

06-0519  
SALES TAX  
TAX YEARS: 2002, 2003, 2004, 2005  
SIGNED: 11-02-2007  
COMMISSIONERS: P. HENDRICKSON, R. JOHNSON, M. JOHNSON, D. DIXON  
GUIDING DECISION

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BEFORE THE UTAH STATE TAX COMMISSION

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<p>PETITIONER,</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><b>FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION</b></p> <p>Appeal No.     06-0519</p> <p>Account No.:   #####</p> <p>Tax Type:       Sales Tax</p> <p>Audit Period:   06/01/02 – 04/30/05</p> <p>Judge:           Chapman</p>
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**Presiding:**

R. Bruce Johnson, Commissioner  
Kerry R. Chapman, Administrative Law Judge

**Appearances:**

For Petitioner:     PETITIONER REP. 1, CPA  
                          PETITIONER REP. 2, from PETITIONER  
For Respondent:    RESONDENT REP., Assistant Utah Attorney General

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on October 4, 2007. Based upon the testimony and evidence presented at the Formal Hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1.     The tax at issue is sales and use tax.
2.     The audit period at issue is June 1, 2002 through April 30, 2005.
3.     On March 30, 2006, Auditing Division (“Division”) issued a Second Statutory Notice – Sales and Use Tax (“Statutory Notice”) to the Petitioner for the audit period, in which it imposed \$\$\$\$ in

additional tax, plus interest. No penalties were imposed.

4. The only portion of the assessment that remains at issue concerns the Division's imposition of sales and use tax on three transactions for the sale of CONTAINER storage units. The three transactions are described in Amended Schedule 5 of the Statutory Notice, as follows: 1) the January 24, 2003 purchase of a portable CONTAINER for \$\$\$\$; 2) the September 4, 2003 purchase of a portable CONTAINER for \$\$\$\$; and 3) the March 8, 2005 purchase of two storage CONTAINER for \$\$\$\$.

Invoices for the three transactions are found in Division's Exhibit 1.

Petitioner's Operations

5. The Petitioner is a manufacturer of ( WORDS REMOVED ).

6. The Petitioner mixes together a number of raw materials to make the PRODUCT it uses to manufacture its various products. The raw materials, which consist of ( WORDS REMOVED ) to produce the PRODUCT. The CONTAINER at issue are used to house ( WORDS REMOVED ) and to deliver it into the ( WORDS REMOVED ). The ( WORDS REMOVED ) are stored in ( WORDS REMOVED ) nearby.

7. In Exhibit R-2, the Petitioner provides pictures of its two "EQUIPMENT," which are integrated pieces of equipment designed to ( WORDS REMOVED ) where they are combined into PRODUCT. The CONTAINER at issue are pieces of equipment that are integrated into the EQUIPMENT.

8. PETITIONER REP. 2, the witness for the Petitioner, testified that the CONTAINER are usually purchased as part of an entire EQUIPMENT. The first two transactions at issue concerned two CONTAINER that were purchased separately for the same EQUIPMENT. The Petitioner stated that at one time, this EQUIPMENT only had one CONTAINER, in which the Petitioner stored a ( WORDS REMOVED ). Because the CONTAINER was leaking, the Petitioner replaced it. It later purchased another CONTAINER

for this EQUIPMENT because it started selling PRODUCT to the DEPARTMENT, which required it to have separate CONTAINER for the ( WORDS REMOVED ). The third transaction concerned the purchase of two CONTAINER to upgrade another existing EQUIPMENT whose CONTAINER were inadequate for the new mixer that Petitioner had acquired.

9. PARAGRAPH REMOVED

10. PARAGRAPH REMOVED

11. PARAGRAPH REMOVED

Petitioner's Argument

12. The Petitioner asserts that the CONTAINER are machinery or equipment that are used in the manufacture of PRODUCT products and, thus, qualify for exemption from sales tax. Although the Petitioner concedes that there is a "storage" element associated with the CONTAINER, it argues that the CONTAINER are used primarily as part of an integrated continuous production cycle. For these reasons, the Petitioner asks the Commission to reverse that portion of the Division's audit assessment relating to the Petitioner's purchases of the CONTAINER at issue.

Division's Argument

13. The Division does not contest the fact that Petitioner is a qualifying manufacturer and that much of the equipment in its EQUIPMENT qualifies for the sales tax exemption. The Division argues, however, that these CONTAINER are used primarily as storage devices that are not part of an integrated continuous production cycle. As a result, the Division argues that the Commission should find that the CONTAINER are subject to sales and use tax and do not qualify for exemption.

APPLICABLE LAW

1. For transactions that would otherwise be subject to sales and use tax, Utah law provides for a number of exemptions from taxation in Utah Code Ann. §59-12-104. Section 59-12-104(14)<sup>1</sup> (2005) provides for the exemption of certain tangible personal property used in a manufacturing facility, as follows in pertinent part:

- (14)(a) the following purchases or leases by a manufacturer on or after July 1, 1995:
  - (i) machinery and equipment:
    - (A) used in the manufacturing process;
    - (B) having an economic life of three or more years; and
    - (C) used:
      - (I) to manufacture an item sold as tangible personal property; and
      - (II) in new or expanding operations in a manufacturing facility in the state;
  - (ii) . . . normal operating replacements that:
    - (A) have an economic life of three or more years;
    - (B) are used in the manufacturing process in a manufacturing facility in the state;
    - (C) are used to replace or adapt an existing machine to extend the normal estimated useful life of the machine; and
    - (D) do not include repairs and maintenance.

....

2. Utah Admin. Rule R865-19S-85 ("Rule 85") provides guidance concerning the manufacturing machinery and equipment exemption, as follows in pertinent part:

- A. Definitions:
  - ....
  - 2. "Machinery and equipment" means:
    - a) 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

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<sup>1</sup> All citations to the Utah Code and Utah Administrative Rules contained herein are to the 2005 version of the Code unless otherwise indicated.

includes automated material handling and storage devices when those devices are part of the integrated continuous production cycle;

#### DISCUSSION

At issue is whether the Petitioner's three purchases of CONTAINER qualify for the manufacturing machinery and equipment exemption from sales and use tax. A number of requirements are set forth in Section 59-12-104(14) for machinery or equipment to qualify for the exemption. The only one of the requirements at issue in this matter is whether the CONTAINER are used in a manufacturing process.

Rule 85(A)(2) provides that "machinery and equipment," for purposes of the exemption, includes "automated material handling and storage devices when those devices are part of the integrated continuous production cycle." The Commission finds that the Petitioner has demonstrated that the CONTAINER at issue are used primarily in an integrated continuous production cycle to produce PRODUCT. The CONTAINER are usually purchased as part of the "EQUIPMENT" used to manufacture PRODUCT. Not only are the CONTAINER used to prevent the escape of the MATERIALS used in the manufacturing process, but they are also used to measure and deliver the components into the ( WORDS REMOVED ). Petitioner's witness, PETITIONER REP. 2, testified that there is no way to introduce the MATERIALS into the UNIT without the use of the CONTAINER. This testimony was uncontroverted. Furthermore, the materials in the CONTAINER are replenished frequently, and the Petitioner maintains a separate storage unit referred to as a "STORAGE UNIT" on the premises to store MATERIAL. For these reasons, the Commission finds that the CONTAINER at issue are "material handling and storage devices . . . [that] are part of the integrated continuous production cycle" and, accordingly, qualify for exemption from sales and use tax pursuant to Rule 85(A)(2). Accordingly, that portion of the Division's assessment that imposes sales tax on the Petitioner's purchase of the CONTAINER is reversed.

The Commission differentiates this result from its decision in *xxxxx v. Auditing Division*,

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USTC Appeal No. 99-0432 (2001), which concerned equipment associated with the grain storage bins at a mill that processed grain into animal feed. In that case, the grain was stored in the bins for an average of six months before it was introduced into the production process. In this case, the MATERIALS are replenished frequently, as often as every day or two for the MATERIAL and every week for the MATERIAL. Furthermore, the CONTAINER at issue in this case appear to be part of the continuous production cycle to make PRODUCT at the EQUIPMENT, whereas the equipment at issue in Appeal No. 99-0432 was part of the storage unit that was not part of a continuous production cycle.

CONCLUSIONS OF LAW

1. The CONTAINER at issue are primarily used as part of an integrated continuous production cycle to produce PRODUCT and, as a result, are “machinery and equipment,” as defined in Rule 85(A)(2), that is exempt from taxation pursuant to Section 59-12-104(14).

DECISION AND ORDER

Based on the foregoing, the Commission grants the Petitioner’s appeal and overturns the Division’s assessment of sales tax on the Petitioner’s three purchases of CONTAINER. It is so ordered.

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2007.

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Kerry R. Chapman  
Administrative Law Judge

BY ORDER OF THE UTAH STATE TAX COMMISSION:

The Commission has reviewed this case and the undersigned concur in this decision.

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DATED this \_\_\_\_ day of \_\_\_\_\_, 2007.

Pam Hendrickson  
Commission Chair

R. Bruce Johnson  
Commissioner

Marc B. Johnson  
Commissioner

D'Arcy Dixon Pignanelli  
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. §63-46b-13. 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. §59-1-601 and §63-46b-13 et seq.

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