natural gas, electricity, heat, coal, fuel oil, or other fuels for industrial use[.]” Section 59-12-102(37) defines “industrial use” to mean use of fuels in various scenarios. Two of those scenarios are similar to those discussed earlier in regards to whether PETITIONER was a “manufacturing facility” for purposes of the manufacturing exemption. Along with several other uses, “industrial use” is defined to include: 1) use “in manufacturing tangible personal property at an establishment described in SIC Codes 2000 to 3999;” and 2) use by a “scrap recycler.” Section 59-12-102(37)(c) and (d).

PETITIONER concedes that if the Commission determines that it is a “scrap recycler,” but not “an establishment described in SIC Codes 2000 to 3999,” it does not qualify for the industrial fuel exemption. However, if the Commission determines that PETITIONER is “an establishment described in SIC Codes 2000 to 3999,” PETITIONER contends that its fuel qualifies for the industrial use exemption. The Division does not disagree with PETITIONER’s contention that its fuel purchases are exempt if PETITIONER is deemed “an

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establishment described in SIC Codes 2000 to 3999.” The Division, however, asserts that PETITIONER qualifies as neither a “scrap recycler” nor “an establishment described in SIC Codes 2000 to 3999” and, as a result, would not qualify for the industrial fuel exemption.

The Commission has previously determined that PETITIONER uses its machinery to manufacture tangible personal property and that PETITIONER is an establishment described in SIC Codes 2000 to 3999. Accordingly, PETITIONER’s use of the fuel at issue qualifies as “industrial use,” as defined in Section 59-12-102(37), and for the industrial fuel exemption provided in Section 59-12-104(39). For purposes of the fuel exemption, PETITIONER must show only that it manufactures tangible personal property. It need not show that any of its product is sold as tangible personal property. For these reasons, PETITIONER’s request for a refund of the sales and use taxes it paid on fuel purchases that occurred between June 1, 2006 and April 30, 2008 should be granted. The request for a refund of sales and use tax paid on fuel purchases that occurred prior to June 1, 2006 should be denied because the refund request was not timely for these transactions.

#### DECISION AND ORDER

Based on the foregoing, the Commission denies PETITIONER’s request for a refund of sales and use tax that it paid on its purchases of machinery. The Commission grants PETITIONER’s request for a refund of the sales and use taxes it paid on fuel purchases that occurred between June 1, 2006 and April 30, 2008, but denies its request for taxes paid on fuel purchases that occurred prior to June 1, 2006.<sup>6</sup> 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:

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<sup>6</sup> Utah Code Ann. §59-1-205(2)(c) provides that in case of a tie vote, the position of the taxpayer is considered to have prevailed. A tie vote has occurred in this appeal. The position of Commission Chair R. Bruce Johnson and Commissioner Michael J. Cragun is more favorable to the taxpayer and, thus, is the majority decision.



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 \_\_\_\_\_, 2012.

R. Bruce Johnson  
Commission Chair

Michael J. Cragun  
Commissioner

PARTIAL CONCURRENCE AND PARTIAL DISSENT

I concur in part and dissent in part with the decision of my colleagues, R. Bruce Johnson and Michael J. Cragun.<sup>7</sup> I concur with the majority's conclusion that PETITIONER does not qualify for the manufacturing exemption, but only on the basis that there is no dispute that PETITIONER does not sell tangible personal property. However, I completely disagree that PETITIONER is a manufacturing facility, and I don't believe that the company or the majority has sufficiently made this case.<sup>8</sup> Because I disagree that PETITIONER qualifies as a manufacturing facility under the SIC Codes, I do not believe that PETITIONER qualifies for the industrial fuel exemption on any of its fuel purchases. Accordingly, I dissent from the majority's conclusion that PETITIONER qualifies for a refund of a portion of the sales and use taxes it paid on its fuel purchases.

While there may not be an industry group that better describes PETITIONER's activity, I do not

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<sup>7</sup> I accept the majority's position on scrap recycling, and do not address it here.

<sup>8</sup> The division failed to show an alternative establishment that better describes PETITIONER. Nor did it

believe that the SIC codes relied upon by the majority actually describe PETITIONER, as is required by the Utah Supreme Court under *Atlas Steel, Inc. v. Utah State Tax Commission*, 61 P.3d 1053 (Utah 2002).

PETITIONER does not meet the two critical statutory requirements for the exemption:

1. PETITIONER's primary activity is not manufacturing for exemption purposes.
2. PETITIONER is not a manufacturing facility.

**PETITIONER's Primary Economic Activity is not Manufacturing ( PRODUCT ) Paving Mixtures or ( PROCESSED PRODUCT ) Rock**

Establishments described in SIC Code 2951 are "primarily engaged in manufacturing ( PRODUCT ) and ( MIXTURES )," which is not PETITIONER's primary activity. In fact, there is no evidence that PETITIONER, as a separate establishment, manufactures anything at all; it simply excavates and ( PROCESSES PRODUCT )<sup>9</sup> that is then delivered to the ( PLANT ), which itself actually manufactures ( PRODUCT MATERIAL ). The SIC Manual on page 67 defines manufacturing establishments as "engaged in the mechanical or chemical transformation of materials or substances into new products." ( PROCESSED PRODUCT ) is not a new product; it is the same product that has been reduced in size. Unlike the copper smelting example used in the SIC Manual, PETITIONER does not extract raw ( PRODUCT ) from ( PRODUCT ) rock.

Page 48 of the SIC Manual provides that "[e]stablishments primarily engaged in crushing [or] pulverizing . . . minerals mined in Industry Group 145 or 149 . . . are classified in Manufacturing, Industry 3295[.]" Group 149 includes native and rock asphalt mining. PETITIONER does not ( PROCESS ) previously mined ( PRODUCT ); it excavates and ( PROCESSES PRODUCT ). Industry Group 3295 covers the crushing and pulverizing of minerals found in Group 149, which does include native ( PRODUCT

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articulate an explanation as to why it is not a manufacturing facility.

<sup>9</sup> ( DEFINITION REMOVED )

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) and ( PRODUCT ) rock. Native ( PRODUCT ) and ( PRODUCT ) rock, however, are not the raw materials used by PETITIONER, or the ( PLANTS ) for that matter.

PETITIONER's *primary* activity is excavating and ( PROCESSING ) previously manufactured ( PRODUCT ). Such an activity is not described in SIC Codes 2951, 3295, or in any of codes found in SIC Codes 2000 to 3999.

**PETITIONER does not operate a Manufacturing Facility.**

Because PETITIONER is not a manufacturer under the SIC Codes, it cannot, by definition, be a manufacturing facility.

**PETITIONER does not qualify for the Manufacturing Exemption.**

The majority indeed correctly recognized that the establishment described in *Appeal No. 97-1342* was a single manufacturing establishment under the same ownership. Accordingly, I agree that had PETITIONER's machinery been owned by a ( PLANT ), it would have been incorporated into the manufacturing process, as was the case of the taxpayer in *Appeal No. 97-1342*. In this case, because PETITIONER has been identified as a separate establishment, its equipment does not meet the fundamental requirement under §59-12-104(14)(a) that the equipment be purchased by a manufacturing facility. Thus, while PETITIONER may subcontract with a manufacturing facility to provide ( PROCESSING ) services, it itself is not a manufacturing facility. Accordingly, it does not qualify for the exemption.

The Court in *Atlas* stated “[t]he Commission is not required to determine which of the SIC codes ‘best describes’ Atlas. The Commission is merely required to determine if one of the SIC codes in the range from 2000 to 3999 describes Atlas in the manner explained above.” That manner described is to “make factual determinations as to the activities in which the establishment is engaged, the extent to which an establishment is engaged in those activities, what processes are used in those activities, and what products result from those

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activities.” PETITIONER is not engaged in any of the activities, nor does it produce any of the products described in either SIC Code 2951 or 3295. Although its economic activity may be as well described by SIC Code 2951 or 3295 than by any of the non-manufacturing codes, PETITIONER does not manufacture ( PRODUCT ), nor does it ( PROCESS ) or pulverize ( PRODUCT ) stone. I am also not convinced that PETITIONER qualifies under the broad definitions for the Manufacturing Division. However, even if it did, there is no specific manufacturing SIC Code that describes its economic activity.

**Conclusion.**

All that is known about PETITIONER, as an establishment, is that at least part of its activity is to contract with other establishments that ( WORDS REMOVED ). It is not known whether this is a de minimis operation or whether it constitutes most or all of its economic activity.

Because this case involves exemptions, any ambiguity in the law should be construed strictly in favor of taxation and should not be construed in favor of the taxpayer. See *Parson Asphalt Prod. v. State Tax Comm'n*, 617 P.2d 397, 398 (Utah 1980). I believe that Utah law, *Atlas* coupled with *Parson*, clearly provides that all of the transactions at issue are taxable and do not qualify for exemption. These distinctions are critical; while general SIC Codes under a “best fit” premise may have been appropriate for tax reporting and general classification purposes, they are not appropriate for exemption purposes.

Marc B. Johnson  
Commissioner

PARTIAL CONCURRENCE AND PARTIAL DISSENT

I concur with the conclusions of my respected colleague, Marc B. Johnson, in his partial concurrence and partial dissent. I agree with him that PETITIONER’s activities are not manufacturing activities and that

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PETITIONER is not a manufacturer for purposes of the exemptions at issue. I do not believe that PETITIONER is a “manufacturer” or that its facility is a “manufacturing facility,” as defined in Utah law. Furthermore, I do not believe that it is “manufacturing” anything under the common usage of that term because it is not making a new product. After reading the definition of “manufacture” and “manufacturer” in Black’s Law Dictionary, Ninth Edition, I hold the Petitioner is a construction contractor who has a ways and means to assist an entity in removing and reusing ( PRODUCT ), but is not creating a new product with an inventive characteristic. I believe that PETITIONER is merely performing a service to ( PROCESS ) a previously-manufactured product and that it is not manufacturing anything new.

D’Arcy Dixon Pignanelli  
Commissioner