

16-105

TAX TYPE: SALES & USE TAX

TAX YEAR: 2012, 2013

DATE SIGNED: 10/29/2018

COMMISSIONERS: J. VALENTINE, M. CRAGUN, R. PERO, R. ROCKWELL

GUIDING DECISION

BEFORE THE UTAH STATE TAX COMMISSION

TAXPAYER, Petitioner, v. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent.	FINDINGS OF FACT, CONCLUSIONS OF LAW, AND FINAL DECISION Appeal No. 16-105 Account No. ##### Tax Type: Sales & Use Tax Audit Period: 01/01/12 – 12/31/13 Judge: Phan
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Presiding:

Robert P. Pero, Commissioner
Rebecca L. Rockwell, Commissioner
Jane Phan, Administrative Law Judge

Appearances:

For Petitioner: REPRESENTATIVE FOR TAXPAYER-1, Attorney at Law
REPRESENTATIVE FOR TAXPAYER-2, Attorney at Law
REPRESENTATIVE FOR TAXPAYER-3, Senior Manager of Finance,
TAXPAYER Launch Systems
REPRESENTATIVE FOR TAXPAYER-4, Senior Accounting Specialist,
TAXPAYER
For Respondent: REPRESENTATIVE FOR RESPONDENT-1, Assistant Attorney General
REPRESENTATIVE FOR RESPONDENT-2, Assistant Attorney General
REPRESENTATIVE FOR RESPONDENT-3, Director, Auditing Division

STATEMENT OF THE CASE

This matter came before the Utah State Tax Commission for a Formal Hearing on May 29, 2018, in accordance with Utah Code §59-1-1410 and §63G-4-201 et seq. Based upon the evidence and testimony presented at the hearing, the Tax Commission hereby makes its:

FINDINGS OF FACT

1. Petitioner (“Taxpayer”) has filed an appeal under Utah Code §59-1-1410 of the decision issued by Respondent (“Division”) to deny Taxpayer’s refund request of sales and use tax for the period of January 1, 2012 through December 31, 2013. The Taxpayer was notified of the refund denial by

Statutory Notice issued on December 24, 2015.¹ The Taxpayer timely appealed the denial and the matter proceeded to this Formal Hearing.

2. The amount of refund originally requested by the Taxpayer was \$\$\$\$\$. At the hearing, the Taxpayer had reduced its refund request by a number of the sample transactions, but how that change to the sample would affect the overall amount of the request was not presented.

3. The issue in this appeal is whether tangible personal property purchased by the Taxpayer for use in U.S. government contracts is resold to the government, and thus is excluded or exempt from Utah sales and use taxes, where the contracts incorporate widely used federal regulations specifying that title to the property transfers to the federal government.

4. Taxpayer is a STATE-1 corporation, with operations in Utah. The Taxpayer manufactures aerospace products, such as rockets, missiles, aircraft or parts used in those products for the United States government or private entities.²

5. During the audit period of January 1, 2012 through December 31, 2013, Taxpayer served as a prime contractor or sub-contractor on a number of contracts with the United States government. For purposes of the refund request, the Taxpayer has focused the request on fourteen contracts that were in effect during the audit refund period. Of the fourteen contracts, the Taxpayer was the direct contractor with the government agency on four of the contracts and the subcontractor on ten of the contracts. Four of the contracts were with WORDS REMOVED, four with the WORDS REMOVED, three with the WORDS REMOVED, two with the WORDS REMOVED and one with WORDS REMOVED.³

6. Pursuant to the fourteen contracts the Taxpayer was to build or build parts for a WORDS REMOVED was to pay for or reimburse the Taxpayer for certain costs pursuant to the contract.

7. During this period, the Taxpayer's procurement personnel coded all tangible personal property purchased by TAXPAYER into one of four categories based on federal regulations.⁴ The Taxpayer was requesting refunds on only the Category #1 & Category #2 items.⁵ The two categories at issue in this appeal:

- a. Category #1- Direct Government Cost Items: Items purchased specifically for use in a single government contract and 100% of the cost of the item was allocated by Taxpayer to a direct

¹ Exhibit 36.

