11-484
TAX TYPE: SALES & USE TAX
TAX YEARS: 07-01-06 through 04-30-09
DATE SIGNED: 4-8-2013
COMMISSIONERS: B. JOHNSON, D. DIXON, R. PERO
EXCUSED: M. CRAGUN
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**INITIAL HEARING ORDER** Appeal No. 11-484 Account No. ##### Tax Type: Sales & Use Audit Period: 07/01/06 – 04/30/09 Judge: Chapman

Presiding:
Kerry R. Chapman, Administrative Law Judge

Appearances:
For Petitioner: REPRESENTATIVE-1 FOR TAXPAYER, Representative
REPRESENTATIVE-2 FOR TAXPAYER, Representative
For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT, from Auditing 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 Sec. 59-1-502.5, on June 27, 2012.

On January 10, 2011, Auditing Division (the "Division") issued a Statutory Notice – Sales and Use Tax ("Statutory Notice") to TAXPAYER (TAXPAYER or "taxpayer"), in which it determined that the taxpayer was entitled to a refund of $$$$$ for the period July 1, 2006 through April 30, 2009. The $$$$$ refund consisted of $$$$$ of sales and use tax and $$$$$ of interest (calculated through February 9, 2011).

The refund the Division derived was less than it would have otherwise been because the Division determined that the taxpayer failed to pay sales and use tax on leases of railroad freight cars during the audit

period. The taxpayer asserts that the leases are exempt from taxation under Utah Code. Ann. §59-12-104(33) because the taxpayer hired multiple authorized carriers to transport the freight cars to their various destinations. As a result, the taxpayer asks the Commission to reverse that portion of the Division's assessment in which it imposed additional sales and use tax on these lease transactions. The amount of sales and use tax at issue on these transactions is approximately $$$$$.

The Division claims that the exemption the taxpayer cites is available only for transactions where an authorized carrier purchases, leases, or uses freight cars. Because the taxpayer is not an authorized carrier, the Division argues that its transactions to lease freight cars are not exempt, even if the taxpayer subsequently hires authorized carriers to transport the freight cars. For these reasons, the Division asks the Commission to sustain its determination that the taxpayer is subject to taxation on these lease transactions.

APPLICABLE LAW

Utah Code Ann. §59-12-103(1)(k) (2008)[1] imposes a tax on "amounts paid or charged for leases or rentals of tangible personal property if within this state the tangible personal property is: (i) stored; (ii) used; or (iii) otherwise consumed[.]"

Utah Code Ann. §59-12-104(33) exempts the following sales and uses from taxation:

> (33) sales, leases, or uses of the following:
> (a) a vehicle by an authorized carrier; or
> (b) tangible personal property that is installed on a vehicle:
> (i) sold or leased to or used by an authorized carrier; and
> (ii) before the vehicle is placed in service for the first time[.]

Utah Code Ann. §59-12-102(110)(b) provides that"[f]or purposes of Subsection 59-12-104(33) only, 'vehicle' includes . . . (ii) (A) a locomotive; (B) a freight car; (C) railroad work equipment; or (D) other railroad rolling stock."

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

Utah Code Ann. §59-12-102(10)(c) defines "authorized carrier" to mean "in the case of locomotives, freight cars, railroad work equipment, or other rolling stock, the holder of a certificate issued by the United States Surface Transportation Board."

Utah Code Ann. §59-12-102(109) defined the term "use" as follows:[2]

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

UCA §59-1-1417 (2013) 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
> (b) construe a statute providing an exemption from or credit against the tax, fee, or charge strictly against the taxpayer.

APPLICABLE FACTS

2 The definition of "use" was amended in 2009. The amendments, however, have no effect on the issue in this appeal.

1. The taxpayer is a mining and manufacturing company that produces (X) and other products. It has two locations in Utah, one of which is its mine and plant operations in RURAL County.

2. The taxpayer uses railroad freight cars at its RURAL County facility where it loads its product into the freight cars. When the taxpayer's product is ready to be shipped, the product is transported in the railroad freight cars to the taxpayer's customers.

3. Beginning in March 2008 and continuing through March 2009, the taxpayer leased railroad freight cars from two separate leasing companies, COMPANY-1 ("COMPANY-1") and COMPANY-2 ("COMPANY-2"). Invoices show that the taxpayer leased approximately ##### freight cars from COMPANY-1 each month at a rate of $$$$$ per car and that it leased approximately ##### freight cars from COMPANY-2 at a rate of $$$$$ per car. The parties did not know if a written contract existed between the taxpayer and either of the leasing companies concerning these transactions.

4. Once the taxpayer is ready for its product to be delivered to its customers, it hires railroad companies, such as COMPANY-3, to transport its leased freight cars to the taxpayer's customers. The railroad companies charge the taxpayer a rate to transport the freight cars to their destinations, based on the location of the destination. Once the taxpayer's product has been delivered to its customers, the railroad companies return the empty freight cars to the taxpayer's site in RURAL County, Utah.

5. The railroad companies that the taxpayer hires to transport its leased freight cars have all been issued a certificate by the United States Surface Transportation Board. The taxpayer has not been issued a certificate by the United States Surface Transportation Board.

DISCUSSION

The railroad freight cars at issue are tangible personal property. Unless an exemption applies, the leases of the freight cars are subject to taxation under Section 59-12-103(1)(k), which imposes tax on leases or rentals of tangible personal property if the property is either stored, used or consumed in Utah.

The parties, however, disagree on whether the taxpayer's transactions to lease the freight cars are exempt from taxation under Section 59-12-104(33), which provides that "sales, leases, or uses of . . . a vehicle by an authorized carrier" is exempt from taxation. Both parties agree that the freight cars at issue are "vehicles" for purposes of the exemption. Section 59-12-102(110)(b). Both parties also agree that the railroad companies that the taxpayer hires to transport its leased freight cars are "authorized carriers" because they hold certificates issued by the United States Surface Transportation Board and that the taxpayer is not an "authorized carrier" because it does not hold such a certificate. Section 59-12-102(10)(c).

The taxpayer argues that the lease transactions between the taxpayer and the two leasing companies from which it leases the freight cars are exempt because each railroad company that the taxpayer hires to transport the freight cars to the taxpayer's customers is an authorized carrier that "uses" the freight cars and because there is an agency relationship between the taxpayer and the railroad company. The Division contends, however, that the transactions at issue are not transactions between the taxpayer and the railroad companies, but are transactions between the taxpayer and the two leasing companies, COMPANY-1 and COMPANY-2.[3] Because the taxpayer is not an authorized carrier, the Division asserts that the leases of the freight cars to the taxpayer do not qualify for the exemption under Section 59-12-104(33) and, as a result, are taxable.

The taxpayer points out that the term "use" is defined in Section 59-12-102(109)(a) to mean the "exercise of any right or power over tangible personal property under Subsection 59-12-103(1), incident to the

3 The Division concedes that the transactions between the taxpayer and the railroad companies are nontaxable.

ownership or the leasing of that property, item, or service." The taxpayer states that the railroad companies hired by the taxpayer to transport its leased freight cars exercise a right or power over the freight cars because they determine the route by which they will move the freight cars to their destination and because the railroad companies are responsible for any damage they cause the freight cars. The taxpayer is unaware of any cases addressing a situation where a company that leased a vehicle has hired an authorized carrier to transport that vehicle. However, the taxpayer states that a number of states have found that an authorized carrier can "use" a vehicle to which it does not have legal title.

The taxpayer's argument is not convincing. Utah Admin. Rule R865-19S-2(B) clarifies that the sales and use tax "is not upon the articles sold or furnished, but upon the transaction, and the purchaser is the actual taxpayer." The transactions at issue in this appeal are the leases entered into by the taxpayer and the two leasing companies for the lease of the freight cars, not the subsequent transactions entered into by the taxpayer for nontaxable services provided by the railroad companies to transport its leased freight cars. As a result, the lease transactions between the taxpayer and the leasing companies are subject to taxation unless an exemption applies. They do not qualify for the Section 59-12-104(33) exemption because the taxpayer, the purchaser, is not an authorized carrier. The fact that the railroad companies later exercise some control over the freight cars due to their contracts to transport the cars has no effect on the taxability of the transactions between the taxpayer and the two leasing companies. The "use" of the taxpayer's leased freight cars by the railroad companies must be looked at in the context of the transactions between the taxpayer and the railroad companies, not the transactions between the taxpayers and the two leasing companies.

The taxpayer also argues Utah Admin. Rule R865-19S-44(C) ("Rule 44"), which provides guidance concerning sales made in interstate commerce, shows that the taxpayer and the railroad companies have agency relationships. The taxpayer contends that the transactions at issue qualify for the Section 59-12-104(33)

exemption because it has an agency relationship with entities that are authorized carriers. Rule 44(C) provides that "[w]here 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."

This argument is also not convincing. Rule 44(C) does not indicate that the taxpayer and the railroad companies have an agency relationship for purposes of the transactions entered into by the taxpayer and two leasing companies from which it leased the freight cars. This rule provides that a common carrier delivering goods for a seller outside of Utah is deemed the agent of the seller "for the purposes of this section;" i.e., for purposes of determining whether the transaction between the seller and its customer is a nontaxable sale made in interstate commerce. As a result, this rule may have an effect upon the taxability of the transactions between the taxpayer and its out-of-state customers to whom it is selling its products, but it does not have any effect upon the transactions between the taxpayer and the two leasing companies from which it leased the freight cars. For these reasons, the taxpayer's appeal should be denied, and the Division's assessment should be sustained.

_____

Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based upon the forgoing, the taxpayer's appeal is denied, and the Division's Statutory Notice is sustained. 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 _____, 2013.

R. Bruce Johnson
Commission Chair

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner