11-1774, 11-2587, & 12-2023
TAX TYPE: SALES TAX
TAX YEARS: 7-01-06 through 12-31-09
DATE SIGNED: 4-9-2014
COMMISSIONERS: B. JOHNSON, M. CRAGUN, R. PERO
EXCUSED: D. DIXON
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, vs. TAXPAYER SERVICES DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION** Appeal Nos. 11-1774, 11-2587 & 12-2023 Account No. ##### Tax Type: Sales Tax Tax Periods: 7/1/06 – 12/31/09 Judge: Phan

Presiding:
R. Bruce Johnson, Commission Chair
Robert Pero, Commissioner
Jane Phan, Administrative Judge

Appearances:
For Petitioner: REPRESENTATIVE-1 FOR TAXPAYER, Attorney at Law
REPRESENTATIVE-2 FOR TAXPAYER, Attorney at Law
REPRESENTATIVE-3 FOR TAXPAYER, Representative
For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General
RESPONDENT, Assistant Director Taxpayer Services Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on December 18, 2013, in accordance with Utah Code Ann. §59-1-501 and §63G-4-201 et seq. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. Petitioner ("Taxpayer") is appealing the denial on the part of Respondent ("Division") to issue refunds to the Taxpayer. At issue in this appeal are four separate refund requests which were denied by the Division. The Taxpayer timely appealed the denials and three separate appeals were opened for the

four requests. The original amounts of refund requested and the revised amount that the Taxpayer was asking for at the start of the hearing for the periods are as follows:

Appeal No. 11-1774	January 2007-December 2007	$$$$$	$$$$$
Appeal No. 11-2587	July 2006 – December 2006	$$$$$	$$$$$
	January 2008-June 2008	$$$$$	$$$$$
Appeal No. 12-2023	July 2008 – December 2009	$$$$$	$$$$$

2. The Taxpayer is seeking a refund of the sales and use tax paid by the Taxpayer at the time the Taxpayer purchased pipe and other materials, which the Taxpayer then used in the construction or assembly of water or sewer pipelines for governmental entities or political subdivisions.

3. During the hearing, the parties reached an agreement on some items physically incorporated into the pipeline and some that were not physically incorporated. For those items physically incorporated into the pipeline, if the Taxpayer were to prevail on the refund request, the sales tax paid on these items should be included in the refund. The parties also were in agreement that some of the items were not pipeline related and should be removed from the refund request where included. There were some items for which the parties were in dispute as to whether they were physically incorporated into the pipeline or not physically incorporated into the pipeline. The parties' agreement regarding the various items are as follows:

Items Physically Incorporated Into the Pipeline	Disputed Items	Items Not Physically Incorporated Into the Pipeline
Pipe (all types)	Manholes including Hatches & Covers	Rentals (Equipment, Vehicles, etc.)
Valves (inc. valve boxes, handles Extensions, etc.)	Vaults	Vehicles
Fittings, Joints, Restraints, Bushing, Gaskets, Seals, etc.	Lift Stations	Diversion Pumping Services
Meters	Bedding (Gravel, Sand Flowable Fill, etc.)	Asphalt
Flow & Pressure Control Tanks & Sensors	Geotechnical Fabric between Bedding & Pipe	Concrete Attached to Real Property (Curbing)
Pumps Moving Items in Pipeline	Thrust Blocks	
Concrete Used as Part of Pipeline		
Pipeline Coatings		

4. The Taxpayer is a licensed contractor that is primarily engaged in the construction of large diameter transmission lines for water and sewer. The Taxpayer's customers are generally political subdivisions or governmental entities. The Taxpayer provided a list at Petitioner's Exhibit 2 of each contract that was at issue in these refund requests and each contract was with a governmental entity. The Taxpayer had some other projects during the refund periods that were not for governmental entities. However, these were not part of the refund requests.

5. Concerning the projects that were included in the refund requests, for all but two the Taxpayer was the general contractor who had contracted directly with the governmental entity for the project.[1]

6. The Taxpayer does not install water and sewer lines within a subdivision on a regular basis, but sometimes will do this type of work. In addition the Taxpayer does work for BUSINESS by assembling or constructing natural gas lines. The Taxpayer's witness testified that the subdivision work or BUSINESS work was not included in the refund request. He also testified that for these contracts that were with subdivisions or BUSINESS, the Taxpayer did not collect sales tax on its invoices to the customer for the finished pipeline, and had, instead, paid sales and use tax on the pipe at the time of purchase, like the Taxpayer had done with the governmental entities' contracts.[2]

7. The Taxpayer has ##### crews and is generally working on 10-15 jobs at any given time. The testimony from the Taxpayer's witnesses was that the Taxpayer passes along materials to the customer at the cheapest price at which the Taxpayer is able to purchase them. The Taxpayer buys the pipe before the Taxpayer installs it. Fifty to sixty percent of the cost charged for the job of constructing the pipeline is for material and the rest is for the labor, though this varies.[3]

8. Pipes generally come in 8 foot sections and are generally standard sizes.[4]

9. The Taxpayer's witness testified that pipelines are generally buried to get them out of sight or out of the way. Pipelines may also be buried because there is less chance of breakage and they are less likely to be disturbed. He also testified that occasionally pipelines are installed above ground, like in canyon areas where it would be difficult to bury the lines, or if they needed to stay above ground for maintenance reasons.

10. For the pipeline construction that is at issue in the refund requests, the pipes were buried, most using the standard trenching construction, but some sections were completed with a trenchless method of construction. For the standard trench method, the Taxpayer digs a five to eight foot trench according to the requirements of the contract for that pipeline. The Taxpayer generally imports a bedding material for the bottom of the trench. The pipe sections are put into place one piece at a time, and attached to the previous section. Imported bedding material may be placed around the pipe to protect the pipe from rocks. However, imported bedding material is not needed in some types of soils. In some places the Taxpayer may add thrust blocking to keep joints from pulling apart. Using the typical trenching

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[1] From Testimony of APPRAISER, Vice President Business Development, TAXPAYER, the Taxpayer had two contracts in the request for which it had acted as subcontractor. NAME-1, CFO, TAXPAYER had stated he thought there was just one project on which the Taxpayer acted as a sub-contractor. That was the PROJECT.
[2] Testimony of NAME-1.
[3] Testimony of NAME-1
[4] Testimony of NAME-1.

method, if the pipe is installed under a roadway the Taxpayer will have to trench through the roadway and then once the pipe has been installed, replace the road bedding and asphalt or concrete. If the pipeline is in a field, after installing the pipeline and filling the trench, the Taxpayer will have to do a surface restoration, like planting grass.[5]

11. Most of the pipe line projects in this appeal were installed using the typical trench method. However some pipeline sections were constructed with a trenchless installation. The Taxpayer, for example, had a section that went under the RIVER and a section under the CANAL. In a trenchless installation the pipe sections would be welded together in one continuous piece,[6] the hole for the pipe bored underground using a horizontal direction drilling with large equipment. The pipeline is pushed through the hole.[7] Once the pipeline is in it could not be pulled back out. The longest section of pipe installed by the trenchless system was 1000 feet.[8]

12. The pipelines at issue in this appeal were generally installed in easements or rights-of-way over which the governmental entity contracting for the construction has an interest or control. The land is not typically owned by the governmental entity contracting for the construction of the pipeline, but that entity has an easement or right of way for pipelines. One example was the CORPORATION PROJECT. CITY-1 contracted for the pipeline and it was run through various easements and rights of way[9] on land owned by someone other than CITY-1. Once constructed, the land owners do not own the pipeline, they do not have the right to hook into the pipeline or remove it.[10] However, the pipeline owner, the City in this case, does have some real property rights in the form of the easement.

13. If repairs are needed, because the pipelines are installed in sections, the failing section or sections can be dug up, removed and replaced. Then the trench is refilled and surface restoration made.

14. In addition the Taxpayer has had contracts to remove unused or obsolete pipelines. An example of this was NAME OF DISTRICT-1, which contracted with the Taxpayer to remove an old pipeline. To remove the pipeline it has to be dug up, then it is removed section by section. After which, the trench is filled in and surface restoration is performed. The Taxpayer also has filled in, rather than removed unused pipelines when there were concerns about its integrity.[11]

15. The biggest single project in the refund request was to bring a buried 96 inch welded steel water pipe 2.7 miles down CANYON. This installation required the pipeline to be buried along the northwest shoulder of State Route-#####. Some of this pipeline was buried in the travel lane and some in

[5] Testimony of APPRAISER, Taxpayer's Exhibits 9 & 16.
[6] Taxpayer's Exhibit 14, pgs. 01098 & 01099.
[7] Testimony of NAME-1.
[8] Testimony of APPRAISER.
[9] Taxpayer's Exhibit 20.
[10] Testimony of APPRAISER & NAME-2, Certified Appraiser, SRA.
[11] Testimony of APPRAISER.

the shoulder of the road. It was all within the UDOT right of way. This contract was with the DISTRICT and the Taxpayer's bid was $$$$$.[12] The pipe for this project was purchased from a STATE manufacturer. For this purchase rather than pay sales tax in STATE, the Taxpayer filed Utah returns and paid Utah use tax. The Taxpayer provided copies of the returns and checks for payment.[13]

16. For pipe purchased in Utah, the Taxpayer paid sales tax to the vendor. It was the testimony of the Taxpayer's representative that sales tax was on the entire amount of the purchases of pipe and materials and built into the Taxpayer's accounting system. According to the testimony they paid sales or use tax on the purchases of the pipe and pipeline material and they did not collect tax from their customers on the cost of the project. During the years of the refund requests, they had treated the transactions for tax purposes like real property construction projects.[14]

17. The Taxpayer was able to provide invoices and documentation that sales tax had been paid on the purchases.[15]

18. Although the Taxpayer generally purchased the pipe, in some of the projects pipe was furnished by the customer. An example of this was the TOWN Water System Improvements project.[16]

19. For the projects where the Taxpayer removed old or obsolete pipelines, the pieces of pipe were taken to the Taxpayer's storage yard where it could be sold. Also the Taxpayer often has extra pieces of pipe from projects that it resold in the storage yard. Although there were some sales of used pipe, they were less than 1% of the Taxpayer's receipts.[17] Some types of pipe, like concrete pipe may not be good to reuse. For all of the jobs at issue in the refund requests, new pipe sections were used.[18] It costs less to use new pipe than to dig up an old pipeline to reuse.[19]

20. From a fee appraisal standpoint pipeline is an improvement. Once attached it is real property. However, the companies that own the pipeline may depreciate pipelines on their books. The pipeline is typically not owned by the land owner on whose land it is installed. Typically it is the pipeline owner who owns the pipeline, not the land owner.[20]

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[12] Taxpayer's Exhibits 15, 16 & 17.
[13] Taxpayer's Exhibit 26.
[14] Testimony of NAME-1.
[15] Taxpayer's Exhibit 24.
[16] Taxpayer's Exhibit 18.
[17] Testimony of NAME-1.
[18] Testimony of APPRAISER.
[19] Testimony of APPRAISER.
[20] Testimony of NAME-2.

APPLICABLE LAW

Sales and use tax is imposed under Utah Code Sec. 59-12-103(2007)[21] as follows in pertinent part:

> (1) A tax is imposed on the purchaser as provided in this part for amounts paid or charged for the following transactions:
> (a) retail sales of tangible personal property made within the state;
> . . .

There are a number of exemptions from sales and use tax which are set out at Utah Code Sec. 59-12-104. Two exemptions pertinent in this matter are at Subsections (2) and (25). Utah Code Sec. 59-12-104 provides as follows:

> The following sales and uses are exempt from taxes imposed by this chapter:
> . . .
> (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 Const. Art. 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
> (b) Tangible personal property in connection with the construction, operation, maintenance, repair, or replacement of a project as identified in section 11-13-103, or facilities providing additional project capacity as defined in Section 11-13-103;
>
> . . .
>
> (25) property purchased for resale in this state, in the regular course of business, either in its original form or as an ingredient or component part of a manufactured or compounded product;

The Tax Commission has adopted Utah Admin. Code R865-19S-58 or the 'Contractor's Rule' clarifying when items of personal property converted to real property are subject to tax. Rule 58 provides as follows:

> A. 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.
> 1. "Construction materials" include items of tangible personal property such as lumber, bricks, nails and cement that are used to construct buildings, structures or improvements on the land and typically lose their separate identity as personal property once incorporated into the real property.

[21] This decision cites to the 2007 version of Utah Code on the substantive legal provisions. There was no change in these provisions during the audit period, however, subsequently there have been some revisions or renumbering.

> 2. Fixtures or other items of tangible personal property such as furnaces, built-in air conditioning systems, built in appliances, or other items that are appurtenant to or incorporated into real property improvement are treated as construction materials for purposes of this rule.
>
> B. 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 supplied to contractors for use in building the home or building are taxable transactions as sales to final consumers.
>
> 1. 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.
>
> 2. Except as otherwise provided in B. 4, 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.
>
> . . .
>
> C. 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.
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> 1. If direct sales are made, the contractor shall obtain a taxes tax license and collect tax on all sales of tangible personal property to final consumers.
>
> 2. 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 materials sold and material consumed.
>
> D. This rule does not apply to contracts whether the retailer sells and installs personal property that does not become part of the real property. Examples of items that remain tangible personal property even when attached to real property are:
>
> 1. Moveable items that are attached to real property merely for stability or for an obvious temporary purpose.
>
> 2. Manufacturing equipment and machinery and essential accessories appurtenant to the manufacturing equipment and machinery; and
>
> 3. Items installed for the benefit of the trade or business conducted on the property that are affixed in a manner that facilitates removal without substantial damage to the real property or to the item itself.

The statute of limitations for requesting a refund is provided at Utah Code Sec. 59-1-1410(8) as follows:

> (a) Except as provided in Subsection (8)(b) or section 19-2-124, 59-7-522, 59-10-529, or 59-12-110, the commission may not make a credit or refund unless a person files a claim with the commission within the later of: (i) three years from the due date of the return including the period of any extension of time provided in statute for filing the return; or (ii) two years from the date the tax was paid.
>
> (b) The commission shall extend the time period for a person to file a claim under Subsection (8)(a) if: (i) the time period described in Subsection (8)(a) has not expired; and (ii) the commission and the person sign a written agreement: (A) authorizing the extension; and (B) providing for the length of the extension.

The Taxpayer had argued a definition of personal property, for property tax purposes as set out in the Property Tax Act should be considered to provide guidance. Utah Code Sec. 59-2-102(27) states:

> "Personal property" includes: (a) every class of property as defined in Subsection (28) which is the subject of ownership and not included within the meaning of the terms "real estate" and "improvements"; [and] (b) gas and water mains and pipes laid in roads, streets or alleys.

Another definition may be considered for guidance. Utah Code Sec. 59-12-102(62) (2006-2007)[22] provides a definition of "permanently attached to real property" as follows in pertinent part:

> (a) "Permanently attached to real property" means that for tangible personal property attached to real property:
>
> (i) the attachment of the tangible personal property to the real property: (A) is essential to the use of the tangible personal property; and (B) suggests that the tangible personal property will remain attached to the real property in the same place over the useful life of the tangible property; or
>
> (ii) if the tangible personal property is detached from the real property the detachment would: (A) cause substantial damage to the tangible personal property; or (B) require substantial alteration or repair of the real property to which the tangible personal property is attached.
>
> (b) "Permanently attached to real property" includes:
>
> . . .
>
> (iii) an attachment of the following tangible personal property to real property, regardless of whether the attachment to real property is only through a line that supplies water, electricity, gas, telephone, cable or supplies a similar item as determined by the commission by rule made in accordance with Title 63, Chapter 46a, Utah Administrative Rulemaking Act: (A) property attached to oil, gas, or water pipelines, other than the property listed in Subsection (62)(c)(iii); (B) a hot water heater; (C) a water softener system; or (D) a water filtration system, other than a water filtration system manufactured as part of a refrigerator.

For 2008 and 2009, Utah Code Sec. 59-12-102(62)(b)(iii) was revised as follows:

> (b) "Permanently attached to real property" includes:
>
> . . .
>
> (iii) property attached to oil, gas, or water pipelines, other than the property listed in Subsection (62)(c)(iii).

[22] The definition of "permanently attached to real property" was revised in 2008 version of the code and renumbered. It is found at Utah Code 59-12-102(83) in the 2013 version of the code. The 2007 version is provided herein.

ANALYSIS

The Taxpayer argues that it is entitled to the requested refunds of sales or use tax erroneously paid at the time the Taxpayer purchased sections of pipe and pipeline materials. These materials were acquired and used by the Taxpayer pursuant to contracts with governmental entities in the construction or installation of underground pipelines, such as water and sewer lines. According to the Taxpayer's representatives, the Taxpayer did not convert tangible personal property (the pipe and pipeline material) into real property and thus the Taxpayer is entitled to a refund because it resold tangible personal property to exempt governmental entities. It is the Taxpayer's contention that the completed underground pipelines remain tangible personal property. The Division argues that the Taxpayer converted the pipe sections and pipeline materials into real property when it constructed the pipelines. Therefore, the Division denied the refund request. It was the Division's position that the Taxpayer acted as a real property contractor and converted tangible personal property to real property. As such Taxpayer would be deemed to have consumed the tangible personal property, so the Taxpayer's purchases of the pipe and pipeline materials is subject to sales or use tax.

An important factor in the Taxpayer's argument is the Taxpayer's assertion that the pipelines are not actually attached to the real property, they are just buried in the ground. The Taxpayer's representative notes, "Underground pipelines are not attached to real property, they are merely buried, and burying does not equate to attachment. Attachment entails mounting or securing an item of personal property onto an item of real property. The mere assembly of a pipeline and then placing the pipeline in a trench that is covered with dirt does not equal attachment to real property."[23] The facts presented at the hearing support that most of the pipes are buried and not otherwise bolted or cemented into the ground. Pieces of pipe can be dug up, removed and replaced if needed, or whole pipelines can be dug up and removed from the ground. Pieces of pipe come in standard sizes and the Taxpayer does sell a small amount of used pipe. Digging up a piece of pipe or a whole pipeline does cause damage, it would leave a trench or hole in the ground or roadway, but it is also something that can and is repairable. The amount of the damage depends on what is over the pipeline. Surface restoration may be refilling the trench with dirt and planting grass or it may be replacing road base and repaving a roadway.

The Taxpayer argues that the Utah Supreme Court has considered the issue of whether personal property is converted to real property and there is one important factor that creates a bright line determination. It was the Taxpayer's position that if personal property is not attached to real property then it cannot be converted to real property. The Taxpayer points out that there have been several Utah Supreme Court decisions determining whether personal property is converted into real property, citing to

[23] Taxpayer's Prehearing Brief pgs. 11-12.

Nickerson Pump & Machinery Co. v. State Tax Comm'n, 361 P.2d 520 at 522 (Utah 1961); *Chicago Bridge & Iron Co. v. State Tax Comm'n*, 839 P.2d 303, 307 (Utah 1992); and *B-J Titan Services v. State Tax Comm'n*, 842 P.2d 822, 829 (Utah 1992). The Taxpayer points out nine factors set out by the court in these cases which "include: (1) whether the property is removable without harm to the structure on which it is placed; (2) whether the property is manufactured with the idea that it could be used elsewhere; (3) whether the parties to the transaction contemplated that the property would be removed for repairs or replacement; (4) whether the primary purpose of the transaction was for the property or the installation of the property; (5) whether the installation was for convenience; (6) whether the transaction indicated that the property was to be treated as real property after installation; (7) whether the purchaser intended to purchase real property; (8) whether the property becomes inseparably meshed into a greater facility which is the object of the transaction; and (9) whether the property becomes attached to real property."[24]

The Taxpayer also argues that even if the pipelines were considered to be attached, it did not necessarily mean they were converted to real property merely by being attached. The Taxpayer cites to provisions of Utah Admin. Rule R865-19S-58(4) (The Contractor Rule) which provides, "Examples of items that remain tangible personal property even when attached to real property are (1) moveable items that are attached to real property merely for stability or for an obvious temporary purpose," . . . and "(3) items installed for the benefit of the trade or business conducted on the property that are affixed in a manner that facilitates removal without substantial damage to the real property or to the item itself."

It was the Taxpayer's argument that the pipelines were buried for convenience, to get them out of the way and any attachment to real property was merely for stability. The Taxpayer argued they can be removed without harm to the ground, they just needed to be dug out of ground. They argue it was not the government entities' intent to acquire real property. The entity either already owned the real property or had an easement through it for the pipeline. The real property owner upon whose land it is placed does not own the pipeline merely because it runs under his or her land. The Taxpayer argues that it does not become inseparably meshed into a greater facility which is the object of the transaction. Additionally the Taxpayer notes that when land is sold, the subject pipelines running under the land are not also sold.

In addition to the cases dealing with the issue of when personal property is converted to real property for sales tax purposes, the Taxpayer argues that it is appropriate to also look to the Property Tax Act definition of "personal property" and it was the Taxpayer's assertion that under that definition pipelines are personal property. Utah Code Sec. 59-2-102(27)(2007) in the Property Tax Act defines "personal property" to be "(a) every class of property as defined in Subsection (28) which is the subject of

[24] Taxpayer's Prehearing Brief, pg. 10.

ownership and not included within the meaning of the terms “real estate” and “improvements”; [and] (b) gas and water mains and pipes laid in roads streets, or alleys . . .”

Although the Taxpayer argues that this definition applies to all the subject pipelines, this Property Tax definition does not state how pipeline that is not “laid in roads, streets, or alleys” is to be treated. The Taxpayer has not gone through all the miles of pipeline which are at issue in this case and designated which portions are laid in roads, streets or alleys. The question of whether the Property Tax definition means pipelines would change status between real and personal property depending on if they were buried under roadways or not was an issue considered by the Second Judicial District Court in *Summit Water Distribution Co. v. Utah State Tax Comm'n & County Board of Summit County, Civil No. 01-0725*. In that case Judge Morris issued his decision on August 31, 2009, finding that under the Property Tax Definition, the pipelines at issue in that case were “improvements” and were not personal property, except those that were expressly excluded under Utah Code Sec. 59-2-102(27) because they were laid under public roadways. He notes in that decision that an individual pipeline would have various sections considered real or personal property depending on what they were located under. He notes, “Thus we have the paradox of a pipe that is personal property for some distance, then real property, then personal property again. As to any perceived absurdity, inconsistency, or illogic, the court is reminded of the admonition given by PROFESSOR at the outset of his course in Federal tax law some decades ago, which, paraphrased, was “don't try to understand or make sense of the rules, just memorize them.””[25] The District Court in *Summit Water* decision was appealed on other issues, but not the issue of real verses personal property of the pipelines.

After Judge Morris issued his decision in *Summit Water,* the Tax Commission considered the issue of whether pipelines were real or personal property for property tax purposes in *Utah State Tax Commission, Initial Hearing Order, Appeal No. 09-0192*. In that case the Tax Commission concluded that the pipelines were in fact improvements and real property, except for those that were specifically excluded because they were laid under roads, streets or alleys. There is no specific exclusion in the Sales and Use Tax Act for pipes laid under roads, streets or alleys and no reason that the exclusion be applied instead of the general property tax rule in a sales tax context. Therefore the Taxpayer's argument in the matter now before the Commission, that the property tax definitions should be applied in this sales tax matter, does not support the Taxpayer's position.