² Exhibit 31.

³ Exhibits 5-18 and 35.

⁴ The Taxpayer cites to Federal Acquisition Regulation ("FAR") 52.216-7, 31.201 et. seq.

⁵ Category# 3 & 4 items were not part of the refund claim. They included the following items:

Category #3- Indirect Unallowable Cost Items: U.S. government does not reimburse TAXPAYER for these items.

Category #4 –Direct Commercial Cost Items: Item purchased specifically for use in a commercial contract and 100% of the cost of the item was allocated to a TAXPAYER direct cost account for that commercial contract.

cost account for that contract and reimbursed in full by the U. S. Government. It is the Taxpayer's position that these items should not be subject to Utah sales and use taxes because these items were purchased for resale to the U.S. Government.

- b. Category # 2- Indirect Allowable Cost Items: These items were purchased for use in one or more U.S. government contracts and other contracts. The U.S. Government reimburses TAXPAYER based on the ratio of U.S. Government contract costs to total contract costs during the period in question, which was 79.69%. It was TAXPAYER's position that the indirect allowable costs allocated to U.S. government contracts should not be subject to Utah sales and use taxes because these are costs for items that are purchased in part for resale to the U.S. Government.

8. During the refund period, TAXPAYER had purchased tangible personal property for Category #1 and Category #2 transactions in connection with the 14 contracts that it had entered into with the U.S. Government. Due to the number of items purchased, which was over 14,000, the parties agreed to use 752 sample transactions.⁶

9. The types of items purchased pursuant to these contracts that are at issue in this appeal were described by the Taxpayer as things like drills and tubing, although in actuality the transactions included a large range of materials and supplies. Some of the items, such as drills, would be used in the process to construct the motors, missiles or rockets, but not become incorporated into the item constructed. Some of the items, such as tubing, may become part of the item constructed.⁷ A complete list of the 752 sample transactions is received into this record as Exhibit 20. That list contained a vast variety of items purchased including things like office supplies, printers and copy rentals and what appeared to be computer software and upgrades. A small sample of the wide variety of personal property items on that list were described as follows:

- Phone Equipment
- Air Handler
- Tubing, #749B4960, 36" x 500'
- Coveralls
- Billet Nozzle
- Media, Plastic
- Bag Polyester
- Supplies
- Hose, 3-Way 120V
- Seat Belt

⁶ Testimony of NAME-1, Sales Tax Audit Manager, Utah State Tax Commission.

⁷ Testimony of NAME-2, Senior Manager of Finance, TAXPAYER Flight Systems Group.

Liquid Nitrogen
Bag, Ziploc, 12" by 15"
Yale Electric Chain Hoist
Sodium Silicate
Air Compressor
Elastic Shock Cord (.25 DIA)
Bulk Liquid Carbon Dioxide
Helium
Conductive Funnel, Disposable

10. Of the 752 transactions, 24 were coded as Category #1 Direct Government transactions, 722 as Category #2 Indirect Allowable transactions, 5 as Category #3 or Category #4 transactions and 1 as undetermined. From the sample transactions, approximately \$\$\$\$ in sales tax was paid on the Category #1 items and \$\$\$\$ on the Category #2 items.

11. For the hearing, TAXPAYER had eliminated its refund request on some of the 752 transactions and was seeking a refund of only 577 of the sample transactions. Of the 24 transactions coded as Category #1-Direct Government Transactions, the Taxpayer was not able to produce the contracts relating to 17 in this category so withdrew its appeal of these 17, which left 7 Category #1 transactions. Of the 722 Category #2-Indirect Allowable Transactions, 152 were rented property items, such as a copier from Xerox. The Taxpayer did not argue that title transferred to the federal government on these type of items so also withdrew its refund claim relating to 152 items, leaving in the refund request 570 Category #2 items.⁸

12. Although Taxpayer was able to tie the 7 Category #1- Direct Government Transaction items to a specific contract, the Taxpayer was not able to tie the Category #2- items to a specific contract because the indirect purchased items were pooled into an account. However, the amounts charged to the government on these contracts are subject to review by government auditors, who work full time on site at the Taxpayer's location and audit the invoices.⁹ The government employees do review the proposal of all costs and certify that the costs are allowable. After the government employees conduct their audits, the adjustments to the Taxpayer's numbers have been minor.¹⁰

13. All 752 items at issue were retained by the Taxpayer. Based on the testimony of NAME-2, Senior Manager of Finance, TAXPAYER Flight Systems Group, the federal government did not claim any of the Category #2-Indirect Items at the completion of the contract. NAME-2 testified however, that with respect to items acquired as Category #1-Direct Government Transactions, if used in another contract, the Taxpayer would be required to pay the government rent for those items.

⁸ Exhibit 42.

⁹ Testimony of NAME-2, Senior Manager of Finance, TAXPAYER Flight Systems Group.

¹⁰ Exhibit 28 and Testimony of NAME-3, Senior Accounting Specialist, TAXPAYER Flight Systems Group.

14. Regarding the Category #2-Indirect Items, the federal government reimburses the Taxpayer based on the percentage of the indirect allowable costs relating to government contracts versus commercial, nongovernment contracts. The Taxpayer had calculated this to be 79.69% for the period at issue. The Taxpayer has a multistep formula by which it calculates this percentage, which is shown in Exhibit 1 incorporated into the record. A witness for the Taxpayer, REPRESENTATIVE FOR TAXPAYER-4, Senior Accounting Specialist, TAXPAYER Flight Systems Group, testified that the actual amount relating to the government contacts was likely higher, but the 79.69% was the amount that they could prove. It was the Taxpayer's position that the backup information that went into the calculation was highly sensitive confidential information and the Taxpayer did not provide copies of the information to the Division or submit it at the hearing. However, the Taxpayer stated at the hearing that it would allow the Division's auditors to have access to the information to review and verify the accuracy of the information.

15. At the time it purchased the items that are at issue in this refund request, the Taxpayer paid sales tax on the items instead of claiming the purchase as exempt and presenting an exemption certificate. When the federal government reimbursed the Taxpayer for these purchases, it reimbursed the Taxpayer for the purchase price and the sales tax amount paid.¹¹

16. The Division agreed that the sales tax had been paid on the items at issue in this appeal, but did not agree that the Taxpayer had established that the items were resold to the government. It was the Division's contention that the government had partially reimbursed the Taxpayer for the cost but that a reimbursement was not a sale. The Division argues that the Taxpayer has not documented that each item was resold and noted that it was a retail sale subject to tax if the purchase was for a purpose other than resale.¹² It was the Division's position that the purpose was not for resale, but instead to use in the construction of the property.

APPLICABLE LAW

The Tax Commission applies the substantive law in effect during the audit refund period, which was January 1, 2012 through December 31, 2013. The parties did not point to any change of law during this period that would affect this appeal, although some provisions have since been renumbered. This decision refers to the 2013 provisions of the law.

Sales and use tax is imposed at Utah Code Subsection 59-12-103(1) (2013) in relevant part:

¹¹ Testimony of NAME-3, Senior Accounting Specialist, TAXPAYER Flight Systems Group.

¹² Testimony of NAME-1, Sales Tax Audit Manager, Utah State Tax Commission.

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 . . .

For purposes of the above provision, “retail sale” is defined at Utah Code Subsection 59-12-102(106) (2013) as:

“Retail sale” or “sale at retail” means a sale, lease, or rental for a purpose other than: (a) resale; . . .

“Sale” is defined at Utah Code Subsection 59-12-102(108) as:

(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:

(i) installment and credit sales;

(ii) any closed transaction constituting a sale;

(iii) any sale of electrical energy, gas, service, or entertainment taxable under this chapter;

(iv) any transaction if the possession of property is transferred but the seller retains the title as security for the payment of the price; and

(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 Sec. 59-12-104(2013) provides a number of exemptions from sales and use taxes, including an exemption for property purchased for resale as follows:

The following sales and uses are exempt from the taxes imposed by this chapter:

. . .

(25) 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 Sec. 59-12-106(3)(a) provides the following regarding exempt sales:

For the purpose of the proper administration of this chapter and to prevent evasion of the tax and the duty to collect the tax, it shall be presumed that tangible personal property or any other taxable transaction under Subsection 59-12-103(1) sold by any person for delivery in this state is sold for storage, use, or other consumption in this state unless the person selling the property, item, or service has taken from the purchaser an exemption certificate . . .

For purposes of appeal proceedings regarding actions by the Utah State Tax Commission, Utah Code §59-1-1417 provides for the burden of proof and for statutory construction 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 Admin. Rule R865-19S-91 provides the following regarding Government Project Managers and Supply Contractors Pursuant to Utah Code Ann. Sections 59-12-102, 59-12-103, and 59-12-104:

A. Sales of tangible personal property or services as defined in Sections 59-12-102 and 59-12-103 to federal, state, or municipal government facilities managers or supply contractors, who are not employees or agents of that government entity, are subject to sales or use tax if the manager or contractor uses or consumes the property. Tax is due even though a contract vests title in the government.

.....

C. If the government entity makes a direct payment to the vendor for the tangible personal property or services, the sale is made to the government entity and not to the facilities manager or the supply contractor. In that case, the sale is not subject to sales tax.

Utah Admin. Rule R865-19S-41 provides in relevant part regarding sales to the United States government:

- (1) Sales to the United States government are exempt if federal law or the United States Constitution prohibits the collection of sales or use tax.
- (2) Sales made directly to the United States government or any authorized instrumentality thereof are not taxable, provided the sale is paid for directly by the federal government. If an employee of the federal government pays for the purchase with his own funds and is reimbursed by the federal government, that sale is not made to the federal government and does not qualify for the exemption.
- (3) Vendors making exempt sales to the federal government are subject to the recordkeeping requirements of Tax Commission rule R865-19S-23.

Utah Admin. Rule R865-19S-22 provides the following regarding record keeping:

A. Every retailer, lessor, lessee, and person doing business in this state or storing, using, or otherwise consuming in this state tangible personal property purchased from a retailer, shall keep and preserve complete and adequate records as may be necessary to determine the amount of sales and use tax for which such person or entity is liable. Unless the Tax Commission authorizes in writing an alternative method of record keeping, these records shall:

1. show gross receipts from sales, or rental payments from leases, of tangible personal property or services performed in connection with tangible personal property made in this state, irrespective of whether the retailer regards the receipts to be taxable or nontaxable;
2. show all deductions allowed by law and claimed in filing returns;
3. show bills, invoices or similar evidence of all tangible personal property purchased for sale, consumption, or lease in this state; and
4. include the normal books of account maintained by an ordinarily prudent business person engaged in such business, together with supporting documents of original entry such as: bills, receipts, invoices, and cash register tapes. All schedules or working papers used in connection with the preparation of tax returns must also be maintained.

48 CFR Ch. 1, 52.245-1(e) provides the following:

- (3) Title under Cost-Reimbursement or Time-and-Material Contracts or Cost-Reimbursable contract line items under Fixed-Price contracts.
 - (i) Title to all property purchased by the Contractor for which the Contractor is entitled to be reimbursed as a direct item of cost under this contract shall pass to and vest in the Government upon the vendor's delivery of such property.
 - (ii) Title to all other property, the cost of which is reimbursable to the Contractor, shall pass to and vest in the Government upon-
 - (A) Issuance of the property for use in contract performance;
 - (B) Commencement of processing of the property for use in contract performance; or
 - (C) Reimbursement of the cost of the property by the Government, whichever occurs first.

ANALYSIS

The Taxpayer argues that the materials and supplies at issue, which it purchases and uses or consumes while manufacturing rockets, missiles, motors and other items for U.S. government agencies, is excluded or not subject to sales or use tax under the tax imposition statutes. Utah Code Subsection 59-12-103(1) imposes sales and use tax on “retail sales of tangible personal property.” It was the Taxpayer’s position that when the Taxpayer purchased the materials and supplies, the purchases did not constitute “retail sales” under the tax imposition statute because the personal property items at issue purchased by the Taxpayer were resold to the U.S. government pursuant to its contracts which incorporated widely used federal regulations specifying that title to the property transfers to the federal government. The Taxpayer points to the broad definition of “sale” set out at Utah Code Subsection 59-12-102(108)(a) which provides

that a “sale” is “any transfer of title,” and which definition the Taxpayer contends is the same whether in reference to the Taxpayer’s initial purchase of the item or as to the Taxpayer’s resale of the item to the government. The Taxpayer argues that it resold these materials and supplies to the government agencies because, based on its contracts and the Federal Acquisition Regulations, title is transferred to the federal government upon either delivery of the item or when the Taxpayer is reimbursed for the item under the contract. So regardless of the fact that most of the transactions at issue in this appeal involved indirect purchases, and the federal government never took possession of the materials and supplies, title did transfer to the federal government under the FAR regulations.

The Taxpayer correctly contends that under the Sales and Use Tax Act provisions actual possession of the item need not transfer to the purchaser to constitute a “sale.” The Taxpayer points to the Utah Supreme Court’s decision in *Heritage Convalescent Center v. Utah State Tax Comm’n*, 953 P.2d 445 (Utah 1997). In that case, which involved the resale of prepared meals to patients, the Court had stated the definition of “sale” is deliberately broad to maximize the reach of the sales tax . . .” and went on to note that Utah’s tax code “plainly and unambiguously defines sales as any transfer of title.” *Id.* at 447 & 448. Additionally, the Court held in *Heritage* that the same broad definition of “sale” applied in the context of a non-taxable “resale.” *Id.* at 448.

However, the Taxpayer focuses on the definition of “sale” and not the key term in the tax imposition statute at Utah Code Subsection 59-12-103(1)(a) (2013) which is, instead, “retail sale.” Subsection 59-12-103(1)(a) imposes sales and use tax on “retail sales of tangible personal property made within the state.” “Retail sale” is defined at Utah Code Subsection 59-12-102(106)(2013) in pertinent part to these proceedings to be “a sale . . . for a purpose other than . . . resale . . .” The issue then before the Commission is to ascertain whether the Taxpayer’s “purpose” in purchasing the drills, tubing and other materials and supplies was to use and consume the items in its manufacture of the rocket or motor, or to resell the drills, tubing and other materials and supplies to the government.

The Taxpayer is a manufacturer that manufactures rockets, missiles, motors and flares pursuant to its contracts with the federal government. The “purpose” of the fourteen contracts the Taxpayer had entered into with the federal government directly or indirectly through the general contractor was to manufacture and provide the rockets, missiles, motors or flares, or parts for those items, not to provide the government with materials and supplies like drills and tubing. The fact that title to the materials and supplies passed to the government is incidental to the primary purpose of the contracts. The Taxpayer’s “purpose” was to use and consume the materials and supplies in its manufacturing pursuant to the contract. The Taxpayer was not a purchasing agent or supplier that acquires drills, tubing and other materials and supplies for the purpose of turning around and selling those items to the government.

Therefore, the Taxpayer acquired the drills, tubing and other materials and supplies for a purpose other than resale, making its acquisition of the drills, tubing and other items at issue a “retail sale” subject to sales and use tax under the tax imposition statute at Utah Code Subsection 59-12-103(1)(a).

Because the transactions are “retail sales” subject to sales and use taxes under the tax imposition statute, the next inquiry is whether the transactions were exempt from sales and use taxes under Utah Code Subsection 59-12-104(25) as “a product purchased for resale.” As noted by the parties at the hearing, the Commission must apply a different statutory construction when considering a tax imposition statute as opposed to a tax exemption statute. Under Utah Code Subsection 59-1-1417(2), the Commission is to construe an exemption statute “strictly against the taxpayer” and an imposition statute “strictly in favor of the taxpayer.”¹³ Additionally, in this proceeding before the Tax Commission, the burden of proof is on the Petitioner under Utah Code Subsection 59-1-1417(1), which means that the Taxpayer must show factually that it is entitled to the exemption.¹⁴ The Division also points to Utah Code Subsection 59-12-106(3)(a) (2013), which provides a presumption that any item of tangible personal property is sold for storage, use or consumption unless the seller “has taken from the purchaser an exemption certificate . . .” At the time the Taxpayer purchased the materials and supplies at issue, it paid sales tax, instead of purchasing the items tax free and providing to the seller an exemption certificate.¹⁵

Utah Code Sec. 59-12-104 (2013) provides “the following sales and uses are exempt from the taxes imposed by this chapter: . . . (25) 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.” The Taxpayer did not show at this hearing that any of the individual items became an ingredient or component part of a manufactured or compounded product. This would have required a review of each type of item purchased and how it was used. For example, from the 752 sample

¹³ Prior to the codification of Subsection 59-1-1417(2), which occurred in 2011, this distinction had been made by the courts in case law. See *Morton Int’l Inc. v. Auditing Div. of the Utah State Tax Comm’n*, 814 P.2d 581 (Utah 1991); *B.L. Key, Inc. v. Utah State Tax Comm’n*, 934 P.2d 1164 (UT App 1997); and *MacFarlane v. Utah State Tax Comm’n*, 134 P.2d 1116 (Utah 2006).

¹⁴ The Division argued at the hearing that the Taxpayer was not entitled to the exemption because its documentation was insufficient pursuant to Utah Administrative Rules. The Division cites to requirements of Utah Admin. Rule R865-19S-22(A) and noted that the Taxpayer needed to identify the contract to which each item was specifically applied or reimbursed, which the Taxpayer is not able to do with the indirect items. The Division also argues the Taxpayer failed to provide evidence that each line item was resold or reimbursed by the U.S. Government, the amount paid for each item by the U.S. Government and the amount of actual use that was apportioned to non-governmental customers. Had this decision concluded that the transactions at issue were not “retail sales” or exempt as sales for resale, the Commission would have needed to further consider the documentation submitted in this matter and whether it was sufficient to meet the burden of proof the Taxpayer has to establish for the refund amount.

¹⁵ The Taxpayer acknowledges that when it was reimbursed by the U.S. Government agencies for these items it was reimbursed for the sales tax, so the Taxpayer is now requesting a refund of amounts for which the Taxpayer has already been reimbursed.

transactions and the list noted above, there is “phone equipment,” “air handler,” “tubing, #749B4960, 36” x 500”” and “Coveralls.” It is possible that some of these items became incorporated into the manufactured product. Some of the items remained in their “original form” and were used or consumed as a tool or a piece of equipment in the manufacturing process.

As the parties had explained at the hearing, the issue of whether material and supplies for which title transferred to federal government agencies pursuant to contract and FAR Regulations, but which were used and consumed in a manufacturing process, is one of first impression before the Utah State Tax Commission and has not previously been before the Utah courts. However, the issue has been addressed by courts in other states with mixed results. The Taxpayer points to the following decisions where the states of STATE-2, STATE-3, STATE-4 and STATE-5 all ruled that purchases by the federal contractor of materials and supplies similar to those at issue in this appeal qualified for exemption or were excluded from sales tax in those states as a sale for resale because title had passed to the government agencies. See *Aerospace Corp. v. State Board of Equal.*, 267 Cal. Rptr. 685 (Cal.App. 1990); *McDonnell Douglas Corp. v. Dir. of Rev.*, 945 S.W.2d 437 (Mo. 1997); *Motorola, Inc. v. STATE-4Dept. of Rev.*, 993 P.2d 1101 (Ariz. App. 1999); and *Strayhorn v. Raytheon E-Systems, Inc.*, 101 S.W.3d 558 (Tex.App. 2003).¹⁶ In each of these cases, the court held the federal contractor resold the same type of materials and supplies at issue in this appeal to the federal government pursuant to the same FAR clause language that applies in this appeal. In each of the cases, the federal contractor was a manufacturer and manufactured items for the federal government and the materials and supplies were used or consumed in that manufacturing process.

The Division cites to *Raytheon Co. v. Commissioner of Revenue*, 916 N.E.2d 372 (Mass. 2009), in which the Supreme Judicial Court of Massachusetts found that the type of items at issue in this appeal were not exempt from sales tax and denied the requested refund.¹⁷ In *Raytheon*, the court acknowledged the cases cited by the Taxpayer in this matter and noted:

Raytheon argues that in almost all of these cases the court was considering sales and use tax provisions, including a sale for resale exemption, that were very similar if not almost identical to their Massachusetts statutory counterparts. In Raytheon’s view, we should follow the lead of these courts and conclude as most of them did, that no sales or use tax may be charged because the statutory sale for resale exemption applies.

We decline to travel down the path that Raytheon lays out for us. Although the statutory provisions discussed in the cited State court cases are indeed very similar to the relevant

¹⁶ All states but the STATE-4 Court of Appeals had analyzed the transaction under each state’s exemption statutes as some variant of a sale for resale exemption. The STATE-4 Court of Appeals found the transactions were not taxable under its version of the tax imposition statute.

¹⁷ The Division had also argued in this appeal that the transactions at issue do not comply with Utah Administrative Rules R865-19S-41 and R865-19S-91 regarding exemptions for sales to government entities.

provisions of the Massachusetts sales and use tax statutes, those decisions do not provide a useful interpretive guide in this instance. *Id.* at 379.

The Massachusetts court goes on to note that it had consistently considered “the inherent nature of the business in question,” in seeking to determine whether a particular sale or type of sale was for “the purpose [of] resale in the regular courses of business,” or whether a particular sale for resale is merely “incidental” to the taxpayer’s business rather than its central focus (internal citations omitted).” *Id.* 379. That court found “the fact that Raytheon thus ‘sells’ items to the Federal government in the regular course of its business does not mean that it purchased these items for the purpose of resale” concluding that the resale of the indirect cost items was only incidental to Raytheon’s business. *Id.* at 381.

The Utah Court of Appeals has provided similar guidance in *Gull Labs. v. UT Tax Comm’n, Auditing Div.*, 936 P.2d 1082 (Utah App. 1997) in considering the resale exemption. In *Gull Labs*, the Utah court stated, “The essential consideration in determining whether the purchased-for-resale exemption applies is the ‘primary purpose of the purchase, not who eventually ended up with the items.’” Citing *Broadcast Int’l, Inc. v. Utah State Tax Comm’n*, 882 P.2d 691, 696 (Utah.Ct.App.1994). In *Gull Labs* the Utah Court of Appeals finds, “Thus, if Gull’s purpose is to effectively consume the media mix in the manufacturing process, and the mix becomes only an incidental ingredient of the kits, then the mix is not “purchased for resale,” and mix purchases are not exempt.” *Id.* at 1086, Citing *Nucor Corp v. Utah State Tax Comm’n*, 832 P.2d at 1297-98 (Utah 1992).

Applying this guidance to the facts before the Tax Commission in this matter, the primary purpose of the purchase of the materials and supplies that constitute the direct and indirect items was to use or consume the items in the manufacturing process of the rockets, missiles, motors and other items, and not for the purpose to resell. Therefore, these purchases are not exempt and the Division properly disallowed the requested refund.

CONCLUSIONS OF LAW

1. Under Utah Code Subsection 59-1-1417(2), the Commission is to construe a tax imposition statute “strictly in favor of the taxpayer” and a tax exemption statute “strictly against the taxpayer.” As noted by the Utah Supreme Court in *Ivory Homes, LTD. v. Tax Comm’n*, 2011 UT 54, ¶21, “When interpreting statutory language our primary objective is to ascertain the intent of the legislature. To discern legislative intent, we first look to the plain language of the statute.” In interpreting the tax imposition statute at issue and the exemption statute, the plain language is clear and not ambiguous in this matter.¹⁸

¹⁸ Additionally, in this proceeding before the Tax Commission, the burden of proof is on the Petitioner under Utah Code Subsection 59-1-1417(1), which means that the Taxpayer must show factually that it is entitled to the refund it

2. Utah Code Subsection 59-12-103(1) imposes sales and use taxes on “retail sales of tangible personal property made within the state.” “Retail sale” is defined at Utah Code Subsection 59-12-102(106)(2013) to be “a sale . . . for a purpose other than . . . resale . . .” The Taxpayer’s purpose in purchasing the materials and supplies at issue in this appeal was to use or consume the materials and supplies in its manufacturing process. The Taxpayer manufactures rockets, missiles, motors, flares and other items. The main “purpose” of the fourteen contracts the Taxpayer has presented in this matter was the Taxpayer’s manufacturing of rockets, missiles, motors, flares or parts of these items, not to provide the government with materials and supplies like drills and tubing. Although title to the materials and supplies passed to the government under the contracts and FAR regulations, this is incidental to the primary purpose of the contracts. The Taxpayer’s “purpose” was to use or consume the materials and supplies in its manufacturing process of the rockets, missiles and other items pursuant to the contract. Therefore, the supplies and materials were purchased for a purpose other than resale and were “retail sales.” As “retail sales” they are subject to sales and use taxes under Utah Code Subsection 59-12-103(1) unless otherwise exempt.

3. Utah Code Sec. 59-12-104 (2013) provides “the following sales and uses are exempt from the taxes imposed by this chapter: . . . (25) 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.” In *Gull Labs 936* the court provided guidance regarding the resale exemption, stating, “The essential consideration in determining whether the purchased-for-resale exemption applies is the “primary purpose of the purchase, not who eventually ended up with the items.” *Id.* at 1086. Applying this guidance to the facts before the Tax Commission in this matter, the primary purpose of the Taxpayer’s purchase of the materials and supplies at issue was to use or consume the items in the manufacturing process and not for the purpose of resale. Therefore, these purchases are not exempt and the Division had properly disallowed the requested refund.

The Taxpayer’s appeal should be denied.

Jane Phan
Administrative Law Judge

is requesting. Had the Commission found that the transactions were not retail sales or were exempt as a purchase for resale, the Commission would be required to give further consideration to the documentation submitted and whether the Taxpayer has met the burden of proof.

DECISION AND ORDER

Based on the foregoing the Utah State Tax Commission upholds the Division's decision to deny Taxpayer's refund request of sales and use taxes for the period of January 1, 2012, through December 31, 2013. It is so ordered.

DATED this _____ day of _____, 2018.

John L. Valentine
Commission Chair

Michael J. Cragun
Commissioner

Robert P. Pero
Commissioner

Rebecca L. Rockwell
Commissioner

Notice of Appeal Rights and Payment Requirement: Any balance due as a result of this order must be paid within thirty (30) days of the date of this order, or a late payment penalty could be assessed. 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. §63G-4-302. 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 et seq. and §63G-4-401 et seq.