

15-1172  
TAX TYPE: SALES & USE TAX  
TAX YEAR: 2012, 2013, 2014  
DATE SIGNED: 10-3-2016  
COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO  
EXCUSED: R. ROCKWELL  
GUIDING DECISION

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BEFORE THE UTAH STATE TAX COMMISSION

<p>TAXPAYER,</p> <p style="padding-left: 40px;">Petitioner,</p> <p>v.</p> <p>AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION,</p> <p style="padding-left: 40px;">Respondent.</p>	<p style="text-align: center;"><b>INITIAL HEARING ORDER</b></p> <p>Appeal No. 15-1172</p> <p>Account No. #####</p> <p>Tax Type: Sales &amp; Use Tax</p> <p>Audit Period: 01/01/12 – 12/31/14</p> <p>Judge: Phan</p>
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**Presiding:**

Jane Phan, Administrative Law Judge

**Appearances:**

For Petitioner: REPRESENTATIVE-1 FOR TAXPAYER, Representative  
REPRESENTATIVE-2 FOR TAXPAYER, Representative  
REPRESENTATIVE-3 FOR TAXPAYER, Representative

For Respondent: REPRESENTATIVE FOR RESPONDENT, Assistant Attorney  
General  
RESPONDENT-1, Deputy Director, Auditing Division  
RESPONDENT-2, Manager, Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission on June 21, 2016 for an Initial Hearing in accordance with Utah Code §59-1-502.5. The representatives for Petitioner (“Taxpayer”) had filed a sales tax refund claim for the period of January 1, 2012 through December 31, 2014. Respondent (“Division”) had audited the refund request and issued a Statutory Notice on May 21, 2015 in which it denied \$\$\$\$ of the refund request. The Division’s audit did allow a refund of \$\$\$\$\$. The Taxpayer timely appealed the audit and the matter proceeded to the Initial Hearing. A portion of the amount denied, \$\$\$\$\$ in tax relating to a fuel surcharge had been resolved prior to the hearing. At issue at the hearing was \$\$\$\$\$ in tax and the interest thereon.

APPLICABLE LAW

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;
  - (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 statutes 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 pet food products which it ships to its customers on pallets. The Taxpayer rents the pallets from a pallet pooling program through COMPANY (“COMPANY”). At the hearing the representatives for Taxpayer explained that all of the Taxpayer’s customers were part of the pallet pooling program. The Division points out that this shows there is a presumption that all pallets will be returned to COMPANY. The Taxpayer had charged sales tax on rental amounts, transfers out and issue fees paid to COMPANY as part of the pallet rental. Taxpayer’s customers do not return the pallets to Taxpayer directly. The pallets would be returned to, or collected by, COMPANY, then placed back into the pallet pool and reused in rotation by the Taxpayer and others that participate in the pallet pool. Pallets remain in the pool and are reused until they are worn out and then they are scrapped. The Division determined that these transactions involve returnable containers and are taxable in Utah, which is

why the Division disallowed the refunds listed on Schedule 2 of the Statutory Notice.<sup>1</sup> The Taxpayer argues that the transactions remaining at issue are exempt as sales of nonreturnable containers and this is the sole issue presented by the parties at this hearing.

The Taxpayer points out that Utah Code §59-12-104(22) exempts “sales of nonreturnable containers.” The Taxpayer argues that there is no definition of “nonreturnable” provided in the statute. The Taxpayer points to Utah Admin. Rule R865-19S-48.A.2 which provides guidance on this issue. Utah Admin. Rule R865-19S-48.A.2 does state that sales of containers are taxable when “sold to a manufacturer, processor, wholesaler, or retailer for use as a returnable container that is ordinarily returned and reused by the manufacturer, processor, wholesaler, or retailer for storing or transporting their product.” The Taxpayer argues that the transactions at issue do not fit under the language of the rule because the pallets are not returned to the manufacturer, processor or wholesaler, they are instead returned to COMPANY. Therefore, the Taxpayer’s representatives argue this situation is not taxable under the rule.

The Division points to Utah Code §59-12-103(1)(k) which imposes sales tax on the rental of tangible personal property “if within this state the tangible personal property is: (i) stored; (ii) used; or (iii) otherwise consumed.” This is the statute that imposes the tax. The Division argues that Utah Admin. Rule R865-19S-48 clarifies that shipping containers and other similar items are subject to sales tax and the Commission has determined that pallets are considered to be shipping containers.<sup>2</sup> There is an express exemption from sales tax at Utah Code §59-12-104(22) for “sales of nonreturnable containers.” The Division has indicated it allowed a refund for the transactions where the containers were shown to be “nonreturnable” but for all those listed on Schedule 2 there was the expectation that the containers would be returned to the pallet pool because they were shipped to customers participating in COMPANY’s pallet pool program. The Division also notes that exemption statutes are strictly construed against a taxpayer, citing *MacFarlane et. al. v. Utah State Tax Comm’n*, 206 UT 25; and *Parson Asphalt Prods., Inc. v. Utah State Tax Comm’n*, 617 P.2d 397 (Utah 1980).<sup>3</sup>

The Division points for support of its position to *Utah State Tax Commission Private Letter Ruling 04-015* issued May 15, 2005, which had upheld the sales tax on rentals of pallets that were subject to a pallet pooling program. The Division also noted that an Initial Hearing had

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<sup>1</sup> The Division and the Taxpayer had resolved some other types of transactions which the Division had agreed qualified as “non-returnable containers.” and the exemption was allowed for those under Utah Code 59-12-104(22).

<sup>2</sup> The Division points to *Utah State Tax Commission Private Letter Ruling 04-015* (May 31, 2005) in which the Commission stated, “. . . the Commission’s long-standing policy is to consider a “pallet” to be a “shipping case” or “container” for purposes of the exemption.”

<sup>3</sup> This concept has been codified at Utah Code §59-1-1417(2)(b).

been held in Appeal No. 15-764, which dealt with the same type of pallet pooling program. At the time of the hearing in this appeal, a decision had not yet been issued in *Utah State Tax Commission Initial Hearing Order Appeal No. 15-764*, but that decision was issued on July 29, 2016, and in that decision the Tax Commission upheld the imposition of sales tax.<sup>4</sup>

After reviewing the arguments of the parties, the Division's position should be upheld. Utah Code §59-12-103(1)(k) imposes a sales tax on amounts paid or charged for rental or lease of tangible personal property. The pallets at issue are leased and they are tangible personal property. Therefore, the amounts paid are taxable unless otherwise exempt. The Taxpayer is arguing that the exemption at Utah Code §59-12-104(22) regarding nonreturnable containers, applies to exempt these transactions from sales tax. However, the Taxpayer's argument is based on the assertion that the shipping pallets at issue, although returned, are returned to COMPANY and not to the Taxpayer. Utah Code §59-1-1417(2)(b) directs the Commission to "construe a statute providing an exemption from or credit against the tax, fee, or charge strictly against the taxpayer." Based on the limited factual information presented, it is the intent that these pallets be returned to COMPANY and then they will be reused by the Taxpayer or other businesses that participate in the pallet pool. The language of the exemption at Utah Code §59-12-104(22) applies only to nonreturnable containers. It does not suggest a container would be considered "nonreturnable" if it was returned to someone other than the Taxpayer. Even the Taxpayer's reliance on Utah Admin. Rule R865-19S-48 is misplaced because the rule does not specify that a returnable container has to be returned directly to the manufacturer without the assistance of an intermediary. It says sales of shipping containers are taxable if sold to a manufacturer "for use as a returnable container that is ordinarily returned and reused by the manufacturer." The Commission has previously determined that leases of pallets from a pallet pool are subject to tax where the expectation was that they would be returned to the pallet pool and reused in *Utah State Tax Commission Initial Hearing Order Appeal No. 15-764* and there was no argument or information presented in this case that would support deviating from this prior decision.

Jane Phan  
Administrative Law Judge

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<sup>4</sup> This and other prior Tax Commission decisions are available for review in a redacted format at [tax.utah.gov/commission-office/decisions](http://tax.utah.gov/commission-office/decisions).

DECISION AND ORDER

Based on the information presented at the hearing, the Commission denies the Taxpayer's appeal regarding the refund of taxes relating to shipping pallets on Schedule 2 of the Sales and Use Tax Audit for the period of January 1, 2012 through December 31, 2014. 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, or emailed, 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

or emailed to:  
taxappeals@utah.gov

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