

FINAL PRIVATE LETTER RULING

REQUEST LETTER

09-018

August 21, 2009

STAFF

Manager, Sales & Use Tax Audit
Utah Tax Commission
210 North 1950 West
Salt Lake City UT 84134

***Re: Request for Private Letter Ruling
Sales and Use Tax***

Dear STAFF:

On behalf of our client, "Company", we respectfully request a letter ruling regarding the Utah sales and use tax implications in connection with related company accounting entries made to account for costs related to equipment and motor vehicles used on certain engineering and construction contracts. In order to facilitate your review of the information necessary to respond to the requested ruling, we have presented the request in the following manner:

- I. Facts
- II. Issue
- III. Pertinent Authority
- IV. Analysis
- V. Ruling Requested

I. Facts

The Company is a diverse organization made up of several legal entities including Companies A, B, C and D below, that provide services that include but are not limited to engineering, procurement and construction ("EPC") services. Company has locations and provides services throughout the United States as well as in other countries. Some of the facts relevant to the imposition of the tax are as follows:

- (a) Equipment purchases and leases including motor vehicles are negotiated and contracted with third parties by a holding company ("Company A").
- (b) Vendor invoices related to the purchases and leases are paid by a purchasing company ("Company B").
- (c) Company B is not currently permitted to collect Utah Sales and use tax.
- (d) Company B generally pays sales tax to its vendors when purchasing or leasing the equipment and motor vehicles (collectively "Equipment").

- (e) Company B believes that the leasing company was remitting sales tax to the state based on the location of the leased equipment.
- (f) Company B depreciates the Equipment on its books for accounting purposes.
- (g) Neither, Company A nor Company B operates the Equipment at issue.
- (h) The Equipment is used by two operating entities (“Company C” and “Company D”) to perform the EPC services that each business offers to the public. In some cases Company C and Company D may use the same Equipment at different times in each of their respective businesses.
- (i) The job costs related to the use of the Equipment is accounted for daily on the books of Company B and company C and Company D via expense accounts and contra expense account entries as well as Due To and Due From account entries.
- (j) The Due to and Due From accounts are not treated in the same manner as the Companies’ Inter Companies Receivable or Payable accounts.
- (k) These Due to and Due From accounts are not used for third party transactions and are **never cleared by eliminating entries**. (See example below)
- (l) No entries are made to the books of Company A as part of these job cost entries.
- (m) The amount shown on the books of Company B reflects the amount paid by Company B for the purchase or lease/rental of the Equipment.
- (n) The amount of the daily intercompany contra expense acct entry from Company B to Companies C or D is a set amount based on the type of property that is provided and it is also based on Company B’s cost of acquiring and maintaining the property and overhead costs.
- (o) It is not the intent for Company B to have any income or profits.
- (p) No money is transferred as payment from Company C and Company D to Company A or Company B.
- (q) There is no written rental agreement between Company B and Company C and D for the use of the Equipment.
- (r) Company B also purchases repair parts and services for the Equipment.
- (s) Sales and use tax is typically paid to the vendor on these Equipment purchases by Company B.
- (t) Title to Equipment is retained at all times by Company B.

Example 1

Company B – Purchased Equipment

Company B’s Books

Dr - Machinery & Equipment (Company B)

Cr - AP Trade (Company B)

Accounting Entries to Record Company C’s use of the Equipment on a EPC job

Company C’s Books

Dr - Expense Acct

Cr - DT DF (“Due to Due From”)

Company B's Books
Dr - DT DF ("Due To Due From")
CR - Contra Expense Acct

Example 2

Company B – Rented Equipment

Company B's Books
Dr - 3rd Party Rental Expense
Cr - AP Trade

Accounting Entry to Record Company C's use of the Equipment

Company C's Books
Dr - Expense Acct
Cr - DT DF ("Due To Due From")

Company B's Books
Dr - DT DF ("Due To Due From").
Cr - Contra Expense Acct

II. Issues

1. Would the job cost accounting entry between Company B and Company C or D for the use of Equipment be considered a sale, rental or a lease subject to Utah sales and use tax?
2. Would the answer be different if the amount booked for the job cost accounting entries did not have an overhead component?
3. If the answer to Question 1 is "yes", is the sales and use tax paid by Company B on the purchase and/or 3rd party leases of the Equipment, repair parts and motor vehicles refundable as purchases for resale?

