15-764 & 15-1503
TAX TYPE: SALES AND USE TAX
TAX YEAR: 03/01/2009 thru 03/31/2013
DATE SIGNED: 07/29/2016
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. ROCKWELL
EXCUSED: R. PERO

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**INITIAL HEARING DECISION** Appeal No. 15-764 Tax Type: Sales and Use Tax Audit Period: March 1, 2012 – March 31, 2013 Judge: Jensen
TAXPAYER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	**INITIAL HEARING DECISION** Appeal No. 15-1503 Tax Type: Sales and Use Tax Audit Period: March 1, 2009 – March 31, 2012 Judge: Jensen

Presiding:
Clinton Jensen, Administrative Law Judge

Appearances:

For Petitioner:	REPRESENTATIVE-1 FOR TAXPAYER, for the Taxpayer REPRESENTATIVE-2 FOR TAXPAYER, for the Taxpayer REPRESENTATIVE-3 FOR TAXPAYER, for the Taxpayer
For Respondent:	REPRESENTATIVE FOR RESPONDENT, Assistant Attorney General RESPONDENT, for the Division

STATEMENT OF THE CASE

Petitioner (the "Taxpayer") is appealing audits by the Division of two sales and use tax refund requests covering dates from March 1, 2009 to March 31, 2012 and from March 1, 2012 to March 31, 2013. The issues for the two audit periods are identical. Although there is overlap between the two audit

periods, no transactions appear in both audits. Based on these factors, the Commission issues this single decision covering both audits.

APPLICABLE LAW[1]

U.S. CONST. amend. XIV, §1 provides for equal protection under the law as follows, in pertinent part:

> No State shall . . . deny to any person within its jurisdiction the equal protection of the laws.

Utah Code Ann. §59-1-1410 provides for time limitations for refund requests, audits, and amended tax returns as follows, in pertinent part:

> (1) (a) Except as provided in Subsections (3) through (7) and Sections 59-5-114, 59-7-519, 59-10-536, and 59-11-113, the commission shall assess a tax, fee, or charge within three years after the day on which a person files a return.
> (b) Except as provided in Subsections (3) through (7), if the commission does not assess a tax, fee, or charge within the three-year period provided in Subsection (1)(a), the commission may not commence a proceeding to collect the tax, fee, or charge.
> . . .
> (3) The commission may assess a tax, fee, or charge or commence a proceeding for the collection of a tax, fee, or charge at any time if:
> (a) a person:
> (i) files a:
> (A) false return with intent to evade; or
> (B) fraudulent return with intent to evade; or
> (ii) fails to file a return; or
> (b) the commission estimates the amount of tax, fee, or charge due in accordance with Subsection 59-1-1406(2).
> . . .
> (8) (a) Except as provided in Subsection (8)(b) or Section 19-12-124, 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.

Utah Code Ann. §59-12-103(1) imposes a sales and use tax on transactions as follows, in pertinent part:

> (a) retail sales of tangible personal property made within the state;
> . . .
> (k) amounts paid or charged for leases or rentals of tangible personal property if within this state the tangible personal property is:
> (i) stored;

[1] Some of the statutes cited in this decision changed in ways not relevant to the outcome of this decision, typically through renumbering, through the audit period. The Commission cites the 2013 version of Utah code.

(ii) used; or
(iii) otherwise consumed;
(l) amounts paid or charged for tangible personal property if within this state the tangible personal property is:
(i) stored;
(ii) used; or
(iii) consumed;

Utah Code Ann. §59-12-104(22) exempts sales of certain property from sales and use taxes as follows:

> [S]ales of nonreturnable containers, nonreturnable labels, nonreturnable bags, nonreturnable shipping cases, and nonreturnable casings to a manufacturer, processor, wholesaler, or retailer for use in packaging tangible personal property to be sold by that manufacturer, processor, wholesaler, or retailer;

Utah Code Ann. §59-1-1417 provides requirements for burden of proof and statutory construction of tax statues 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.

Utah Administrative Rule R865-19S-48 provides additional guidance for the sales and use tax exemption under Utah Code Ann. §59-12-104(22) as follows:

> A. Sales of containers, labels, bags, shipping cases, and casings are taxable when:
> 1. sold to the final user or consumer;
> 2. sold to a manufacturer, processor, wholesaler, or retailer for use as a returnable container that is ordinarily returned to and reused by the manufacturer, processor, wholesaler, or retailer for storing or transporting their product; or
> 3. sold for internal transportation or accounting control purposes.

B. Returnable containers may include water bottles, carboys, drums, beer kegs for draft beer, dairy product containers, and gas cylinders.

1. Labels used for accounting, pricing, or other control purposes are also subject to tax.

C. For the purpose of this rule, soft drink bottles and similar containers that are ultimately destroyed or retained by the final user or consumer are not considered returnable and are exempt from the tax when purchased by the processor.

D. When tangible personal property sold in containers, for example soft drinks, is assessed a deposit or other container charge, that charge is subject to the tax. Upon refund of this charge, the retailer may take credit on a sales tax return if the tax is refunded to the customer.

DISCUSSION

The Taxpayer manufactures (X) and (Y) products. It ships its products on pallets from BUSINESS-1 ("BUSINESS-1"), a vendor that supplies pallets through a pooling program. The Taxpayer pays BUSINESS-1 three types of charges for the pallets it uses: 1) Daily hire fees for the per day usage of pallets on hand to the Taxpayer; 2) issue fees for adding new pallets to the Taxpayer's pool; and 3) transfer fees for removing pallets from the Taxpayer's pool. The parties agree that the daily hire fees and issue fees are taxable transactions. These transactions are not at issue in this case. The sole issue in these appeals is whether the transactions for removing pallets from the Taxpayer's pool are properly taxable or whether they are exempt under Utah Code Ann. §59-12-104(22) as "sales of nonreturnable containers [or] nonreturnable shipping cases."

The Taxpayer provided detail regarding the charges for pallets transferred out of the BUSINESS-1 system. The Commission quotes the relevant part of the letter from the Taxpayer's representatvie as follows:

1) Transfers Out – Surcharges associated with:

a. **To Distributor – U.S. (Collection) - $$$$$** – This surcharge is due to the classification of the distributor (customer) that TAXPAYER ships products to. Essentially, this customer is one that participates in the BUSINESS-1 program, but doesn't always return pallets to BUSINESS-1. BUSINESS-1 charges customers who ship product to them a surcharge due to the potential of the pallet not returning to BUSINESS-1.

b. **To Non-Participating – U.S. (Non-Cooperative) - $$$$$**– a non-participating / non cooperative customer is one that does not have a contract with BUSINESS-1 nor do they participate in the program. They will accept BUSINESS-1 pallets but they will not be responsible for charges once the pallet comes in their door. Due to this risk, BUSINESS-1 charges the customer who ships the product out on BUSINESS-1 pallets an additional fee because there is a higher probability that the pallet will not be returned to them. Essentially, TAXPAYER is charged an additional $$$$$ per pallet that is shipped to a non-participating customer.

c. **To Non-Participating – U.S. (Semi-Cooperative) - $$$$$**– A non-participating/ semi-cooperative customer is one that does not have a contract with BUSINESS-

1 nor do they participate in the program, but they do allow BUSINESS-1 to pick up the pallet from their facility at least 75% of the time. Since there is a higher probability that BUSINESS-1 will receive that pallet back from the customer as compared to a non-cooperative customer, the fee associated is lower. As such, TAXPAYER is charged an additional $$$$$ per pallet that is shipped to a non-participating customer.

2) What is a Non-Participating – US (Semi-Cooperative) distributor?

a. A Non-Participating / Semi-Cooperative distributor is a classification that BUSINESS-1 uses to designate customers that do not have a contract with BUSINESS-1 and have no contractual obligations to pay them for lost pallets, but do cooperate with BUSINESS-1 and allow for BUSINESS-1 to make collections at the facility. Typically, a customer is classified as this if they return at least 75% of the pallets that are shipped to them. Due to the risk that BUSINESS-1 could potentially still not receive back all of the pallets, BUSINESS-1 charges their customers [an] additional fee to ship to these types of customers.

3) What is the difference between a lost pallet fee and the surcharges discussed in part 1?

a. A lost pallet fee would be charged to TAXPAYER (or any other customer that has a signed contract with BUSINESS-1) for any pallets that are lost or not tied out during the yearly audit with BUSINESS-1. TAXPAYER (or any other customer that has a contract) has an obligation to BUSINESS-1 to report out pallets that leave their facility. If pallets that leave TAXPAYER are not reported correctly, and TAXPAYER cannot provide proof of where those pallets are shipped to, TAXPAYER is liable for paying a lost pallet fee.

4) What happens to the pallets when they are transferred to the Non-Participating – US (Non-Cooperative) and the Non-Participating – US (Semi-Cooperative) distributors?

a. Once a pallet leaves TAXPAYER's facility and is reported correctly (through an EDI exchange of data), the pallet is no longer TAXPAYER's responsibility. If TAXPAYER chooses to ship pallets to either of the aforementioned distributors, TAXPAYER is charged a fee by BUSINESS-1, but TAXPAYER is not responsible for the pallet from that point onward. BUSINESS-1 will try to collect pallets from these distributors, but may not be successful. TAXPAYER is not at all involved in the collection process of these pallets.

In addition to its arguments for exemption under Utah Code Ann. §59-12-104(22), the Taxpayer makes additional preliminary arguments that the Division acted beyond the statute of limitations to audit the Taxpayer's refund requests and that the Division's actions violate the Equal Protection Clause of the United States Constitution. Because a decision on one of these preliminary issues would render moot any discussion of the substantive issues of exemption, the Commission will address the preliminary matters first.

The Taxpayer cites Utah Code Ann. §59-1-1410 for the proposition that the Division has acted beyond the statute of limitations to audit the Taxpayer's refund requests for the audit periods at issue in this case. It takes the position that Utah Code Ann. §59-1-1410(1)(a) requires that the Commission shall "assess a tax, fee, or charge within three years after the day on which a person files a return." It points out that as a taxpayer requesting a refund of sales and use tax, it was never required to file a return. Rather, it paid sales and use tax at the time it made purchases. The Taxpayer argues that the Division is improperly treating its refund request as a "return," when it is not a return. On that basis, the Taxpayer's position is that Utah Code Ann. §59-1-1410(1)(a) does not give the Division three years to audit a refund request.

While the Taxpayer's position might have more credence if the Commission only considered subsection (1)(a) of Utah Code Ann. §59-1-1410, another subsection causes issues for the Taxpayer's position. When a taxpayer fails to file a return, Utah Code Ann. §59-1-1410(3) provides that the commission may assess a tax "at any time." While neither of these statutes directly addresses a situation in which a taxpayer has no duty to file a return, the Division has selected the shorter of the two statutes of limitations that could possibly apply to this situation, which is more favorable to the Taxpayer. If anything, the Division's willingness to treat a refund request as a tax return thus shortens the statute of limitations from the unlimited time of Utah Code Ann. §59-1-1410(3) to the three year time of Utah Code Ann. §59-1-1410(1)(a). Because the Division made its audits of the Taxpayer's refund requests within the three year limit provided by Utah Code Ann. §59-1-1410(1)(a), it acted within the applicable statute of limitations.

The Taxpayer's second preliminary argument is that Utah's sales and use tax statutes violate U.S. CONST. amend. XIV, §1, the equal protection clause, which forbids an action by a state that would "deny to any person within its jurisdiction the equal protection of the laws." The Taxpayer has not provided any source of law that would give the Utah State Tax Commission the authority to declare a Utah statute unconstitutional. The Commission takes administrative notice that federal and state law generally reserves this authority for the judicial branch of government and that the Commission is part of the executive branch. Because the Commission does not have the authority to address an issue of constitutionality, it does not address the Taxpayer's equal protection argument.

Because the Commission lacks authority to declare a statute unconstitutional and the Division's actions were within the applicable statute of limitations, the Commission considers the Taxpayer's argument on the merits for exemption from sales and use tax.

Utah Code Ann. §59-1-1417(2)(a) provides that the Commission is to "construe a statute imposing [a] tax, fee, or charge strictly in favor of the taxpayer." Utah Code Ann. §59-1-1417(2)(b) directs the Commission to "construe a statute providing an exemption from or credit against [a] tax, fee,

or charge strictly against the taxpayer." The Taxpayer's arguments arise under Utah Code Ann. §59-12-104(22), an exemption statute. The Commission thus construes Utah Code Ann. §59-12-104(22) strictly against the Taxpayer. The Taxpayer's argument is that BUSINESS-1's charges for pallets transferred out of the system transforms returnable pallets from returnable containers, shipping cases, or casings to nonreturnable items. A more reasonable reading of the statute, however, is that a returnable item remains returnable even if a user later loses, discards, or destroys the item. This reading of Utah Code Ann. §59-12-104(22) is supported by the Taxpayer's description of the different charges for pallets leaving the BUSINESS-1 system, which are based on the risk of future loss. Under the Commission's mandate to construe exemption statutes strictly, there is good cause to accept the more reasonable reading that a returnable item remains returnable even if for some reason a customer might not return it.

The Commission's reading of the exemption in Utah Code Ann. §59-12-104(22) is consistent with a previous Utah State Tax Commission Private Letter Ruling, PLR No. 04-015. In PLR No. 04-015, the Commission considered a pallet leasing arrangement. The Commission found lease payments under the lease program to be taxable leases of returnable shipping cases or containers. It found settlement fees for lost pallets to be exempt from taxation as nonreturnable shipping cases or containers, noting the critical factor that it was "not contemplated that the pallet [would] be returned." The case now before the Commission is different and thus distinguishable. Each of the pallet surcharges listed in the information provided by the Taxpayer in the case now before the Commission contemplates the possibility of return of pallets. In the case now before the Commission, each of the scenarios for charges are based on the varying degrees of risk of loss of a pallet rather than the cost of a pallet. This is a different, and thus distinguishable, set of facts from those presented in PLR 04-015.

There is good cause to find that the Division properly audited the Taxpayer's audit request within three years. There is good cause to find that an exemption in Utah Code Ann. §59-12-104(22) for certain nonreturnable packaging items does not apply to the Taxpayer's pallets.

Clinton Jensen
Administrative Law Judge

DECISION AND ORDER

Based on the information presented at the hearing, the Commission sustains the Division's audit as to the Utah sales and use tax for the audit periods at issue in this case. It is so ordered.

This decision does not limit a party's right to a Formal Hearing. However, this Decision and Order will become the Final Decision and Order of the Commission unless any party to this case files a written request within thirty (30) days of the date of this decision to proceed to a Formal Hearing. Such a

request shall be mailed to the address listed below and must include the Petitioner's name, address, and appeal number:

Utah State Tax Commission
Appeals Division
210 North 1950 West
Salt Lake City, Utah 84134

Failure to request a Formal Hearing will preclude any further appeal rights in this matter.

DATED this _____ day of _____, 2016.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
Commissioner