

10-2057
SALES TAX
TAX YEARS: 2006, 2007, 2008, 2009
SIGNED: 10-07-2011
COMMISSIONERS: M. JOHNSON, D. DIXON, M. CRAGUN
EXCUSED: R. JOHNSON

BEFORE THE UTAH STATE TAX COMMISSION

PETITIONER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION Respondent.	INITIAL HEARING ORDER Appeal No. 10-2057 Account No. ##### Tax Type: Sales Tax Tax Period: Sept. 1, 2006 – June 30, 2009 Judge: Jensen
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Presiding:

Clinton Jensen, Administrative Judge

Appearances:

For Taxpayer: PETITIONER REP., for the Taxpayer, appearing by telephone
For Respondent: RESPONDENT REP. 1, Assistant Attorney General
 RESPONDENT REP. 2, for the Division
 RESPONDENT REP. 3, for the Division

STATEMENT OF THE CASE

This matter came before the Commission for an Initial Hearing on March 31, 2011 in accordance with Utah Code Ann. §59-1-502.5.

Petitioner (the "Taxpayer") is appealing an audit deficiency of additional Utah sales and use tax and interest, which the Auditing Division ("Division") imposed for the period September 1, 2006 through June 30, 2009 in a Statutory Notice – Sales and Use Tax ("Statutory Notice") dated June 10, 2010. In its Statutory Notice, the Division assessed sales or use tax on approximately \$\$\$\$ of machinery purchased during the 2009 tax year. The Taxpayer had claimed a manufacturer exemption from sales tax on the machinery.

The Division determined that the Taxpayer did not qualify to purchase the items of tangible personal property tax-free under the manufacturer exemption because the Taxpayer did not meet all of the conditions required to qualify, as set forth in Utah Code Ann. §59-12-104(14). Specifically, the Division determined that

the Taxpayer was not a “manufacturing facility,” which is defined in UCA §59-12-102(52) to mean an establishment described in Codes 2000 to 3999 of the 1987 Standard Industrial Classification Manual (“SIC”).

The Taxpayer disputes the Division’s determination, arguing that its operation is best described under SIC Code 3999 – Manufacturing, Not Elsewhere Classified.

APPLICABLE LAW¹

Utah Code Ann. §59-12-103(1)(a) provides that a tax is imposed on the purchaser for amount paid or charged for retail sales of tangible personal property made within the state.

For sales that would otherwise be taxable, Utah law provides for a number of exemptions from sales and use tax. UCA §59-12-104(14) exempts from taxation certain sales of tangible personal property that are used in a manufacturing facility. Section 59-12-104 provides as follows in pertinent part:

The following sales and used are exempt from the taxes imposed by this chapter:

....

(14) (a) except as provided in Subsection (14)(b), amounts paid or charged on or after July 1, 2006, for a purchase or lease by a manufacturing facility except for a cogeneration facility, of the following:

(i) machinery and equipment that:

(A) are used:

(I) for a manufacturing facility except for a manufacturing facility that is a scrap recycler described in Subsection 59-12-102(55)(b):

(Aa) in the manufacturing process;

(Bb) to manufacture an item sold as tangible personal property; and

(Cc) beginning on July 1, 2009, in a manufacturing facility described in this Subsection (14)(a)(i)(A)(I) in the state; or

(II) for a manufacturing facility that is a scrap recycler described in Subsection 59-12-102(55)(b):

(Aa) to process an item sold as tangible personal property; and

(Bb) beginning on July 1, 2009, in a manufacturing facility described in this Subsection (14)(a)(i)(A)(II) in the state; and

(B) have an economic life of three or more years

For purposes of the manufacturer exemption in Section 59-12-104(14), “manufacturing facility” is defined in UCA §59-12-102(54)(a) to mean “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[.]”

The 1987 Standard Industrial Classification Manual SIC Code 0723 describes “Crop Preparation Services for Market, Except Cotton Ginning” to include the following establishments:

Establishments primarily engaged in performing services on crops, subsequent to their harvest, with the intent of preparing them for market or further processing.

¹ The statutes at issue in this case underwent changes during the audit period. None of those changes affect the outcome of this case. The Commission cites 2009 statutes.

The 1987 Standard Industrial Classification Manual SIC Code 3999 describes “Manufacturing Not Elsewhere Classified” to include the following establishments:

Establishments primarily engaged in manufacturing miscellaneous fabricated products, including beauty shop and barber shop equipment; hair work; tobacco pipes and cigarette holders; coin-operated amusement machines; matches; candles; lamp shades; feathers; artificial trees and flowers made from all materials, except glass; dressed and dyed furs; umbrellas, parasols, and canes; and other articles, not elsewhere classified.