III. Pertinent Authority

Sale

A sale is defined as a transfer of title, exchange or barter, conditional or otherwise, in any manner, of tangible personal property or any other taxable transaction under Subsection 59-12-103(1) for consideration.¹

¹ Utah Code Annotated §59-12-102(94)(a)

A lease or rental means a transfer of possession or control of tangible personal property or a product transferred electronically for (a) a fixed term, (b) an indeterminate term, and consideration.²

Purchase price and sales price mean the total amount of consideration: valued in money and for which tangible personal property, a product transferred electronically, or services are sold, leased or rented.³

Resale

A retail sale or sale at retail means a sale, lease, or rental for a purpose other than resale, sublease or subrent.⁴ Product stored in the State for resale is exempt from tax.⁵

IV. Analysis

1. In order for a transaction to fit the definition of a sale, a transfer of title or possession of tangible personal property for consideration must take place. There is no doubt that possession of equipment owned by Company B or rented from third parties by company B is transferred temporarily to entities related to Company B. However, we believe that Company B does not receive consideration from its related entities. There is no transfer of money, assumption of liabilities, or any receivable recorded. Title is not transferred by Company B to any equipment used by Company C or D.

Further, the actions of Company B and that of Company C and D are evidence that the transfer of equipment is not a taxable lease. When making the job cost accounting entry to account for the use of the Equipment, a contra expense account is credited on the owning company's books (e.g., Company B) and a debit is made to an expense account of the company that uses the Equipment, Company C in our example above. The accounting entries booked in the facts presented in this letter ruling request do not reflect cash received or paid, nor do they reflect accounts receivable or accounts payable for the item. Further, the Due to and Due From accounts are never settled. This is a clear indication that these accounts are not treated as receivable and payable accounts and there is no obligation by Company C and D to give consideration to Company B. In addition, a legal obligation for Company C or D to make a lease payment to Company B does not exist. There is no written contract between either of the parties to support a conclusion that Company B is benefiting from the transfer of the equipment to Company C and D or that Company C and D have an obligation to make lease payments to Company B. Company C and D book an entry to an expense account so that the Company as a whole can make a proper assessment of the profitability of each job, not to substantiate a legally enforceable right that Company B has to receive lease payments from its related entities. Therefore, we conclude that the transfer of possession of

² Utah Code Annotated §29-12-102(48)(a), (a)(i)(a), (a)(i)(b), (a)(ii)

³ Utah Code Annotated §59-12-102(82)(a), (a)(i), (a)(ii), (a)(ii)(A)(B)(C)

⁴ Utah Code Annotated §59-12-102(92)(a)(b)(c)

⁵ Utah Code Annotated §59-12-104(23)

equipment between Company B and Company C and D without transfer of title or consideration is not a sale, rental or lease of Equipment subject to sales and use tax.

2. Based on our conclusion to questions no. 1, the overhead component has no bearing on the tax treatment of the accounting entry between Company B and Company C and D for the transfer of equipment and motor vehicles.
3. If it is determined by the Utah Tax commission that the transfer of equipment and motor vehicles between Company B and Company C and D and the job cost accounting entry on the books is a sale/lease subject to sales and use tax, Company B should be due a refund or credit for any sales and use tax paid on purchases or leases of the equipment and motor vehicles from third parties exempt from sales/use tax for resale as well as any parts or taxable repair services performed on the leased equipment or motor vehicles.

V. Ruling Requested

We respectfully request that the Utah State Tax Commission issue a letter ruling in which it sets forth its agreement or disagreement with these taxability determinations and its reasoning behind the ruling. We respectfully request a conference to discuss our request for a letter ruling if the Department contemplates an adverse ruling on the issues contained in this request.

* * * * *

As you review the request, please feel free to contact me at PHONE 1 or NAME 2 at PHONE 2, if you have any questions or require clarification in regard to any of the facts.

Sincerely,

NAME 1
TITLE, DIVISION

RESPONSE LETTER

March 4, 2010

NAME 1
TITLE, DIVISION
COMPANY
ADDRESS

RE: Private Letter Ruling Request—Sales Tax Treatment of Transactions Between Related Companies Transferring Use of Equipment

Dear NAME 1:

You have requested a ruling about whether certain transactions between related entities are leases subject to Utah sales and use tax. The transactions involve the following four companies, which are separate legal entities:

- **Company A** is a holding company that negotiates and contracts with third parties for the purchase and lease of equipment, including motor vehicles (collectively, the “Equipment”).
- **Company B** is a purchasing company that receives invoices from the third party vendor and pays for the Equipment. Generally, Company B pays sales tax when purchasing or leasing the Equipment. Company B thinks that the third party leasing vendor has remitted sales tax to the state based on the leased Equipment’s location. Company B capitalizes and depreciates the Equipment on its books and maintains and services the Equipment; it always retains title to the Equipment. Company B does not currently operate the leased or purchased Equipment for itself. Consistent with this, we assume that in the past, Company B has not operated the Equipment for itself and that at the times of the purchases or leases, Company B intended for Companies C and D to be the users of the Equipment.
- **Companies C and D** use the Equipment when they perform engineering, procurement and construction services for their customers.

For each day that Company C or D uses the Equipment, Companies C or D and B make the following journal entries:

Company C’s or D’s Books

Dr. – Expense account
Cr. – Due To/Due From Company B

Company B’s books

Dr. – Due To/Due From Company C or D
Cr. – Contra expense account

The amount of the journal entry is set based on the type of Equipment provided and also on Company B's costs to acquire and maintain the Equipment and to cover its overhead. Company B does not intend to have any profits. You have asserted that no money is transferred as payment and that there is no written rental agreement. Additionally, we assume that Company B's purchases or leases from third parties and Company C's or D's use of the Equipment occur in Utah.

You have asked the following three questions:

1. Would the job cost accounting entry [journal entry] between Company B and Company C or D for the use of the Equipment be considered a sale, rental or a lease subject to Utah sales and use tax?
2. Would the answer be different if the amount booked for the job cost accounting entries did not have an overhead component?
3. If the answer to Question 1 is "yes," are the sales and use taxes paid by Company B on the purchases and/or third party leases of the Equipment, repair parts and motor vehicles refundable as purchases for resale?

Below, we will address each of your questions after listing the applicable law.

I. Applicable Law

Utah Code Ann. § 59-12-103(1)(a), (k) provides that amounts paid for retail sales and for leases or rentals of tangible personal property are taxable, as follows:

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

Utah Code Ann. § 59-12-102(48) defines the term "lease" or "rental" as follows, in pertinent part:

- (a) "Lease" or "rental" means a transfer of possession or control of tangible personal property or a product transferred electronically for:
 - (i) (A) a fixed term; or
 - (B) an indeterminate term; and
 - (ii) consideration.

Utah Code Ann. § 59-12-102(82) defines the terms “purchase price” and “sales price” as follows, in pertinent part:

- (a) "Purchase price" and "sales price" mean the total amount of consideration:
 - (i) valued in money; and
 - (ii) for which tangible personal property, a product transferred electronically, or services are:
 - (A) sold;
 - (B) leased; or
 - (C) rented.

Utah Code Ann. § 59-12-102(94) defines the term “sale” as follows, in pertinent part:

- (a) "Sale" means any transfer of title, exchange, or barter, conditional or otherwise, in any manner, of tangible personal property or any other taxable transaction under Subsection 59-12-103(1), for consideration.
- (b) "Sale" includes:
 -
 - (v) any transaction under which right to possession, operation, or use of any article of tangible personal property is granted under a lease or contract and the transfer of possession would be taxable if an outright sale were made.

Utah Code Ann. § 59-12-104(25) provides an exemption from sales and use tax for “a product 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[.]”

Utah Code Ann. § 59-1-1410(8) provides a time limitation on refunds as follows, in pertinent part:

- (a) Except as provided in Subsection (8)(b) or Section 19-2-124, 59-7-522, 59-10-529, or 59-12-110, the commission may not make a credit or refund unless a person files a claim with the commission within the later of:
 - (i) three years from the due date of the return, including the period of any extension of time provided in statute for filing the return; or
 - (ii) two years from the date the tax was paid.

II. Analysis

A. The Transaction Between Company B and Company C or D for the Use of the Equipment is a Rental or a Lease Subject to Utah Sales and Use Tax.

Based on the facts that you have presented, Company B is leasing the Equipment to Company C or D. The amounts charged are the amounts of the journal entries, and they are taxable under § 59-12-103(1)(k). You have provided that Companies B, C, and D are separate legal entities, that Company B owns and maintains the Equipment while Company C or D uses

the Equipment, and that for each day Company C or D uses Company B's equipment, the companies make journal entries to record the transaction. We find that the possession or control of the Equipment was transferred from Company B to Company C or D for consideration, all companies being separate legal entities. The consideration is reflected in the journal entries on the companies' books. For each daily transfer of possession or control, Company C's or D's books reflect either a decreased asset or an increased liability when it books a journal entry crediting the Due To/Due From Company B account. Similarly, Company B's books reflect either an increased asset or a decreased liability when Company B debited the Due To/Due From Company C or D account.

We disagree with your statement that Companies C and D do not have obligations even though such journal entries are made on their books and on Company B's books. While you claim that the journal entries are merely entered so the Company as a whole (Companies A-D combined) can make a proper assessment of the profitability of each job, such statement is inconsistent with the fact that each company is a separate legal entity. Also, Company B's primary purpose is, apparently, to provide equipment for use by Companies C and D and Company B is paying money to purchase, lease, and maintain the Equipment. These facts suggest that Company B is receiving income to offset these costs and expenses to break even.

We believe that our ruling here is supported by case law. In *Institutional Laundry, Inc. v. State Tax Comm'n*, 706 P.2d 1066 (Utah 1985), the Utah Supreme Court has found that a transaction between a parent and its wholly-owned subsidiary was subject to sales tax even though "Institutional [the subsidiary] existed only for the administrative convenience of WMMS [the parent], providing laundry services for the parent on a nonprofit basis." *Id.* at 1067. In *Institutional Laundry*, the Court ruled:

A corporation, be it parent or subsidiary, has its own legal identity and existence. Common ownership or control does not automatically destroy that separate identity. Although in appropriate cases equity may look through the corporate shell to its alter-ego to prevent fraud or wrong doing, the general rule still applies that corporations are separate legal entities bound by the obligations as well as the benefits. *Surgical Supply Center v. Industrial Commission of Utah, Dept. of Employment Security*, 118 Utah 632, 223 P.2d 593, 595 (1950); *Messick v. PHD Trucking Service, Inc.*, Utah, 678 P.2d 791 (1984). The corporate structure will not be disregarded just to facilitate tax avoidance. *Western States Bankcard Association v. City & County of San Francisco*, 19 Cal.3d 208, 137 Cal.Rptr. 183, 561 P.2d 273 (1977).

Having elected to operate as a corporation, for whatever benefits that separate status conferred upon Institutional and its parent, Institutional must also accept the tax burden and responsibility attendant to its corporate form. . . . When a taxpayer has chosen to conduct business under a particular arrangement, it cannot disregard the consequence of that arrangement when it would otherwise be to the taxpayer's disadvantage. 19 Cal.3d at 219, 137 Cal.Rptr. 183, 561 P.2d 273; *Mercedes-Benz of North America, Inc. v. State Board of Equalization*, 127 Cal.App.3d 871, 179 Cal.Rptr. 758 (1982); *Montgomery Ward & Co. v. State*,

Colo., 628 P.2d 85 (1981); *Simplicity Pattern Co. v. State Board of Equalization*, 27 Cal.3d 900, 167 Cal.Rptr. 366, 615 P.2d 555 (1980).

Id. at 1067-68.

Additionally, in *SF Phosphates Limited Company v. State Tax Comm'n*, 972 P.2d 384, 387 (Utah 1998), the Utah Supreme Court stated:

Additionally, we note that Phosphates' ownership of Pipeline does not exempt Phosphates from paying sales tax on transactions between the two. Having elected separate corporate forms, Phosphates and Pipeline are bound by the obligations and benefits of those forms. *See Institutional Laundry Inc. v. State Tax Comm'n*, 706 P.2d 1066, 1067 (Utah 1985) . . . Historically, we have recognized separate corporate forms and imposed sales tax liability on transactions between a parent company and its wholly- or partially owned subsidiaries. . . .

Likewise in this situation, Company B and Companies C and D are separate legal entities, receiving benefits and obligations because of their legal forms. Therefore, Companies B, C, and D must accept the tax burdens that come from their legal forms; they cannot avoid these consequences by being treated as one company. For this ruling, the expense accounts of Companies C and D represent rent expense and the contra expense account of Company B represents rent income. As such, unless some other exemption applies, Company B's rent income is subject to Utah sales and use tax.

B. The Taxability of the Transaction Between Company B and Company C or D Does Not Change Even If the Overhead Component is Not Included.

The lease or rental transactions between Company B and Company C and D are taxable regardless of whether the overhead component is included. For taxability of a lease, the Utah Code does not distinguish among transactions based on the items composing the lease payment.

C. The Sales and Use Taxes Paid by Company B on its Purchases and Leases of Equipment from Third Parties and on its Purchases of Repair Parts are Refundable as Purchases for Resale if the Time Limits of § 59-1-1410(8)(a) are met.

If Company B intended to lease the Equipment to Companies C and D for a reasonable rental amount when it purchased or leased that Equipment from third parties, then Company B's purchases or leases from the third parties are exempt under § 59-12-104(25), as purchases for resale. Additionally, Company B's purchases of repair parts for the Equipment are also exempt under § 59-12-104(25). If the time limitations of § 59-1-1410(8) for refunds have been met, then Company B may apply for a refund of the sales tax it paid on its purchases or leases of the Equipment. You may contact our Technical Research Unit of the Taxpayer Services Division at 801-297-7705 for information on how Company B may make such a refund request.

III. Conclusion

The transactions between Company B and Company C and D for the use of the Equipment are rentals or leases subject to Utah sales and use tax. The taxable amounts are the amounts recorded on the companies' books. Company B may qualify for a refund of the Utah sales and use tax that it paid on its purchases or leases from third party vendors if Company B intended to lease the Equipment when it purchased or leased it and if its refund request meets the time limitations of § 59-1-1410(8). For more information on making a refund request, you may call the Technical Research Unit at 801-297-7705. Our conclusions are based on the facts as described. Should the facts be different, a different conclusion may be warranted. If you feel we have misunderstood the facts as you have presented them, if you have additional facts that may be relevant, or if you have any other questions, please contact us.

For the Commission,

Michael J. Cragun
Commissioner

MJC/aln
09-018