14-1838
TAX TYPE: SALES AND USE TAX
TAX YEAR: 06/01/11 – 11/30/13
DATE SIGNED: 6-27-2016
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO, R. ROCKWELL
GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION** Appeal No. 14-1838 Account No. ##### Tax Type: Sales and Use Tax Audit Period: 06/01/11 – 11/30/13 Judge: Chapman

Presiding:
John L. Valentine, Commission Chair
Kerry R. Chapman, Administrative Law Judge

Appearances:
For Petitioner: REPRESENTATIVE FOR TAXPAYER, Attorney
For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General

STATEMENT OF THE CASE

TAXPAYER ("Petitioner," "taxpayer," or "TAXPAYER") is appealing a sales and use tax assessment that Auditing Division ("Respondent" or "Division") has imposed upon it. This matter came before the Utah State Tax Commission for a Formal Hearing on August 4, 2015. Based upon the evidence and arguments, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. The tax at issue is sales and use tax.

2. The period at issue is June 1, 2011 through November 30, 2013 ("audit period").

3. The parties agreed to waive an Initial Hearing on this matter and proceed directly to a Formal Hearing.

4. At the Formal Hearing, the parties stipulated to the admission of two exhibits, specifically: 1) the Statutory Notice – Sales and Use Tax dated September 3, 2014 ("Statutory Notice")[1]; and 2) the taxpayer's PowerPoint Presentation.[2] In addition, the parties stipulated to 11 "Stipulated Facts" (and one "Stipulated Footnote"), which appear below as Findings of Facts #5 through #15 (and Footnote #3).

Stipulated Facts

5. TAXPAYER is engaged in the business of producing A METAL from MINERAL-1 and MINERAL-2. METAL is a rare, lightweight metal used in components for items such as aircraft, missiles, spacecraft, satellites, and X-ray machines. The vast majority of METAL is obtained by mining MINERAL-1, a mineral from TAXPAYER's MINE northwest of CITY-1, Utah, which contains between .2-.34% METAL. Two-thirds of the world's METAL is mined and extracted from MINERAL-1 deposits in these MOUNTAINS in Utah.

6. TAXPAYER operates a processing facility located north of CITY-1, and about 45 miles from the MINE. The MINERAL-1 mined and delivered to the processing facility contains only about 0.3% METAL or about 5.6 pounds of finished METAL per ton. At the processing facility, TAXPAYER extracts METAL from the MINERAL-1 using a solvent extraction process and produces METAL, which is then sent to TAXPAYER's STATE-1 plant for further processing into METAL.

7. The first step at TAXPAYER's processing facility is to crush the MINERAL-1 into a fine powder. This powder is then mixed with water and sulfuric acid in agitated tanks at 95 degrees centigrade, thereby dissolving the METAL and other naturally occurring metals contained in the ore. The liquid mixture

1 Formal Hearing Exhibit 1. The Statutory Notice shows that the Division disallowed a refund request that TAXPAYER had claimed in the amount of $$$$$ for the 30-month audit period.
2 Formal Hearing Exhibit 2.

undergoes a "thickening" or "settling" process whereby the sludge is discarded and the solution containing the METAL and other metals is separated from the sludge.

8. The solution containing the METAL (the "extraction feed") then undergoes a "solvent extraction process" whereby the extraction feed is pumped into another series of tanks that contain an organic mixture comprised of two chemicals CHEMICAL-1 ("CHEMICAL-1") and CHEMICAL-2 (CHEMICAL-2). CHEMICAL-2 acts as a carrier to CHEMICAL-1 and is necessary to introduce the CHEMICAL-1 to the METAL laden extraction feed. Neither chemical is water soluble.

9. When the extraction feed (the water-based fraction) is mixed with the organic compound, approximately 70% of the METAL contained in the extraction feed is "loaded," or physically attached, to the CHEMICAL-1 molecule in the organic compound. This solvent extraction process is repeated ten times. Each time the extraction process is repeated, approximately 70% of the METAL remaining in the extraction feed is loaded to the CHEMICAL-1 molecules in the organic compound. After the ten repeated processes, approximately 97-98% of the METAL is contained in the organic fraction.

10. As the METAL concentrates in the organic fraction, other elements such as the aluminum, iron, and other metals remain in the water-based fraction. A very small percentage of the organic compound does not completely separate from the water-based fraction and is considered a "fugitive loss." Of the 125,000 gallons of organic compound used in the solvent extraction process, approximately 27 gallons of the organic compound (.022%) is lost each time the ten cycle process is repeated.

11. The final concentrated organic fraction containing the METAL is treated with an ammonium carbonate solution that separates the METAL from the organic compound. The ammonium carbonate solution containing the METAL is further purified and the resulting product is METAL.[3]

3 The ammonium carbonate solution used in this process is consumed in the process. As is typical for chemicals, the ammonium carbonate solution does not have a three-year economic life. As such, TAXPAYER is not seeking exemption for the ammonium carbonate solution. TAXPAYER is seeking exemption only for

12. After the METAL has been removed, the organic compound (CHEMICAL-1 and CHEMICAL-2), less the .022% loss, is returned to the solvent extraction process where it is again combined with extraction feed and the process is repeated. CHEMICAL-1 and CHEMICAL-2 both have a perpetual life as neither chemical is dissolved, consumed, or degraded in the solvent extraction process.

13. Each year, TAXPAYER purchases additional CHEMICAL-1 and CHEMICAL-2 to replace the fugitive losses. TAXPAYER does not purge the volume of CHEMICAL-2 and CHEMICAL-1 to replace it with "fresher" stock. During the four year period, from 2011 through 2014, TAXPAYER replaced approximately 49.7% of the organic compound with new chemicals. Over time the working volume is completely replaced based on the fugitive loss rate. Based on the rate of replacement of fugitive losses, when continually used in the solvent extraction process, CHEMICAL-1 and CHEMICAL-2 have at least an eight-year life.

14. This case arose pursuant to a September 3, 2014 Statutory Notice issued by the Auditing Division of the Utah State Tax Commission (the "Division") for the period June 1, 2011, through November 30, 2013, specifying that TAXPAYER's purchases of CHEMICAL-1 from COMPANY-1 and CHEMICAL-2 from COMPANY-2 are not exempt from Utah sales tax.

15. Thereafter, TAXPAYER timely filed a Petition for Redetermination.

APPLICABLE LAW

1. During the audit period, Utah Code Ann. §59-12-103(1)(a) (2013)[4] provides that "retail sales of tangible personal property made within the state" are subject to Utah sales and use tax.

2. During the audit period, UCA §59-12-104(14)[5] exempts certain purchases and leases by specified establishments from sales and use taxation, as follows in pertinent part:

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the CHEMICAL-1 and CHEMICAL-2, which are unusual chemicals that do have a three-year life.

4 All cites are to the 2013 version of Utah law, unless otherwise indicated.

5 Effective July 1, 2014 (after the audit period), Subsection 59-12-104(14)(c) was amended and

(c) amounts paid or charged for a purchase or lease made on or after January 1, 2008, by an establishment described in NAICS Subsector 212, Mining (except Oil and Gas), or NAICS Code 213113, Support Activities for Coal Mining, 213114, Support Activities for Metal Mining, or 213115, Support Activities for Nonmetallic Minerals (except Fuels) Mining, of the 2002 North American Industry Classification System of the federal Executive Office of the President, Office of Management and Budget, of the following:

(i) machinery and equipment that:

(A) are used:

(I) (Aa) in the production process, other than the production of real property; or (Bb) in research and development; and

(II) beginning on July 1, 2009, in an establishment described in this Subsection (14)(c) in the state; and

(B) have 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 in:

(I) (Aa) the production process, except for the production of real property; and (Bb) an establishment described in this Subsection (14)(c) in the state; or

(II) (Aa) research and development; and (Bb) in an establishment described in this Subsection (14)(c) in the state;

. . . .

(e) for purposes of this Subsection (14) and in accordance with Title 63G, Chapter 3, Utah Administrative Rulemaking Act, the commission:

(i) shall by rule define the term "establishment"; and

(ii) may by rule define what constitutes:

(A) processing an item sold as tangible personal property;

(B) the production process, except for the production of real property;

(C) research and development; or

(D) a new or expanding establishment described in Subsection (14)(d) in the state; and

. . . .

3. Utah Admin. Rule R865-19S-121 ("Rule 121") provides guidance concerning the sales and use tax exemption for specified mining establishments, as authorized by Subsection 59-12-104(14)(c). In Rule 121(1)(b), "machinery and equipment" is defined throughout the audit period to mean "electronic or mechanical devices having an economic life of three or more years including any accessory that controls the operation of the machinery and equipment."

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renumbered in Senate Bill 65 (2014) ("SB 65"). In this bill, Subsection 59-12-104(14)(e) was also amended and renumbered. Because this statute is substantive law, it is the version of the statute in effect during the audit period that is applicable to this appeal.

4. UCA §59-1-1417 (2015) provides that the burden of proof is generally upon the petitioner in proceedings before the Commission (with limited exceptions not applicable to this appeal) and provides guidance on how tax statutes should be construed, 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.

DISCUSSION

Pursuant to Subsection 59-1-1417(1), the burden of proof in this matter is upon the taxpayer. Because the chemicals at issue are tangible personal property, the taxpayer's purchases of them are subject to sales and use tax pursuant to Subsection 59-12-103(1)(a), unless an exemption applies. Subsection 59-12-104(14)(c) provides that purchases or leases made by mining establishments may be exempt from sales and use taxation if a number of requirements are met. With one exception, the parties agree that the taxpayer's purchases of CHEMICAL-1 and CHEMICAL-2 meet all of the requirements for exemption under Subsection 59-12-104(14)(c). The parties disagree on whether CHEMICAL-1 and CHEMICAL-2 qualify as "machinery and equipment," which is one of the requirements for exemption.

The term "machinery and equipment" is not defined in the Utah Tax Code. The Commission, however, has adopted Rule 121 to provide guidance concerning the Subsection 59-12-104(14)(c) mining establishment exemption. In Rule 121(1)(b), the Tax Commission has defined the term "machinery and equipment" to mean "electronic or mechanical devices having an economic life of three or more years including any accessory that controls the operation of the machinery and equipment." The parties agree that CHEMICAL-1 and CHEMICAL-2 have an economic life of three or more years. In addition, neither party suggests that the chemicals are an accessory that controls the operation of machinery and equipment. Moreover, the taxpayer does not contend that CHEMICAL-1 and CHEMICAL-2 are "mechanical devices." The taxpayer does, however, contend that the chemicals are "electronic devices" and, as a result, that they satisfy Rule 121's definition of "machinery and equipment."

However, in the event the Commission finds that the chemicals at issue are not "electronic devices," the taxpayer contends that the Commission should find that Rule 121's definition of "machinery and equipment" is too narrow because the chemicals are "equipment" for purposes of the controlling statute, Subsection 59-12-104(14)(c). The Commission will first address whether the chemicals at issue are "electronic devices" under Rule 121. Only if the Commission finds that the chemicals are not "electronic devices" will the Commission address the taxpayer's argument that the chemicals are, nevertheless, "equipment" for purposes of Subsection 59-12-104(14)(c).

I. Are CHEMICAL-1 and CHEMICAL-2 "electronic devices" for purposes of Rule 121's definition of "machinery and equipment"?

The Commission has not defined the term "electronic devices" in Rule 121, nor is it defined in statute. In *Keene v. Bonser*, 2005 UT App 37, ¶ 10 (Utah Ct. App. 2005), the Utah Court of Appeals stated that when interpreting statutory provisions, including definitions, "[w]e look first to the plain language of the statute to discern the legislative intent.... 'Only when we find ambiguity in the statute's plain language need we seek

guidance from the legislative history and relevant policy considerations.'" (quoting *Gohler v. Wood*, 919 P.2d 561 (Utah 1996)) (other citations omitted). The Court further stated in *Keene* that "[i]n construing the plain language of a statute, words 'which are used in common, daily, nontechnical speech, should, in the absence of evidence of a contrary intent, be given the meaning which they have for laymen in such daily usage.'" (quoting *Mesa Dev. Co. v. Sandy City Corp.*, 948 P.2d 366 (Utah Ct. App. 1997)) (other citations omitted).[6] The Court also stated in *Keene* that "courts often refer to the dictionary to define statutory terms" and "adopt common, nontechnical, dictionary-definition meanings."[7]

The taxpayer indicates that the term "electronic devices" is not found in the dictionary, but contends that the words "electronic" and "device" are both in the dictionary and that the chemicals at issue meet definitions found for both of these words. The taxpayer asserts that the Merriam-Webster Online Dictionary defines "electronic" to mean "of or relating to electrons."[8] Because CHEMICAL-1 and CHEMICAL-2 have electrons and are used for chemical bonding, the taxpayer contends that the word "electronic" applies to them.

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6 *See also Ambassador Athletic Club v. Utah State Tax Comm'n*, 27 Utah 2d 377 (Utah 1972), in which the Utah Supreme Court stated that where the Legislature has not provided a definition of a statutory term, "it must be assumed it was intended to have a meaning generally understood and accepted by the public." *See also Hercules Inc. v. Utah State Tax Comm'n*, 2000 UT App 372, 21 P.3d 231 (Utah Ct. App. 2000).

7 In *Gohler*, the Court also stated we "will interpret a statute according to its plain language, unless such a reading is unreasonably confused [or]inoperable. . . ." (quoting *Perrine v. Kennecott Mining Corp.*, 911 P.2d 1290 (Utah 1996)). In *Gohler*, the Court further stated that "[o]nly when we find ambiguity in the statute's plain language need we seek guidance from the legislative history and relevant policy considerations" (quoting *World Peace Movement of Am. v. Newspaper Agency Corp.*, 879 P.2d 253, 259 (Utah 1994)). *See also Rent-A-Center West, Inc. v. Utah State Tax Comm'n*, 2016 UT 1, ¶ 15 (Utah 2016), in which the Court stated that "these possible [dictionary] definitions 'will often fail to dictate what meaning a word *must* bear in a particular context'" and that "[w]here this is the case, we must identify the meaning of the statutory language 'based on other indicators of meaning evident in the context of the statute (including, particularly, the structure and language of the statutory scheme).'" (quoting *Hi-Country Prop. Rights Grp. v. Emmer*, 2013 UT 33, ¶ 19, 304 P.3d 851 (Utah 2013)) (other citations omitted) (emphasis in original).

8 The Merriam-Webster Online Dictionary is located at http://www.merriam-webster.com/. The taxpayer did not indicate when it last visited the website and obtained this definition of "electronic." However, on April 29, 2016, the "simple" and "full" definitions of "electronic," as found on this website, are as follows: 1) "**operating through the use of many small electrical parts (such as microchips and transistors)**"; 2) "**produced by the use of electronic equipment**"; 3) "operating by means of a computer: involving a computer or a computer system"; 4) "of or relating to electrons"; 5a) "**of, relating to, or utilizing devices constructed**

In addition, the taxpayer asserts that the word "device" is defined in the Merriam-Webster Online Dictionary and in TheFreeDictionary.com Online Dictionary to mean "something devised or contrived," "a piece of equipment or a mechanism designed to serve a special purpose," and "[a] contrivance or invention serving a particular purpose."[9] The taxpayer asserts that the word "device" applies to CHEMICAL-1 and CHEMICAL-2 because the chemicals are devised or contrived and are designed to serve a special or particular purpose of beneficiating METAL. The taxpayer concludes that because CHEMICAL-1 and CHEMICAL-2 meet these definitions of "electronic" and "device," they are "electronic devices" for purposes of Rule 121 and, thus, qualify as "machinery and equipment" for purposes of exemption.

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or working by the methods or principles of electronics <*electronic fuel injection*>"; 5b) "implemented on or by means of a computer: involving a computer <*electronic banking*>"; 6a) "generating musical tones by electronic means <*an electronic organ*>"; 6b) "of, relating to, or being music that consists of sounds electronically generated or modified"; and 7) "of, relating to, or being a medium (as television) by which information is transmitted electronically <*electronic journalism*>" (emphasis added).

9 In a pre-hearing brief, the taxpayer indicated that the Division had cited these definitions in the Division's own pre-hearing brief. The definitions the taxpayer cited for "device" are *some* of the definitions that the Division cited for "device" from these two online dictionaries. Neither party, however, indicated when the Division last visited the online dictionaries and obtained these definitions.

On April 29, 2016, however, the "simple" and "full" definitions of "device," as found on the Merriam-Webster Online Dictionary, are as follows: 1) "**an object, machine, or piece of equipment that has been made for some special purpose**"; 2) "a weapon that explodes"; 3) "something that is done in order to achieve a particular effect"; 4) "something devised or contrived: as" (a)(1) "plan, procedure, technique"; (a)(2) "a scheme to deceive: stratagem, trick"; (b) something fanciful, elaborate, or intricate in design"; (c) "something (as a figure of speech) in a literary work designed to achieve a particular artistic effect"; (d) "*archaic*: masque, spectacle"; (e) "a conventional stage practice or means (as a stage whisper) used to achieve a particular dramatic effect"; (f) "**a piece of equipment or a mechanism designed to serve a special purpose or perform a special function <*an electronic device*>**"; 5) "desire, inclination <*left to my own devices*>"; and 6) "an emblematic design used especially as a heraldic bearing" (emphasis added).

TheFreeDictionary.com Online Dictionary is located at http://www.thefreedictionary.com/ and compiles definitions for a word or term from a number of different sources. In its pre-hearing brief, the Division cited to one of the definitions this online dictionary had provided from the American Heritage Dictionary of the English Language. On April 29, 2016, the definitions of "device," as found on TheFreeDictionary.com Online Dictionary (citing American Heritage Dictionary of the English Language (5th ed. 2011)), are as follows: 1) "**[a] contrivance or invention serving a particular purpose, especially a machine used to perform one or more relatively simple tasks**"; 2) "[a] literary contrivance, such as parallelism or personification, used to achieve a particular effect"; 3a) "[a] decorative design, figure, or pattern, as one used in embroidery. . . "; 3b) "[a] graphic symbol or motto, especially in heraldry"; and 4) "[a] plan or scheme for accomplishing something" (emphasis added).

The taxpayer's argument is unpersuasive. In *Morton International, Inc. v. Utah State Tax Comm'n*, 814 P.2d 581 (Utah 1991), the Utah Supreme Court cautioned that attempts to define a multi-word term by combining different definitions for words in that term may be inappropriate. In *Morton*, the meaning of the term "synthetic fuel processing and upgrading plant" was at issue. Morton argued that certain items qualified as synthetic fuel based on separate definitions it had found and combined for the words "synthetic" and "fuel." The Court found that "a method of construction which is based solely on one of many possible definitions is inappropriate." It further stated that "[w]hen the use of an ordinary meaning of a statutory term results in a statute that is 'confused beyond reason,' the court does not resolve the confusion by modifying the ordinary meaning of the term."

In the instant case, the taxpayer has selected definitions of the words "electronic" and "device" and combined them to define the term "electronic devices" to mean, in essence, something of or relating to electrons that is devised, contrived, or designed to serve a special or particular purpose. Defining "electronic devices" in this manner not only appears to be incongruent with the underlying statute, but also results in a meaning for this term that is not generally understood and accepted by the public.

First, there are other definitions of "electronic" and "device" found in the two online dictionaries cited by the parties that, when combined, would result in a definition of "electronic devices" that seems more harmonious with the underlying statutory term "machinery and equipment." As shown in Footnotes #6 and #7, "electronic" is also defined to mean "operating through the use of many small electrical parts (such as microchips and transistors)" and "of, relating to, or utilizing devices constructed or working by the methods or principles of electronics," while "device" is also defined to mean "a piece of equipment or a mechanism designed to serve a special purpose or perform a special function," an example of which is an "electronic device" (which is the term at issue). As a result, definitions of "electronic" and "device" that, when combined, would seem to provide a more meaningful definition of "electronic devices," in the context of the controlling

statute's use of "machinery and equipment," are those that are related to the use of electrical parts in an object, machine, or piece of equipment to serve a special purpose or perform a special function.[10]

These more meaningful definitions of "electronic" and "device" also suggest that the term "electronic devices" should not be read, as the taxpayer suggests, so broadly that it includes anything of or relating to electrons that is devised, contrived, or designed to serve a special or particular purpose. Reading "electronic devices" this broadly could result in the statutory term "machinery and equipment" being interpreted to include any item because it is arguable that all items not only have electrons, but also serve a particular purpose. The Commission is not convinced that the Utah Legislature ("Legislature") intended the term "machinery and equipment," as used in Subsection 59-12-104(14), to mean any item of personal property or any input (that might meet the other exemption requirements). Had this been the Legislature's intent, it could have used language to refer to any input or, as it used in the farming operations exemption of Subsection 59-12-104(18), any item of "tangible personal property," but it did not.[11] As a result, interpreting the term "electronic devices"

10 Further supporting this conclusion is the definition of the related word "electronics." Entering the term "electronic devices" into TheFreeDictionary.com Online Dictionary "redirects" a visitor to definitions of the word "electronics," which is defined as: 1) "[t]he science and technology of electronic phenomena"; 2) "[e]lectronic devices and systems"; 3) "**the science and technology concerned with the development, behaviour, and applications of electronic devices and circuits**"; 4) "**the circuits and devices of a piece of electronic equipment**"; 5) "**the science dealing with the development and application of devices and systems involving the flow of electrons in a vacuum, in gaseous media, and in semiconductors**"; 6) "such devices considered as components of something"; and 7) "[t]he use and study of electricity in semiconductors" (emphasis added). TheFreeDictionary.com, http://www.thefreedictionary.com/electronic+devices (citing American Heritage Dictionary of the English Language (5th ed. 2011) for the 1st and 2nd definitions) (citing Collins English Dictionary – Complete and Unabridged (12th ed. 2014) for the 3rd and 4th definitions) (citing Random House Kernerman Webster's College Dictionary (2010) for the 5th and 6th definitions) (citing Dictionary of Unfamiliar Words by Diagram Group (2008) for the 7th definition) (last visited April 29, 2016).

11 Furthermore, if "electronic devices" is interpreted as broadly as the taxpayer suggests, it could also render the word "mechanical" that appears in Rule 121's definition of "machinery and equipment" to be superfluous because a "mechanical device," too, would not only have electrons, but also serve a particular purpose. The Utah Supreme Court has found that such an interpretation should be avoided. *See Platts v. Parents Helping Parents*, 947 P.2d 658 (Utah 1997), in which the Court stated that "[w]e will avoid an interpretation which renders portions of, or words in, a statute superfluous or inoperative" (citing *State v. Hunt*, 906 P.2d 311 (Utah 1995)).

as the taxpayer proposes does not appear to be congruent with the underlying statute's limiting the exemption to just "machinery and equipment."

Second, the Commission does not believe that the taxpayer's combined definition for "electronic devices" is one that would generally be understood and accepted by the public. The Commission does not believe that the public generally understands and accepts the meaning of "electronic devices" to be something of or relating to electrons that is devised, contrived, or designed to serve a special or particular purpose. The Commission believes, instead, that the public associates the term "electronic devices" with "electronics" and "electronic equipment" and to include objects, machines, or pieces of equipment that have electrical parts. For these reasons, the Commission is not persuaded by the taxpayer's argument that CHEMICAL-1 and CHEMICAL-2 are "electronic devices" for purposes of Rule 121's definition of "machinery and equipment." Accordingly, the Commission finds that the plain language of Rule 121, including its use of the term "electronic devices," excludes CHEMICAL-1 and CHEMICAL-2 from being deemed "machinery and equipment" for purposes of the exemption.

Lastly, the Commission would have reached the same conclusion if it had found that ambiguity existed in regards to the meaning of "electronic devices." If ambiguity exists in the meaning of a statute (or rule) that concerns a tax exemption, that statute (or rule) is construed strictly against the taxpayer.[12] Accepting the taxpayer's proposed definition of "electronic devices" would not construe Rule 121's definition of "machinery and equipment" strictly against the taxpayer. It would improperly construe the definition broadly in favor of the taxpayer. In conclusion, the Commission finds that CHEMICAL-1 and CHEMICAL-2 are not "electronic devices" for purposes of Rule 121.

Missouri has also addressed whether chemicals that are used through a number of production cycles of a manufacturing process can be exempt from sales and use tax. *See* Missouri Department of Revenue Letter

12 *See* Subsection 59-1-1417(2)(b). *See also Hales Sand & Gravel, Inc. v. Utah State Tax Comm'n*, 842

Ruling No. LR3301 (Aug. 31, 2006). In its ruling, the department indicated that chemicals had to meet the definitions of "machinery," "equipment," or "parts" to qualify for exemption. The department explained that in order for an item to be considered "machinery" or "equipment," it had to be a "device." The department found that the chemicals were not a "device." It further found that the chemicals were not "parts" because they are liquids. For these reasons, the Missouri Department of Revenue found that chemicals were not exempt. Neither party provided the statutes and/or regulations that the department considered when making its ruling. In addition, the Commission is not bound by other states' precedents. As a result, the Commission does not rely on this letter ruling to reach its conclusion that the chemicals at issue are not "electronic devices." Nevertheless, it does lend some support to the Commission's conclusion.

II. Does the exclusion of the chemicals CHEMICAL-1 and CHEMICAL-2 from the Rule 121 definition of "machinery and equipment" improperly narrow the Subsection 59-12-104(14)(c) exemption?

In the event the Commission found that CHEMICAL-1 and CHEMICAL-2 are not "electronic devices," the taxpayer asks the Commission to find that the chemicals at issue are, nevertheless, considered "machinery and equipment" for purposes of Subsection 59-12-104(14)(c) and, thus, to find that Rule 121's definition of "machinery and equipment" improperly narrows the underlying statute.

In regards to the use of the term "machinery and equipment" in Subsection 59-12-104(14)(c)(i), the taxpayer concedes that CHEMICAL-1 and CHEMICAL-2 are not "machinery," but contends that they are "equipment."[13] The taxpayer analogizes that because CHEMICAL-1 and CHEMICAL-2 are used in the solvent extraction process to extract METAL, they are similar to crushers and separators used in non-solvent extraction processes to extract other metals or minerals.[14] As a result, the taxpayer contends that these

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P.2d 887 (Utah 1992); *Parson Asphalt Prods., Inc. v. Utah State Tax Comm'n*, 617 P.2d 397 (Utah 1980).

13 The taxpayer explained that because the Legislature exempted both "machinery" and "equipment," "equipment" must mean something different than "machinery." Otherwise, the word "equipment" would be superfluous, which, as discussed earlier, is an interpretation that should be avoided.

14 The taxpayer acknowledges that most mining processes are mechanical. However, because the

chemicals, like crushers and separators, should be considered "machinery and equipment" for purposes of the exemption. To do otherwise, the taxpayer contends, would discriminate between mining operations employing solvent extraction processes and mining operations that do not. In addition, the taxpayer contends that the only difference between the chemicals at issue and crushers and separators is that the chemicals are liquid in form when they are purchased while crushers and separators are solid in form.

The taxpayer contends that CHEMICAL-1 and CHEMICAL-2 are "equipment" under the plain language of Subsection 59-12-104(14)(c). Because there is no statutory definition of "equipment" as it relates to this exemption, the taxpayer relies on a definition from the Merriam-Webster Online Dictionary, in which "equipment" is defined to mean "the set of articles or physical resources serving to equip a person or thing: as (1) the implements used in an operation or activity."[15] The taxpayer contends that the chemicals at issue are

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taxpayer's beneficiation process also involves the solvent extraction process, the taxpayer contends that the chemicals used in that portion of the process should also be exempt from taxation. The 2002 North American Industry Classification System ("NAICS") provides the following definition at NAICS Subsector 212 (Mining (except Oil and Gas)):

> Industries in the Mining (except Oil and Gas) subsector primarily engage in mining, mine site development, and beneficiating (i.e., preparing) metallic minerals and nonmetallic minerals, including coal. The term "mining" is used in the broad sense to include ore extraction, quarrying, and beneficiating (e.g., crushing, screening, washing, sizing, concentrating, and flotation), customarily done at the mine site.
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> Beneficiation is the process whereby the extracted material is reduced to particles which can be separated into mineral and waste, the former suitable for further processing or direct use. The operations that take place in beneficiation are primarily mechanical, such as grinding, washing, magnetic separation, centrifugal separation, and so on. In contrast, manufacturing operations primarily use chemical and electrochemical processes, such as electrolysis, distillation, and so on. However some treatments, such as heat treatments, take place in both stages: the beneficiation and the manufacturing (i.e., smelting/refining) stages. The range of preparation activities varies by mineral and the purity of any given ore deposit.
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http://www.census.gov/cgi-bin/sssd/naics/.

15 The taxpayer did not indicate when it last visited the website and obtained this definition of "equipment." However, on April 29, 2016, the "simple" and "full" definitions of "equipment," as found on this website, are as follows: 1) "supplies or tools needed for a special purpose"; 2) "the act of equipping someone or something"; 3a) "the set of articles or physical resources serving to equip a person or thing: as (1) :

clearly "equipment" within this definition because they are "articles or physical resources serving to equip" the taxpayer with the ability to beneficiate METAL through the solvent extraction process. If Rule 121 provides that CHEMICAL-1 and CHEMICAL-2 are not "equipment" for purposes of the exemption, the taxpayer contends that the rule is invalid and should be amended.[16]

The taxpayer has defined the word "equipment" to mean "articles or physical resources serving to equip." This definition appears sufficiently broad to include the chemicals at issue because they are articles or physical resources and because they serve to equip. However, in *Gohler*, the Utah Supreme Court stated that we "will interpret a statute according to its plain language, unless such a reading is unreasonably confused[or] inoperable. . . ." Isolating the word "equipment" from the term "machinery and equipment" and defining it in the manner the taxpayer proposes would result in a reading that is improper. The taxpayer's definition of "equipment" is so broad that it would arguably include any item that could also be identified as "machinery" because items of machinery are also articles or physical resources that serve to equip. By reading the word "equipment" so broadly, the taxpayer has rendered the word "machinery" superfluous. As the taxpayer has pointed out, Utah courts will avoid an interpretation which renders portions of, or words in, a statute superfluous or inoperative.

Furthermore, reading "equipment" as broadly as the taxpayer proposes appears to be incongruous with the underlying statute's limitation of the exemption to just "machinery and equipment." As already discussed,

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the implements used in an operation or activity: apparatus <*sports equipment*> (2): all the fixed assets other than land and buildings of a business enterprise (3): the rolling stock of a railway"; 3b) "a piece of such equipment"; 4a) "the equipping of a person or thing"; 4b) "the state of being equipped"; and 5) "mental or emotional traits or resources."

16 The taxpayer cites to *Sanders Brine Shrimp v. Utah State Tax Comm'n*, 846 P.2d 1304 (Utah 1993), in which the Utah Supreme Court found that "[i]t is a long-standing principle of administrative law that an agency's rules must be consistent with its governing statutes. Thus, a rule that is out of harmony with a governing statute is invalid" (citations omitted). The Commission also notes that in *Department of Community Affairs v. Merit System Council*, 614 P.2d 1259 (Utah 1980), the Utah Supreme Court found that "administrative regulations are presumed to be reasonable and valid and cannot be ignored or followed by the agency to suit its own purposes. Such is the essence of arbitrary and capricious action. Without compelling

in Subsection 59-12-104(14)(c)(i), the Legislature did not use language to extend the exemption to all items of tangible personal property or all inputs. Instead, it only exempted "machinery and equipment." For these reasons, the Commission declines to find that the plain meaning of the word "equipment" includes the chemicals at issue.

Based on the foregoing, the plain meaning of the term "equipment" is not helpful in determining the Legislature's intent of what constitutes "machinery and equipment." To assist in determining the Legislature's intent, the taxpayer refers the Commission to comments made by Senator Howard Stephenson, who, in 2007, sponsored a bill to expand the exemption found in Subsection 59-12-104(14) to certain mining establishments.[17] The taxpayer indicates that in the 2007 legislative debates, Senator Stephenson explained that the amendment reflected the current "movement toward the idea that we should not be taxing business inputs, especially basic industry. We should be taxing their outputs."[18] However, the "machinery and equipment" language the Legislature actually used in the amendment suggests that while its intent was to exempt *many* of the inputs that a mining establishment may employ in its operations, it did not intend to exempt *all* inputs employed in these operations. Again, had it been the intent of the Legislature to exempt all tangible personal property, it could have easily done so as it did in the Subsection 59-12-104(18) farming operations exemption. As a result, the Commission declines to interpret "machinery and equipment" to include all inputs.

Because ambiguity still exists in regards to the meaning of the word "equipment," the Commission must construe it narrowly, pursuant to Subsection 59-1-1417(2)(b). It appears that the Division allows the

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grounds for not following its rules, an agency must be held to them."

17 The taxpayer explained that the amendment to expand Subsection 59-12-104(14) to include certain mining establishments was originally proposed as Senate Bill 142 (2007), but was ultimately incorporated into and passed as part of Senate Bill 223 (2007).

18 The taxpayer cites Audio Recording: Senate Debate on SB 142, 57th Leg. Gen. Sess. (Feb. 5, 2007) (comment of Senator Stephenson).

mining establishment exemption for items that include crushers, separators, vats, tanks, pipes, and hand tools,[19] but not for items that include chemicals or gases.[20] Such a delineation does not appear unreasonable, especially where the term "machinery and equipment" and the word "equipment" must be construed narrowly and against the taxpayer. The taxpayer has not suggested how "machinery and equipment" can be interpreted differently so that the exemption does not apply to all items of personal property or all inputs (that meet the other statutory requirements for exemption).[21] For these reasons, the Commission accepts the Division's position and finds

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19 The taxpayer admitted that it received the Subsection 59-12-104(14)(c) exemption for the crushers and separators it used in its mining operations. It also admitted that it received the exemption for items seen in the photographs of its "wet grind," "CCD," "leach," and "solvent extraction" operations (Formal Hearing Exhibit 2, p. 23), which clearly includes piping and vats or tanks. In addition, at the hearing, Commission Chair Valentine indicated that the word "equipment" may include hand tools, which the Division did not refute. Furthermore, the taxpayer did not indicate that it was not receiving the Subsection 59-12-104(14)(c) exemption for hand tools employed in its mining operations. It is arguable that piping, vats, hand tools, and even computers are not "machinery." As a result, the exemption of such items as "equipment" instead of "machinery" discounts the taxpayer's argument that the Division is only exempting items that are considered "machinery" and giving no effect to the word "equipment."

20 In the instant case, the Division determined that "machinery and equipment" does not include the chemicals at issue. In a prior case involving the Subsection 59-12-104(14)(a) exemption for manufacturing establishments, the Division determined that ammonia gas did not qualify as "machinery and equipment" for purposes of the statute or as an "electronic or mechanical device" for purposes of Utah Admin. Rule R865-19S-85 ("Rule 85"), the rule in which "machinery and equipment" is defined for purposes of the manufacturing establishment exemption. *See USTC Appeal No. 07-0067* (Findings of Fact, Conclusions of Law, and Final Decision Mar. 11, 2010), in which the Commission found, as follows in pertinent part:

> The Taxpayer uses ammonia gas as a refrigerant. The Taxpayer testified that ammonia lasts more than three years. We do not believe, however, that ammonia gas is "machinery or equipment" or a "part," within the meaning of the statute, or "an electronic or mechanical device" within the meaning of the rule, We do hold, however, for the Taxpayer's future guidance, that the refrigeration equipment was part of the manufacturing process.

In the instant case, the taxpayer encourages the Commission to issue an order that would overturn *Appeal No. 07-0067*. The Commission, however, is hesitant to effectuate a policy change through the appeals process where the requested policy change does not clearly reflect the Legislature's intent. *See Williams v. Pub. Serv. Comm'n,* 754 P.2d 41 (Utah 1988), in which the Utah Supreme Court "noted that 'prior determinations [of administrative agencies] are entitled to great weight.... [R]adical departures from administrative interpretations consistently followed cannot be made except for most cogent reasons.'" (quoting *Husky Oil Co. v. Utah State Tax Comm'n*, 556 P.2d 1268 (Utah 1976)) (other citation omitted).

21 While admitting that any ambiguity in the statutory language of the exemption must be read strictly against it, the taxpayer points out in *OSI Industries, Inc. v. Utah State Tax Comm'n*, 860 P.2d 381 (Utah Ct. App. 1993), the Utah Court of Appeals held that "[a]lthough exemptions from taxation are generally construed narrowly, they should, nonetheless, be construed with sufficient latitude to accomplish the intended purpose"

that neither the term "machinery and equipment" nor the word "equipment," as used in Subsection 59-12-104(14)(c), should be interpreted so broadly as to include the two chemicals at issue.

This conclusion is supported by the Legislature's enactment of Senate Bill 21 (2015) ("SB 21") subsequent to the audit period. In this bill, the Legislature enacted a sales and use tax exemption for the purchase or lease of molten magnesium in Subsection 59-12-104(83) (2015), which is an exemption that is separate from the exemption for "machinery and equipment" that is found in Subsection 59-12-104(14)(a) (2015) (for certain manufacturing establishments) and the renumbered Subsection 59-12-104(14)(b) (2015)[22] (for certain mining establishments). At the hearing, REPRESENTATIVE FOR TAXPAYER, the taxpayer's counsel, indicated that molten magnesium (which, like the chemicals at issue, has a liquid form and a long economic life) is used in the operations of a different taxpayer who was also a client of his. He also expressed his belief that the molten magnesium was "equipment" for Subsection 59-12-104(14) exemption purposes. To avoid the risk of litigation and to ensure that his client was exempt from taxation on its purchases or leases of molten magnesium, REPRESENTATIVE FOR TAXPAYER indicated that he sought out the Legislature to exempt this particular liquid. However, if the word "equipment," as used in Subsection 59-12-104(14), had

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(quoting *Utah County v. Intermountain Health Care, Inc.*, 725 P.2d 1357 (Utah 1986)) (other citations omitted). The taxpayer, however, has not shown that the Commission's interpretation of "machinery and equipment" is insufficient to accomplish the intended purpose of the exemption, especially where the taxpayer appears only to have been denied the exemption for the two chemicals at issue, but has received the exemption for many other items.

The taxpayer also contends that CHEMICAL-1 and CHEMICAL-2 should be exempt because its production of METAL would cease without the chemicals. The taxpayer's suggestion that any item indispensable to the mining production process should qualify as "machinery and equipment" is also unpersuasive. Such an interpretation could expand the exemption to include any item of tangible personal property or any input used in the process. For reasons already explained, such an interpretation would not accomplish the intended purpose of the statute to exempt *many*, but not *all*, items of tangible personal property (that meet the other requirements for exemption).

22 In SB 65, the Legislature amended the Subsection 59-12-104(14)(c) mining establishment exemption at issue in the instant matter and renumbered it Subsection 59-12-104(14)(b).

been broad enough to provide an exemption for the molten magnesium, the Legislature would not have needed to create a new, separate exemption for it.[23]

The Commission's conclusion is also supported by the Legislature's enactment of Senate Bill 182 (2015) ("SB 182"). In this bill, the Legislature enacted a sales and use tax exemption in Subsection 59-12-104(84) (2015) to allow a drilling equipment manufacturer to purchase or lease certain items for use in its manufacturing process tax-free. Subsection 59-12-104(84)(a) specifically provides, in pertinent part, that the items a drilling equipment manufacturer may purchase tax-free are "machinery, equipment [and] **materials**" (emphasis added). While the mining exemption at issue in the instant matter is available for "machinery and equipment," the drilling equipment exemption is available not only for "machinery and equipment," but also for "materials." As a result, "materials" must be interpreted to include items that are not included in "machinery and equipment," which supports the Commission's conclusion that "machinery and equipment," as used in the mining exemption statute, is less inclusive than the taxpayer contends.

The Commission acknowledges that revenue departments and/or courts in four other states that exempt the "machinery" and "equipment" of certain entities have found that their exemptions may apply to chemicals (or similar items).[24] As previously mentioned, however, decisions from other states are not binding on Utah proceedings. In addition, the Commission is not convinced that a Utah court would interpret the Utah statute in the same manner as these other states have interpreted their statutes. For example, some of these other states' courts reached their decisions after considering the intent of amendments that their legislatures had

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23 It does not appear that an entity other than REPRESENTATIVE FOR TAXPAYER other client purchased or leased molten magnesium. REPRESENTATIVE FOR TAXPAYER indicated that SB 21 did not have a fiscal note because the company he was representing was new and because the state had never budgeted for taxes from the sale or lease of molten magnesium.

24 The taxpayer provided the following four cases for the Commission's consideration: 1) *State ex rel. Ariz. Dep't of Revenue v. Capitol Castings, Inc.*, 88 P.3d 159 (Ariz. 2004); 2) *Weiss v. Chem-Fab Corp.*, 984 S.W.2d 395 (Ark. 1999); 3) *Anonymous Corporation v. South Carolina Dep't of Revenue*, No. 99-ALJ-17-0153-CC (Administrative Law Judge Div. Nov. 9, 1999) (aff'd by South Carolina Court of Appeals, Unpublished Decision No. 2003-UP-029, South Carolina Supreme Court cert. denied Oct. 8, 2002); and 4)

made to their applicable exemption statutes. It does not appear that the actions taken by these other states' legislatures were similar to the actions taken by the Utah Legislature in SB 21 and SB 182.

Furthermore, the court in the Arizona case acknowledged that by finding the chemicals (and other similar items at issue in that case) were exempt, "certain items not traditionally considered to be machinery or equipment may qualify as such depending on their function in the process." In a treatise prepared by Walter Hellerstein (State Taxation, ¶ 14.05(3)(b), 3rd ed.), Mr. Hellerstein commented on the Arizona case and stated that it "embraced a broad view of the definition of 'machinery and equipment[.]'" The Commission is not persuaded that Subsection 59-12-104(14)(c) should be interpreted in a manner that would exempt items not traditionally considered machinery and equipment. For these reasons, the Commission finds that the cases from these four other states are not controlling in the instant matter.

Lastly, the taxpayer points out that the definition of "machinery and equipment," as found in Rule 121 (for purposes of Subsection 59-12-104(14)'s mining establishment exemption) is narrower than the definition of "machinery and equipment" as found in Rule 85 (for purposes of Subsection 59-12-104(14)'s manufacturing establishment exemption). Since the early 2000's, Rule 85(1)(b) has defined "machinery and equipment" for the manufacturer establishment exemption, as follows:

> (i) 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
> (ii) any accessory that is essential to a continuous manufacturing process. Accessories essential to a continuous manufacturing process include:
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> (A) bits, jigs, molds, or devices that control the operation of machinery and equipment; and
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> (B) 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.

While Rule 121 is narrower than Rule 85, the Commission declines to find that Rule 85 improperly

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Eastman Chem. Co. v. Johnson, 151 S.W.3d 503 (Tenn. 2004).

narrows the mining establishment exemption found in Subsection 59-12-104(14)(c) in regards to the two chemicals at issue. The Commission is not convinced that these chemicals would have been considered "machinery and equipment" under the definition found in Rule 85, but not Rule 121. The Commission has previously found that ammonia gas is not "machinery and equipment" for purposes of the manufacturing establishment exemption (i.e., under Subsection 59-12-104(14)(a) and Rule 85). The chemicals at issue in the instant matter appear more similar to ammonia gas than to crushers, separators, and other items for which the taxpayer has received the mining establishment exemption. Furthermore, the taxpayer, who has the burden of proof, has not established whether the Division implements the two rules differently, and if so, to what extent. For these reasons, the chemicals at issue do not warrant exemption on the basis that the definition of "machinery and equipment" is narrower in Rule 121 than in Rule 85. The chemicals would not be considered "machinery and equipment" under either rule.[25]

In conclusion, the chemicals at issue, CHEMICAL-1 and CHEMICAL-2, are not "electronic devices" for purposes of Rule 121's definition of "machinery and equipment," nor are they "equipment" for purposes of Subsection 59-12-104(14)(c), the underlying statute. As a result, these chemicals do not satisfy all requirements for exemption.

CONCLUSIONS OF LAW

1. Pursuant to Subsection 59-1-1417(1), the burden of proof in this appeal is upon the taxpayer.

2. The chemicals at issue are not exempt from sales and use tax under Subsection 59-12-104(14)(c) because they do not satisfy all the requirements necessary to qualify for exemption. Specifically, the chemicals are not "machinery and equipment," which is one of the requirements for exemption.

25 That being said, the Commission will study whether Rule 121 or Rule 85 needs to be amended for purposes of consistency.

3. Because the chemicals are not exempt from taxation under Subsection 59-12-104(14)(c) and because the taxpayer does not contend that another exemption applies, the chemicals are subject to sales and use tax pursuant to Subsection 59-12-103(1)(a). Accordingly, the Commission should deny the taxpayer's appeal and sustain the Division's Statutory Notice, in which it denied the taxpayer's refund request.

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Kerry R. Chapman
Administrative Law Judge

DECISION AND ORDER

Based on the foregoing, the Commission finds that the chemicals at issue do not qualify for an exemption from sales and use tax. The Division's Statutory Notice, in which the Division denied the taxpayer's refund request, is sustained. It is so ordered.

DATED this _____ day of _____, 2016.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
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. §§59-1-601et seq. and 63G-4-401 et seq.