Utah Code Ann. §59-1-1417 provides, “[i]n a proceeding before the commission, the burden of proof is on the petitioner”

DISCUSSION

The only issue before the Commission is whether the Taxpayer qualifies as a “manufacturing facility” for purposes of the manufacturer exemption from sales and use tax. If the Commission determines that the Taxpayer is not a “manufacturing facility,” then the Taxpayer does not meet all the requirements necessary to qualify for the exemption, and its appeal will be denied. If the Commission determines that the Taxpayer is a “manufacturing facility,” it will then determine whether there is sufficient evidence to show that the Taxpayer meets all other requirements in order to qualify for the exemption.

The list of requirements that must be met to qualify for the manufacturer exemption is found in Section 59-12-104(14). To qualify, the tangible personal property must first qualify as a normal operating replacement; or machinery or equipment used in new or expanding operations. If it qualifies as either of these, the property must also: 1) be used in the manufacturing process; 2) have an economic life of three or more years; and 3) be used in a manufacturing facility in Utah. If the tangible personal property at issue does not meet all of these requirements (i.e., even if it meets all requirements but one), then the purchase or lease of that property does not qualify for the exemption and, thus, is a taxable transaction.

The Division asserts that the Taxpayer does not qualify for the manufacturer exemption on the purchases at issue because it does not meet the definition of “manufacturing facility,” one of the requirements to qualify for the exemption. Specifically, the Division argues that Taxpayer is not a “manufacturing facility,” as defined in Section 59-12-104(54). Under that definition, a business is not a “manufacturing facility” and cannot qualify for the exemption unless it is “an establishment described in SIC Codes 2000 to 3999 of the 1987 Standard Industrial Classification Manual.”

The Division argues that the Taxpayer’s facility is classified under SIC Code 0723 of the 1987 Standard Industrial Classification Manual, which includes “[e]stablishments primarily engaged in performing services on crops, subsequent to their harvest, with the intent of preparing them for market or further processing.” The SIC Manual provides examples for this classification, including “seed cleaning, corn shelling,

cotton seed delinting, nut hulling and shelling, and peanut shelling.” The Taxpayer disagrees, and would place its establishment under SIC Code 3999 as “Manufacturing Not Elsewhere Classified.”

In support of its position, the Taxpayer looks to the SIC Manual’s description of “manufacturing.” As quoted by the Taxpayer, the SIC Manual describes its manufacturing section as follows:

The manufacturing division includes establishments in the mechanical or chemical transformation of materials or products or substances into new products. These establishments are usually described as plants, factories, or mills, and characteristically use power driven machines and material handling equipment. Also included is the blending of materials

The materials used by manufacturing establishments may be purchased directly from producers, obtained through customary trade channels, or secured . . . by transferring the product from one establishment to another which is under the same ownership. Manufacturing production is usually carried on for the wholesale market . . . or to order for industrial users, rather than for direct sale to the domestic consumer.

The Division agrees with the Taxpayer that manufacturing requires “the mechanical or chemical transformation of materials or products or substances into new products.” It cites cases indicating that processing agricultural products does not transform the agricultural products into new products. *See Hartranft v. Wiegmann*, 121 U.S. 609, 615 (1887) (processing corks by stamping, removing contaminants, washing, steaming, and removing tannin to remove elasticity not manufacturing); *see also East Texas Motor Freight Lines v. Frozen Food Express*, 351 U.S. 49, 54 (1956) (“A chicken that has been killed and dressed is still a chicken. Removal of its feathers and entrails has made it ready for market. But we cannot conclude that this processing which merely makes the chicken marketable turns it into a ‘manufactured’ commodity”).

Applying these principles to the Taxpayer’s operation, it is clear that the Taxpayer cleans extraneous materials from (WORDS REMOVED), and bags the final product for use by end customers. But the final product has not been transformed into anything other than (X). It is clear that the Taxpayer’s operations perform vital functions to ready (X) for market. Nevertheless, the activities are not manufacturing and thus do not qualify the Taxpayer’s for tax-free purchases under the manufacturer exemption.

Clinton Jensen
Administrative Law Judge

DECISION AND ORDER

Based upon the foregoing, the Commission finds that the Taxpayer is not a “manufacturing facility” for purposes of the manufacturer exemption and that, as a result, its purchases do not qualify for the exemption. Accordingly, the Commission denies the Taxpayer’s appeal and sustains the Division’s audit assessment. It is so ordered.

Appeal No. 10-2057

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 Taxpayer's name, address, and appeal number:

Appeal No. 10-2057

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 _____, 2011.

R. Bruce Johnson
Commission Chair

Marc B. Johnson
Commissioner

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner