

REQUEST LETTER

04-015

NAME
COMPANY

Re: Request for Advisory Opinion

We respectfully request an advisory opinion that the pallets addressed in the following factual situation qualify for exemption either under Section 59-12-104(23) as “sales 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”, or Section 59-12-104(26) as “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”.

Statement of Facts

A Utah manufacturer produces product for sale and shipment to customers. Manufactured products are placed into cartons, which are then stacked onto a pallet. The pallet, along with its contents (the cartons), is then stretch-wrapped to form a secure, unitary package for shipment. The entire package is then loaded onto trucks for shipment to customers. The manufacturer does not request that the pallet be returned or charge a separate fee or deposit for the pallet. The manufacturer’s cost of the pallet is merely factored into the sales/purchase price paid by customers for the manufactured product.

Acquisition and Disposition of Pallets

As opposed to “buying” the pallets outright, the manufacturer contracts with a pallet provider to “lease” the pallets on a day-to-day basis under a pallet pooling arrangement. The pooling arrangement provides that the manufacturer is charged a certain amount for each day that a pallet is deemed to be in the manufacturer’s possession. Pallets are no longer deemed to be in the manufacturer’s possession (and the manufacturer is therefore no longer obligated for payments) when the pallets are shipped to customers within the pooling program or are otherwise transferred outside the pooling program. For pallets that are transferred outside the pooling program, the manufacturer pays a predetermined settlement fee per pallet to the pallet provider to cover any losses.

Contractually, title to all leased pallets vests with the pallet provider. The pallet provider maintains responsibility for the recovery and recycling of all pallets back into the pooling program. The manufacturer is merely responsible for providing the pallet provider with tracking information regarding the destination or disposition of all pallets.

Missouri Supreme Court Decision

In *Brambles Industries, Inc. v Director of Revenue*, 80687 S.W.2d 568 (12/22/98), the Missouri court determined that “leased” pallets obtained under pooling arrangements similar to the factual situation discussed above qualify for Missouri’s resale exemption.

Opinion Requested

We respectfully request that the Utah State Tax Commission issue an advisory opinion that pallets leased under the pooling arrangement discussed above qualify for exemption under Section 59-12-104(23) as “sales of nonreturnable containers, nonreturnable labels, nonreturnable bags, nonreturnable shipping cases, and nonreturnable casing to a manufacturer, processor, wholesaler or retailer for use in packaging tangible personal property to be sold by that manufacturer, processor, wholesaler or retailer.” The manufacturer uses the pallets as containers used to ship product to customers and the customers are under no obligation to the manufacturer to return the pallets.

Alternatively, the pallets qualify for exemption under Section 59-12-104(26) as “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 manufacturer sells its product in the form of a stretch-wrapped, unitary package which includes a pallet. The manufacturer transfers both possession of the pallet and title to the products contained thereon to its customers for consideration (i.e., the sales/purchase price paid for the unitary package). This “resale” argument is further supported by Section 59-12-102(60), which generally provides that a taxable “retail sale” or “sale at retail” means a sale, lease, or rental for a purpose other than: (a) resale; (b) sublease; or (c) subrent.

We are not aware of any pending Utah audits, refund claims, or cases regarding the factual situation underlying this advisory opinion request. If you have any questions regarding this advisory opinion request or any other matter, please phone me at PHONE NUMBER.

RESPONSE LETTER

May 31, 2005

NAME
ADDRESS

RE: Private Letter Ruling Request – Sales Tax and Leases of Pallets in a Pooling Arrangement

Dear NAME,

We have received your request for an opinion concerning the taxability of transactions involving a manufacturer's lease of pallets on a day-to-day basis under a pallet pooling arrangement. Although the Commission has previously ruled a similar transaction to be taxable in *Utah State Tax Commission Private Letter Ruling 00-018*, you have asked the Commission to find the transaction exempt under either of two Utah provisions. Your first point relates to Utah Code Ann. §59-12-104(23), which exempts "sales 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." Second, you refer to UCA 59-12-104(26), which exempts "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[.]" We understand the "shipping pool" you describe to involve a manufacturer leasing pallets from a supplier for a limited period of time until the pallet is shipped to the manufacturer's customer, then returned to the "shipping pool." For any pallet not returned to the "shipping pool," the manufacturer pays the supplier a predetermined price.

From the information you have provided, there appear to be two possible, distinct transactions. First, the manufacturer enters into a transaction to lease a pallet on a daily basis for use in shipping its products to its customers. Should the pallet be shipped outside the pooling program and lost, however, the manufacturing must pay a predetermined settlement fee. The Commission considers the settlement fee to be the purchase price of a second transaction, which is the purchase of the pallet. In other words, the first transaction is the lease of the pallet, while the second transaction, the purchase of the pallet, only occurs if the pallet is not returned to the shipping pool. We will separately address the taxability of each of these transactions below.

Before discussing each of these transactions, we address whether a "pallet" is the type of item contemplated for exemption under Section 59-12-104(23). While this section exempts certain specified nonreturnable items including "shipping cases" and "containers," the language does not include the term "pallet." However, the Commission's long-standing policy is to consider a "pallet" to be a "shipping case" or "container" for purposes of the exemption. The Commission believes such a conclusion is reasonable, given that a pallet is usually one part of the total shipping case or container.

Lease. You contend that the lease of pallets under the circumstances described is exempt from taxation. To support your position, you refer to *Brambles Indus. v. Director of Revenue*, 981 S.W.2d 568 (Mo. banc 1998), in which the Supreme Court of Missouri found that leases of pallets in a pooling arrangement by Brambles Industries, Inc. (a/k/a/ Chep USA) to a manufacturer were exempt from taxation. That case did not address whether Missouri had a specific exemption for transactions involving pallets or other container and packaging materials. Nor did the Court specifically analyze whether a “sale” of pallets (involving a transfer of title) was exempt from taxation under Missouri’s resale exemption. Instead, because the Director of Revenue had conceded that a “sale” of pallets in a pooling arrangement would be exempt under the resale exemption, the issue before the Court was whether a “lease” of pallets (without passage of title) should be treated similarly to a “sale” under Missouri law and, as a result, also be exempt.¹

States without explicit provisions governing the taxability of sales of containers and other packaging materials generally resolve issues by determining whether the manufacturer purchases the materials for resale (as part of the product it sells) or whether it consumes the materials (as an incident to its sales and delivery of its product). However, Utah has an explicit statute for dealing with the taxability of such materials. UCA 59-12-104(23) provides an exemption from taxation, but only if the container or other packaging materials are “nonreturnable.” Under the pooling arrangement you describe, the pallets are returned to the lessor in order to terminate the manufacturer’s responsibilities with respect to the leased pallets. Under such circumstances, we consider the pallets to be “returnable” materials and, accordingly, the transactions you describe to be taxable under Utah law.

With respect to your second point, when the Commission considers the applicability of Utah’s resale exemption, we believe the lease transactions are still taxable. Utah Admin. Rule R865-19S-48(

A)(1) (“Rule 48”) provides that sales of containers, labels, bags, shipping cases, and casings are taxable when “sold to the final user or consumer[.]” We do not consider the manufacturing’s customer to be the final user or consumer of the pallets. Under the circumstances described, we would consider the manufacturer, who leases the pallets, to be the final consumer of the pallets for that period for which it is entitled to the right of possession or use under the lease. Accordingly, the manufacturer’s transaction to lease pallets that are returnable is not a sale for resale. We note that while the lease between the pallet provider and the manufacturer is subject to taxation, the pallet provider may purchase the pallets tax-free under the resale exemption.

¹ The Commission is also aware that other states, both with and without specific exemptions relating to containers and packaging materials, have considered transactions involving leases of pallets in a pooling arrangement to be taxable. See *In the Matter of the Appeal of Imperial Sugar Company from a Decision by the Department of Revenue*, 2002-108, 06/11/2003 (also involving leases by Chep USA); *California Sales Tax Counsel Ruling No. 195.1526* (1/2/98; 5/14/98) (ruling that pallets leased to a manufacturer in a pooling arrangement constitute “returnable” containers); *Texas Comptroller’s Decision No. 40,282* (12/09/2002).

Settlement Fee. As for the second potential transaction, we understand that subsequent to leasing a pallet, there may be occasion when a manufacturer ships a “leased” pallet to a customer outside the pooling program. If so, the manufacturer is required to pay a settlement fee for the “lost” pallet. Under these circumstances, the Commission considers the settlement fee to be the purchase price of a pallet that, at the time of the purchase, will not be returned. It does not matter that the pallet is the “type” of pallet that could have been returned. What is critical is that, at the time of the second transaction, it is not contemplated that the pallet will be returned. Accordingly, the pallet purchased is now a “nonreturnable” shipping case or container and its purchase is exempt from taxation under Section 59-12-104(23). The fact that the settlement fee is exempt does not affect the taxability of the lease payment associated with the same pallet. At the time the pallet was leased, it was contemplated that it would be returned. Again, we consider these to be separate and distinct transactions.

The Commission’s ruling is based on the facts and circumstances described herein. Should the actual circumstances be different, our response could also be different. Please contact us if we can provide any further assistance.

For the Commission,

Marc B. Johnson
Commissioner

MBJ/KC
04-015