The Division denied the refunds at issue in this matter. For some of the periods at issue the Division argued that the refund claim was barred by the statute of limitations set out at Utah Code Sec.

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[25] *Summit Water Distribution Co. v. Utah State Tax Comm'n & County Board of Summit County, Civil No. 01-0725*. Ruling Granting Petitioner's Appeal in Part and Denying Respondent's Motion for Summary Judgment, pg. 19.

59-1-1410(8). However for all of the periods it was the Division's position that Taxpayer was the consumer of pipe and pipeline materials that it had purchased as tangible personal property and used in conjunction with the construction of the pipelines pursuant to its real property contracts. As the consumer of the materials the Taxpayer's purchases of the pipe and materials were properly subject to sales and use tax. The Division cites as support *Chicago Bridge & Iron Co., v. Utah State Tax Comm'n.*, 839 P.2d 303 (Utah 1992). In that case the Court held, "One who purchases building materials for use in constructing homes, highways and the like, is a real property contractor, and the contractor's purchases of tangible personal property, used for such purposes are taxable transactions under the sales tax law." *Id.* at 306. Because the Taxpayer is a real property contractor, Rule 58, the Contractor Rule, is directly applicable in this matter. Under the Contractor Rule, "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."

Furthermore, the Division points out if the Taxpayer's purchases of the pipe and materials were, in fact a purchase of tangible personal property for resale and that transaction was not subject to tax, the resale of the items as tangible personal property would be subject to sales tax unless specifically exempt. If was the Division's position that refunds are to be construed against the Taxpayer, citing to the Utah Supreme Court's decision in *Ivory Homes Ltd., v. Utah State Tax Comm'n.*, 2011 UT 54. In that case the Court held, "We generally construe tax imposition statutes liberally in favor of the taxpayer. But the refund statute imposes no tax. Instead, the refund statute provides a tax credit. Similar to deductions and exemptions, such credits are matters of legislative grace and should be construed in favor of the taxing entity where legislative intent is not clear." *Id*. Prg. 44-45.

It was the Division's position that the object of the transaction or contract was for the Taxpayer to provide a functioning sewer or water pipeline. The Division argues that there is no intent to resell the pipe sections and pipeline materials as tangible personal property to the governmental entities. The Division points out that the Taxpayer seeks construction of the exemption at 59-12-104(25) that would give the broadest possible scope to the terms "manufactured or compounded product." The Taxpayer's argument had been that its purchase of the pipe sections and pipeline material were exempt from tax, because they were purchased for resale under Utah Code Sec. 59-12-104(25) as an ingredient or component part of a manufactured or compounded product, that being the finished pipeline. The Division cites to *Utah Concrete Products Corp. v Utah State Tax Comm'n*, 125 P.2d 408, (1942). In that case, the court, citing *City of St. Louis v Smith*, 342 Mo. 317, stated, "in its judgment the contractors in this case did not buy the materials in question for the purpose of reselling such materials to the city. They were under contract to deliver a finished product. It was the inseparable commingling of labor and material that produced the finished product." *Id.* 410. It is noteworthy that the sales at issue in *Utah Concrete Products*

included concrete pipe and that the Utah Concrete Pipe Company was a co-plaintiff. Similarly, the *City of St. Louis* case involved, *inter alia*, sewer contractors who were presumably primarily engaged in constructing pipelines.

Even if the Taxpayer were to show that its purchase of the pipe section and pipeline materials would be exempt under Utah Code Sec. 59-12-104(25), the Taxpayer would then have to show why its sale to the governmental entity was exempt from sales tax. As noted by the Division, the Court in *Utah Concrete Products Corp.* considered the issue of selling the product to a city or state. In that case the court held, "It is true that under this section sales made directly by plaintiff's to the state would be exempt, but in instant case, the sales are to an independent contractor and not to an agent of the State. These independent contractors are the consumers of the articles in the process of building roads for the state. As such, no exemption is extended to them. And Plaintiff's are liable for the collection of the tax. . . . The fact that the burden of the tax is passed by the contract to the state in the form of higher bids, and in this matter is indirectly paid by the state does not bring Plaintiff's under the exemption found in Section 6." *Id.* at 411 (Internal Citations Omitted). It was the Division's argument that for the Taxpayer to receive a refund, not only would Utah Code Sec. 59-12-104(25) need to be broadly construed, so would 59-12-104(2) which provides an exemption for sales to the state and in its political subdivisions.

After reviewing the evidence submitted at the hearing and arguments of the parties, the Commission concurs with the Division that the completed pipelines are not tangible personal property. They are improvements to real property. As such, the Taxpayer is a real property contractor and consumes the pipe and pipeline materials in the construction of the pipelines. The Taxpayer properly paid sales or use tax at the time of the purchases of the pipe and materials and is not entitled to the refund of the tax.

The Commission looks at the factors articulated by the Taxpayer and listed above from *Nickerson Pump & Machinery Co.,* and *Chicago Bridge & Iron Co.,* and reaches a different conclusion than has the Taxpayer based on the evidence. The first factor was whether the property is removable without harm to the structure on which it is placed. The pipeline is buried in the ground and may be under roadways. Removing the pipeline requires digging a significantly sized trench. This causes harm to the ground or roadways. The fact that the harm can be repaired is not the issue; most damage to improvements can be repaired. The second factor was whether the property is manufactured with the idea that it could be used elsewhere. The Taxpayer wants the Commission to focus on the individual sections of pipe and argues that they are generally standard sizes and can be used elsewhere. However, the individual pipe sections is not the product being resold, it is the pipeline as a whole. The pipeline is constructed specifically for the purpose and location and it must be configured to follow the twists and turns of the easements or right of ways. One would not expect the Taxpayer to remove a whole 2.7 mile long pipeline and use it somewhere else. It would not be configured correctly. Factor three of the test was whether the parties to

the transaction contemplated that the property would be removed for repairs or replacement. Again this is not likely for the pipeline as a whole. However, the parties likely did contemplate an occasional pipeline section being removed to be repaired or replaced. The fourth factor was whether the primary purpose of the transaction was for the property or the installation of the property. In this matter, the purpose was to have a functioning pipeline not numerous unconnected sections of pipe. The fifth consideration was whether the installation was for convenience. The testimony at the hearing indicates the installation of the pipeline appears to be far more significant than just a convenience. The equipment and labor required in the installation are roughly half of the costs of the project.

The sixth and seventh factors are related, whether the transaction indicated that the property was to be treated as real property after installation and whether the purchaser intended to purchase real property. Contemporaneously with entering into these contracts these transactions were treated as real property contracts by the parties. The witness for the Taxpayer acknowledged that the Taxpayer considered itself to be a real property contractor at the time. Sales tax was built into the price of the contract for the pipe and pipeline materials at the time of purchase; tax was not added to the sale of the final product to either political subdivisions, or the private parties who contracted for a finished pipeline. The eighth factor was whether the property becomes inseparably meshed into the greater facility which is the object of the transaction. The object of the transaction was a functioning pipeline. The removal of any piece of pipe would render the pipeline nonfunctioning.

The last factor, and the one that the Taxpayer noted was the key factor, was whether the property becomes attached to real property. As noted by the Taxpayer, the pipelines are not bolted down or cemented into footings. However, they are attached and kept in place by the fact that the pipeline is buried under ground and also by the fact that the individual sections are fastened together. There are also techniques such as thrust blocking to keep the pipeline from moving. The pipeline is attached to the real property by the weight of the earth and the size of the pipeline.

The Taxpayer had cited to prior Tax Commission decisions or Private Letter Rulings that considered whether items were attached to real property for sales tax purposes, but they are distinguishable. In *Utah State Tax Commission, Findings of Fact, Conclusions of Law, and Final Decision, Appeal No. 05-1035* (2007) the Commission found that precast concrete constant slope barriers that could be moved and repositioned along roadways remained tangible personal property. Unlike the subject appeal, the constant slope barriers were freestanding barriers, set on the shoulder surface of the roadways. They were not attached to the roadway and were designed so that they could be moved or repositioned, and, in fact, they were moved and repositioned, without damage to the roadway or the constant slope barrier. In the subject case removal of the pipeline requires digging a trench through the ground or roadways that is the length of pipeline. In *Private Letter Ruling 05-003* (2005) the issue was

whether component playground equipment remained tangible personal property. The equipment was attached to supporting posts for stability. The posts were dug into the ground and concrete was poured around the postholes. This equipment was and could be moved by unbolting the equipment from the supporting posts without damage to the equipment or the ground. The supporting posts could be dug out of the ground. This is also distinguishable from the subject case because the equipment itself could be removed from the supporting posts without damage to the equipment or ground. Removal of the supporting posts would create a posthole in the ground that would need to repaired, but repairing a posthole is substantially different than refilling a trench and surface restoration the entire length of a pipeline.

The Taxpayer also cited to Private Letter Ruling 95-051DJ, which was issued in 1995. As noted by the Taxpayer, in that ruling the Commission stated, "We understand that the natural gas pipeline will be an underground pipeline. The manner in which the pipeline is attached is more intrusive on the land than the matter in which the transmission lines are attached, but the pipeline remains personal property which is appurtenant to the gas turbines, not appurtenant to the land. We do not consider the materials used to construct the pipeline to be construction materials which will be incorporated into real property. Therefore, sales of pipeline materials constitute sales of personal property." The facts in that ruling were distinguishable because the ruling was about the construction of an electric generation and transmission system and there were various types of materials and equipment that would be purchased to construct this plant. The pipelines were found to be appurtenant to the gas turbines that were part of the equipment at the plant.

The Taxpayer had argued that the Commission look to the Property Tax definition of tangible personal property for guidance in this matter. That definition, at Utah Code Sec. 59-2-102(27), stated that "personal property" includes gas and water mains and pipes laid in roads, streets or alleys. As noted above, even for property tax purposes this has been interpreted to be limited to those pipelines in roads streets or alleys and does not apply to pipeline laid elsewhere. Another definition, this one in the Sales and Use Tax Act, may also provide guidance, although as noted by the Taxpayer it is not directly controlling. Utah Code Sec. 59-12-102(62) provides a definition of "permanently attached to real property." The definition seems to contemplate that pipeline is real property because it provides "property attached to oil, gas, or water pipelines" is permanently attached to real property. It would be difficult to say property attached to the pipelines was attached to real property, if the pipelines themselves are not real property.

The Taxpayer did note in its Posthearing Brief that this definition of "permanently attached to real property" is to clarify the taxation of labor charges on "repairs or renovations of tangible personal property." Utah Code Sec. 59-12-103(1)(g) imposes sales and use tax on "amounts paid or charged for

services for repairs or renovations of tangible personal property . . .," which is a different tax imposition provision than Subsection (1)(a) imposing a tax on retail sales of tangible personal property at issue in this appeal. A repair to real property is not subject to sales tax and a repair to personal property is subject to tax. "Repairs or renovations of tangible personal property" is defined at 59-12-102(98)(2012) to be (i) a repair or renovation of tangible personal property that is not permanently attached to real property; So then 59-12-102(79)(2012) defines "permanently attached to real property" which includes under Subsection (b)(iii) property attached to oil, gas, or water pipelines . . ."

The Taxpayer does have a point about the application of the definition of "permanently attached to real property" applying to a different tax imposition section. However, it is appropriate for the Commission to consider this definition as guidance and consideration supports the Division's position in this matter.

CONCLUSIONS OF LAW

1. Throughout the refund periods at issue in these requests, the Taxpayer purchased pipe and other pipeline materials as tangible personal property. Such purchases are taxable under Utah Code Sec. 59-2-103(1) unless subject to an exemption.

2. The Taxpayer argues that it resold the pipe and pipeline materials as either tangible personal property or as an ingredient or component part of a manufactured or compounded product, arguing for an exemption from sales and use tax on its purchases of the pipe and pipeline material under Utah Code Sec. 59-2-104(25). The Taxpayer then argues the second set of transactions was exempt, the sales from the Taxpayer to the governmental entities. The Taxpayer points to Utah Code Sec. 59-2-104(2). However, neither exemption is applicable in this matter because the Taxpayer was acting as a real property contractor.

3. The Taxpayer acted as a real property contractor. The Taxpayer converted items of tangible personal property into real property by using them in the construction of pipelines. The pipelines did not remain tangible personal property as argued by the Taxpayer. The pipeline became attached to the real property by being affixed together and buried in trenches. The pipeline cannot be removed without causing damage to the ground or roadways under which it lays. For the reasons outlined above including the nine factors from *Nickerson Pump & Machinery Co., Chicago Bridge & Iron Co.,* and *Utah Concrete Products Corp*., the completed pipelines did not remain items of tangible personal property.

4. As a real property contractor, the Taxpayer is deemed to have consumed the tangible personal property, so the Taxpayer's purchases of the pipe and pipeline materials are subject to sales or use tax. Utah Admin. Rule R865-19S-58(A) provides, "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. When

entering into the contracts for the transactions that are at issue in this appeal, the Taxpayer had paid sales and use tax as a real property contractor at the time the pipe and pipeline materials were purchased. The Taxpayer is not now entitled to a refund of that sales and use tax, because that tax was not erroneously paid.

5. The Division had raised the issue that some portions of the refund requests should also be denied on the basis that the request was filed after the applicable statute of limitations under Utah Code Sec. 59-1-1410(8). Because the Commission concludes that all of the refund requests be denied on the basis that the tax was not erroneously paid, the Commission does not further consider the statute of limitations issue.

Jane Phan
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission denies the Taxpayer's appeal. It is so ordered.

DATED this ___________day of __________________, 2014.

R. Bruce Johnson
Commission Chair

D'Arcy Dixon Pignanelli
Commissioner

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Notice of Appeal Rights: You have twenty (20) days after the date of this order to file a Request for Reconsideration with the Tax Commission Appeals Unit pursuant to Utah Code Ann. §63G-4-302. A Request for Reconsideration must allege newly discovered evidence or a mistake of law or fact. If you do not file a Request for Reconsideration with the Commission, this order constitutes final agency action. You have thirty (30) days after the date of this order to pursue judicial review of this order in accordance with Utah Code Ann. §59-1-601 et seq. and §63G-4-401 et seq.