Brigham Young University Law School
BYU Law Digital Commons

Utah Supreme Court Briefs

1991

Chicago Bridge & Iron v. Auditing Division of the Utah State Tax Commission : Brief of Appellant

Utah Supreme Court

Follow this and additional works at: https://digitalcommons.law.byu.edu/byu_sc1

Part of the Law Commons

Original Brief Submitted to the Utah Supreme Court; digitized by the Howard W. Hunter Law Library, J. Reuben Clark Law School, Brigham Young University, Provo, Utah; machine-generated OCR, may contain errors.
Lee Dever; Assistant Attorney General; Attorney for Appellee.
Robert A. Peterson; Ronald G. Moffitt, Van Cott, Bagley, Cornwall & McCarthy; Attorneys for Appellant.

Recommended Citation
Brief of Appellant, *Chicago Bridge & Iron v. Auditing Division of the Utah State Tax Commission*, No. 910265.00 (Utah Supreme Court, 1991).
https://digitalcommons.law.byu.edu/byu_sc1/3589

This Brief of Appellant is brought to you for free and open access by BYU Law Digital Commons. It has been accepted for inclusion in Utah Supreme Court Briefs by an authorized administrator of BYU Law Digital Commons. Policies regarding these Utah briefs are available at http://digitalcommons.law.byu.edu/utah_court_briefs/policies.html. Please contact the Repository Manager at hunterlawlibrary@byu.edu with questions or feedback.

AH
CUMENT
U
.9
DOCKET NO. 910265
BRIEF
UTAH SUPREME COURT

IN THE SUPREME COURT

OF THE STATE OF UTAH

CHICAGO BRIDGE & IRON COMPANY, Petitioner-Appellant, vs. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent-Appellee.	)	Case No. 910265 Priority No. 15

BRIEF OF APPELLANT

On Appeal From Two Orders Of The Utah State Tax Commission

Robert A. Peterson
Ronald G. Moffitt
VAN COTT, BAGLEY, CORNWALL & McCARTHY
50 South Main Street, #1600
Salt Lake City, Utah 84145

Attorneys for Appellant

Lee Dever
Assistant Attorney General
36 South State Street, 11th Floor
Salt Lake City, Utah 84111

Attorney for Appellee

FILED

SEP 1 8 1991

CLERK SUPREME COURT, UTAH

IN THE SUPREME COURT

OF THE STATE OF UTAH

CHICAGO BRIDGE & IRON COMPANY, Petitioner-Appellant, vs. AUDITING DIVISION OF THE UTAH STATE TAX COMMISSION, Respondent-Appellee.	)	Case No. 910265 Priority No. 15

BRIEF OF APPELLANT

On Appeal From Two Orders Of The
Utah State Tax Commission

Robert A. Peterson
Ronald G. Moffitt
VAN COTT, BAGLEY, CORNWALL
& McCARTHY
50 South Main Street, #1600
Salt Lake City, Utah 84145

Attorneys for Appellant

Lee Dever
Assistant Attorney General
36 South State Street, 11th Floor
Salt Lake City, Utah 84111

Attorney for Appellee

PARTIES TO PROCEEDINGS BELOW

The petitioner below was Chicago Bridge and Iron Company ("CBI"). The respondent was the Auditing Division of the Utah State Tax Commission ("Tax Commission"). There were no other parties to the proceedings below.

g:\wpc\082\00000134y.w51
09/16/91

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

STATEMENT OF JURISDICTION iv

ISSUES PRESENTED FOR REVIEW iv

STANDARD FOR REVIEW v

DETERMINATIVE STATUTORY AND REGULATORY PROVISIONS vi

STATEMENT OF THE CASE 1

FACTS 3

SUMMARY OF THE ARGUMENTS 8

ARGUMENT 9

A. CBI'S PURCHASES WERE EXEMPT FROM UTAH SALES TAX BECAUSE THEY WERE OF STEEL PLATE AND RAW MATERIALS THAT ENTERED INTO AND BECAME A COMPONENT PART OF MANUFACTURED PRODUCTS. 9

B. THE POSITION OF THE TAX COMMISSION IS INTERNALLY INCONSISTENT AND WILL SUBJECT CBI TO DOUBLE TAXATION. 12

C. CBI SHOULD NOT BE SUBJECT TO PENALTIES ON ANY DEFICIENCIES ULTIMATELY DETERMINED TO BE DUE. 17

CONCLUSION 21

TABLE OF AUTHORITIES

Cases | Page

Armstrong's Inc. v. Iowa Dept. of Revenue, 320 N.W.2d 623 (Iowa 1982) 19

Bevans v. Industrial Comm'n of Utah, 790 P.2d 573 (Utah Ct. App. 1990) v

Butler v. State Tax Comm'n of Utah, 13 Utah 2d 1, 367 P.2d 852 (1962) 14

Chemical & Indus. Corp. v. State Tax Comm'n, 11 Utah 2d 406, 360 P.2d 819 (1961) 14

Chicago Bridge & Iron Co. v. Johnson, 19 Cal.2d 162, 119 P.2d 945 (1941) 12-14, 17

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977) . . 15

Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 169 (1983) 15

Du Mont Ventilation Co. v. Department of Revenue, 425 N.E.2d 606 (Ill. 1981) 19

El Centro Villa v. Tax and Rev. Dept. of New Mexico, 108 N.M. 795, 779 P.2d 982 (1989) 18

Gathings v. Bureau of Revenue, 87 N.M. 334, 533 P.2d 107 (1975) 18

Genex/London, Inc. v. Kentucky Bd. of Tax Appeals, 622 S.W.2d 499 (Ky. 1981) 19

Goldberg v. Sweet, 109 S.Ct. 582 (1989) 14, 15

In Re Brown, 743 F.2d 664, 669 (9th Circ. 1984) 18

Matter of Grayco Land Escrow, Ltd., 559 P.2d 264 (Hawaii 1977) 20

U.S. v. Boyle, 105 S.Ct. 687 (1985) 19

Video Tape Exchange v. Indiana Dept. of State Rev., 533 N.E.2d 1302 (Ind. Tax 1989) 20

Walter v. Comm'n of Int. Rev., 753 F.2d 35 (6th Cir. 1985) . 19

Statutes

I.R.C. § 6651(a) 18, 19

Treas. Regs. § 301.6651-1(c)(1) 18

Utah Code Ann. § 59-1-401 19

Utah Code Ann. § 59-1-401(3) 17

Utah Code Ann. § 59-1-401(3)(a) 18

Utah Code Ann. § 59-1-401(3)(b) 18

Utah Code Ann. § 59-12-103(1)(l) (Supp. 1991) 14

Utah Code Ann. § 59-12-104(27) (Supp. 1991) 9

Utah Code Ann. § 59-12-104(28) 14

Utah Code Ann. § 59-12-104(33) 16

Utah Code Ann. § 59-16-4(g) 9, 11, 17

Utah Code Ann. § 59-16-4(h) 14

Utah Code Ann. § 63-46b-16 iv

Utah Code Ann. § 63-46b-16(4)(d) v

Utah Code Ann. § 78-2-2(3)(e) iv

STATEMENT OF JURISDICTION

Jurisdiction of this Appeal is based on Utah Code Ann. § 63-46b-16, which jurisdiction is vested in this Court exclusively pursuant to Utah Code Ann. § 78-2-2(3)(e).

ISSUES PRESENTED FOR REVIEW

1. Can the State of Utah levy a sales tax on purchases of steel plate and other raw materials even though the steel plate and other materials enter into and become an ingredient or component part of a product manufactured in Utah that is shipped as component parts for assembly outside the State of Utah?

2. Can the State of Utah levy a sales tax on steel plate and other raw materials which enter into and become an ingredient or component part of such a manufactured product even though all states in which such manufactured products are assembled, including Utah, impose a sales or use tax on the steel plate and other raw materials?

3. Can the State of Utah impose penalties on sales tax deficiencies where there is a genuine disagreement by the parties as to whether or not a tax is payable to Utah and where there is no evidence of willful disregard of established law or precedent?

STANDARD FOR REVIEW

The standard of review applicable to each issue presented by this Appeal is whether the Appellant has been substantially prejudiced by the agency having erroneously interpreted or applied the law. Utah Code Ann. § 63-46b-16(4)(d).

Pursuant to Section 63-46b-16(4)(d), it is appropriate for the reviewing court to review the agency's interpretation of law as a question of law with no deference to the agency's view of law. The "correction of error" standard is appropriately applied to such issues. Bevans v. Industrial Comm'n of Utah, 790 P.2d 573 (Utah Ct. App. 1990).

DETERMINATIVE STATUTORY AND REGULATORY PROVISIONS

Utah Code Ann. § 59-15-4(a) (Supp. 1985, accord Supp. 1984); accord § 59-12-103(1)(a) (Supp. 1991):

> From and after the effective date of this act there is levied and there shall be collected and paid:
>
> (a) A tax upon every retail sale of tangible personal property made within the state of Utah equivalent to the following rates: (i) 4-5/8% from October 1, 1983, through June 30, 1986, . . . of the purchase price paid or charged . . . .

Utah Code Ann. § 59-16-3(a) (Supp. 1985, accord Supp. 1984); accord § 59-12-103(1)(l) (Supp. 1991):

> There is levied and imposed an excise tax on:
>
> (a) The storage, use, or other consumption in this state of tangible personal property purchased for storage, use, or other consumption in this state at the rate of: (i) 4-5/8% from October 1, 1983, through June 30, 1986, . . . of the sales price of such property . . . .

Utah Code Ann. § 59-16-4(g) (Supp. 1984, accord Supp. 1985):

> The storage, use or other consumption in this state of the following tangible personal property is specifically exempted from the tax imposed by this act:
>
> . . . .
>
> (g) Property which enters into and becomes an ingredient or component part of the property which a person engaged in the business of manufacturing, compounding for sale, profit or use manufactures or compounds . . . .
>
> Accord § 59-12-104(27) (Supp. 1991): The following sales and uses are exempt from the taxes imposed by this chapter: . . . 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.

Utah Code Ann. § 59-16-4(h) (Supp. 1984, accord Supp. 1985):

> The storage, use or other consumption in this state of the following tangible personal property is specifically exempted from the tax imposed by this act:
>
> . . . .
>
> (h) Property upon which a sales or use tax was paid to some other state, or one of its subdivisions, or the United States; provided that the state of Utah shall be paid any difference between such tax paid and the tax imposed by this act and the Uniform Local Sales and Use Tax Law of Utah, except that no adjustment shall be allowed if tax paid was greater than the tax imposed by this act and the Uniform Local Sales and Use Tax Law of Utah.
>
> Accord § 59-12-104(28) (Supp. 1991): The following sales and uses are exempt from the taxes imposed by this chapter: . . . property upon which a sales or use tax was paid to some other state, or one of its subdivisions, except that the state shall be paid any difference between the tax paid and the tax imposed by this part and Part 2, and no adjustment is allowed if the tax paid was greater than the tax imposed by this part and Part 2.

Utah Code Ann. § 59-12-104(33) (Supp. 1991):

> The following sales and uses are exempt from the taxes imposed by this chapter:
>
> . . . .
>
> Sales of tangible personal property to persons within this state that is subsequently shipped outside the state and incorporated pursuant to contract into and becomes a part of real property located outside of this state, except to the extent that such other state or political entity imposes a sales, use, gross receipts, or other similar transaction excise tax on it against which such other state or political entity allows a credit for taxes imposed by this chapter.

Utah Code Ann. § 59-1-401(3) (Supp. 1991):

> (3) The penalty for underpayment of tax is as follows:
>
> (a) If any underpayment of tax is due to negligence, the penalty is 10% of the underpayment.
>
> (b) If any underpayment of tax is due to intentional disregard of law or rule, the penalty is 15% of the underpayment.
>
> (c) For intent to evade the tax, the penalty is the greater of $500 per period or 50% of the tax due.
>
> (d) If the underpayment is due to fraud with intent to evade the tax, the penalty is the greater of $500 per period or 100% of the underpayment.

STATEMENT OF THE CASE

This case involves Utah sales taxes during the period October 1, 1983 through December 31, 1985. In this case, taxpayer, Chicago Bridge & Iron Company ("CBI"), appeals from two separate Orders from the Utah State Tax Commission ("Tax Commission"). The first order, entitled "Findings of Fact, Conclusions of Law, and Final Decision" ("Original Order"), is dated February 13, 1991; the second order, entitled "Order" ("Supplemental Order"), is dated May 7, 1991.

In its Original Order, the Tax Commission ruled that purchases of steel plate and other raw materials by CBI in the State of Utah were subject to sales tax in the State of Utah, even though these materials were manufactured, pursuant to specific contracts, into storage tanks, pressure vessels and other large steel containers and equipment which were then shipped out of the State of Utah for use or consumption out of the State of Utah. With only insignificant exceptions, all of the steel plate and other raw materials at issue in this case were purchased specifically to meet the requirements of individual customer contracts; none of the steel plate or other raw materials was purchased for inventory or to be manufactured into items that would be considered as inventory of CBI. All of the manufactured products were subject to sales or use tax in the

state of destination. In each case, sales or use tax was paid by CBI to the state of destination.

In its Original Order, the Tax Commission found that CBI was, in fact, engaged in the business of manufacturing, and, therefore, was a manufacturer. Notwithstanding that finding, the Tax Commission ruled that in those cases where CBI both manufactured and installed the manufactured products in a state other than Utah, it did so as a real property contractor, and, therefore, was responsible for Utah sales tax at the time the steel plate and other raw materials were purchased in Utah. Specifically, the Tax Commission ruled that if CBI's contract called for both manufacturing and assembly services, CBI was a real property contractor; if the contract did not call for assembly services, CBI was a manufacturer.

The Tax Commission further ruled that in those cases where CBI was a "real property contractor," sales tax on steel plate and other raw materials was first due on the purchase of such steel plate and other raw materials in Utah, and payment of use tax to California and other states did not relieve CBI of liability for Utah sales tax, notwithstanding a specific California Supreme Court ruling subjecting CBI to use tax in California.

Subsequent to the Tax Commission's ruling, CBI filed a Request for Reconsideration, dated March 4, 1991. That request

asked the Tax Commission to reconsider its Original Order in light of its specific finding that CBI was a "manufacturer." The request also asked for a recalculation of deficiency in accordance with the ruling of the Tax Commission as to those contracts where assembly services were not performed. Finally, the request asked for a ruling on whether penalties should be imposed upon CBI. The issue of penalties, although argued before the Tax Commission, was not addressed in the Original Order.

On May 7, 1991, the Tax Commission issued the Supplemental Order in response to CBI's Request for Reconsideration. The Supplemental Order was limited to a finding that there was insufficient evidence to justify the 50% penalty originally assessed by the Audit Division. The Tax Commission, instead, imposed a 15% penalty on the deficiency as recalculated by the Audit Division, finding that CBI had apparently intentionally disregarded established law or rule. The Supplemental Order did not, however, address CBI's request for a reconsideration of the Tax Commission's finding on the deficiencies themselves.

<u>FACTS</u>

The following facts were established by testimony and documentary evidence at the hearing.

CBI's primary business activity involves the custom design, engineering, manufacture, and, in most cases, field

assembly of large all-welded steel plate water storage tanks, petroleum and chemical storage tanks, low-temperature pressure vessels for liquefied gases, waste water treatment equipment, pulp and woodyard equipment, and other large metal structures for the storage, processing, mixing or blending of materials. (Transcript at pages 24-29.) (These manufactured products are sometimes collectively referred to hereinafter as "tanks".)

During the period in question, CBI operated a manufacturing facility in Salt Lake City, Utah. (Transcript at pages 16-17.) (In addition, CBI operated manufacturing facilities at Birmingham and Cordova, Alabama; Fontana, California; New Castle, Delaware; Kankakee, Illinois; and Memphis, Tennessee).

Due to the nature of the tanks and other products CBI manufactures, CBI often finds it necessary to include the assembly on the customer's premises of the products it manufactures. As a result, after the tanks have been manufactured, they are shipped in subassembled form by rail or flatbed truck to their final destination, where CBI's field assembly crews or the customer employees assemble and weld the various component parts which comprise the finished tank. (Transcript at pages 22-23.)

Except for assembly and welding labor performed at the customer's assembly site, most, if not all, of the activities

performed by CBI with respect to the manufactured products at issue were rendered at its manufacturing facility. (Transcript at pages 10, 21-22; Brief of Petitioner to Tax Commission at page 4.)

Under a typical contract, the steel plate pieces that comprise the tank are cut, rolled, and manufactured into the component parts (subassemblies) at CBI's manufacturing facility. (Transcript at pages 22-23.) Often, the manufactured products are assembled (without welding the parts together) to make sure everything fits, and are then disassembled so that they can be shipped to their final destination to be assembled. (Transcript at pages 44-45.) Rarely is any cutting, shaping or other manufacturing activities be performed at the site of assembly. (Transcript at pages 40-44.)

Typically, the manufacturing process consists of two stages: (1) the steel plate which has been custom ordered from a steel mill consistent with the customer contract to specific thickness and rectangular configurations is treated, cut, shaped and welded together into component parts or subassemblies of a final tank; and (2) these subassemblies are then heat treated using high temperatures to relieve the stress created by the welding and bending processes. (Transcript at pages 7, 18-22.)

Transportation restrictions, the large size, shape or other physical restrictions, prevent the tanks from being

transported in their final and completed form. (Transcript at pages 10, 23-24, 40.) But for the practical limitations of transporting such large tanks, pressure vessels, etc., they would be assembled and then shipped in their final form from the Salt Lake facility (or other manufacturing facilities) to their ultimate destination. (Transcript at pages 23-24, 40.)

CBI's field assembly crews were run by a wholly separate and distinct division from CBI's manufacturing facility in Salt Lake City. None of the assembly crews were headquartered or permanently stationed in Utah. The Salt Lake facility did not perform, schedule or supervise any field assembly services. (Transcript at pages 30-31, 37, 46-47.) Occasionally, a third party, or the customer itself, performed the field assembly services. Irrespective of whether CBI or a separate third party performed the assembly services, generally the single major expense under a contract was the manufacturing of the component parts.

Although not at issue in this case, because the Tax Commission has conceded this issue, during the period in question, approximately 50% of the work performed at CBI's Salt Lake City facility was for a contract on the Golden Gate Bridge in which CBI provided manufacturing services only. (Transcript at pages 34, 43.)

During the period in question, CBI purchased its steel plate from vendors located within the State of Utah. (Transcript at page 7.) Sales tax was paid on all purchases of materials and supplies which were consumed in the manufacturing process itself. Sales tax was also paid on all purchases of steel plate and other raw materials for tanks that were assembled and installed in the State of Utah. In cases where the tanks were assembled outside the State of Utah, sales tax was not paid to the Utah steel vendors. Rather, CBI paid a use tax to the state where the tank was ultimately assembled and installed. During the period in question, the majority of the contracts for manufacture and assembly were with customers in California. In California, CBI was required to pay use tax on the basis of the purchase price of the steel plate and other raw materials that were ultimately incorporated into tanks in California. (Transcript at pages 7-8, 11-12.)

During the period in question, the Utah Code provided exemptions for purchases of tangible personal property that enters into and becomes an ingredient or component part of a manufactured product and for purchases of tangible property where a sales or use tax is properly paid to another state. (Transcript at pages 9, 11.)

SUMMARY OF THE ARGUMENTS

1. CBI's activities at the Salt Lake City facility consisted exclusively of manufacturing tanks, spherical pressure vessels, storage containers, and other personal property and, as such, its purchases of steel plate and other raw materials were exempt from Utah sales tax.

2. Because CBI was required to pay use tax to the state of final destination of its tanks, spherical pressure vessels, storage containers and other manufactured personal property, the Tax Commission's position is internally inconsistent with federal constitutional precedents and results in double taxation.

3. Even if sales tax is found properly payable to the State of Utah, it is improper for the Tax Commission to impose penalties on any deficiency, since there is no evidence that CBI willfully disregarded any established precedent or law. In fact, CBI's treatment of sales and use taxes was consistent with established California case law that specifically examined the transactions at issue in this case, and with United States Supreme Court precedent.

ARGUMENT

A. CBI'S PURCHASES WERE EXEMPT FROM UTAH SALES TAX BECAUSE THEY WERE OF STEEL PLATE AND RAW MATERIALS THAT ENTERED INTO AND BECAME A COMPONENT PART OF MANUFACTURED PRODUCTS.

CBI's purchases of steel plate and other raw materials from Utah vendors were exempt from Utah sales tax by virtue of Utah Code Ann. § 59-16-4(g), the statute in effect during the time period at issue in this case. That statute exempted from Utah sales and use taxes the following purchases:

> Property which enters into and becomes an ingredient or component part of property which a person engaged in the business of manufacturing, compounding for sale, profit or use manufactures or compounds . . . .

Accord, Utah Code Ann. § 59-12-104(27) (Supp. 1991).

The facts relevant to this exemption were established by uncontroverted evidence at the hearing. Those facts are as follows:

1. CBI is a manufacturer of large all-welded steel plate water storage tanks, petroleum and chemical storage tanks, low-temperature pressure vessels for liquefied gases, waste water treatment equipment, pulp and woodyard equipment, and other large metal structures for the storage, processing, mixing or blending of materials. (Transcript at pages 24-29.)

2. The Salt Lake facility was built exclusively for manufacturing steel plate into such tanks, spherical pressure

vessels, storage containers, and other products. (Transcript at pages 16-17.)

3. The equipment housed at the Salt Lake facility was designed and used exclusively for manufacturing steel plate into such tanks, spherical pressure vessels, storage containers, and other products. (Transcript at page 17.)

4. Neither the Salt Lake facility and the equipment located in it, nor the personnel at the Salt Lake facility, were ever used to assemble and install manufactured tanks, either within Utah or outside of Utah. (Transcript at pages 30-31, 37, 46-47.)

5. The functions performed at the Salt Lake facility consisted solely of manufacturing large steel plate water storage tanks, petroleum and chemical storage tanks, low-temperature pressure vessels for liquefied gases, waste water treatment equipment, pulp and woodyard equipment, and other large metal structures, and, during the period in question, decking for the Golden Gate Bridge. (Transcript at pages 21-22.)

6. But for the practical constraints of transporting such large tanks, CBI would have assembled and shipped them in completed form to their final destinations. (Transcript at pages 10, 23-24, 40.)

7. On occasion, tanks that have been assembled and erected at a customer's site are later disassembled, transported

to another location, and reassembled, although never by CBI personnel from the Salt Lake facility. (Transcript at page 45.)

8. The Audit Division of the Tax Commission concedes that if CBI is a manufacturer, its purchases of steel plate are exempt from sales and use taxes in Utah. (Transcript at page 62.)

The uncontroverted evidence presented at the hearing showed that CBI's activities at its Salt Lake facility consisted exclusively of manufacturing. The Audit Division presented no evidence that CBI's activities at its Salt Lake facility consisted of anything but manufacturing tanks, spherical pressure vessels, etc. To the extent assembly activities took place outside the Salt Lake facility, it was simply because the manufactured tanks, spherical pressure vessels, etc. were too large to ship in their completed form. Final assembly at the customer's site was never performed by CBI employees from the Salt Lake facility. To the extent practical constraints of disassembly and transportation do not make it impractical, CBI's tanks and other manufactured products can be, and sometimes are, disassembled at a customer's "old" site, transported to a customer's "new" site, and reassembled at the "new" site.

CBI respectfully submits that under the uncontested facts of this case it qualifies for the exemption that existed under Utah Code Ann. § 59-16-4(g) during the period in question,

and there is no reason that CBI should be disadvantaged simply because of the enormous size of the tanks and other products it manufactures. CBI respectfully submits that if it manufactured home hot water tanks and shipped them to other states where they were installed in homes, the Audit Division would not seek to tax the purchase of raw materials for manufacturing such home hot water tanks, even though they become fixtures when installed and are rarely, if ever, moved from one house to another. CBI should not be taxed on the purchase of raw materials that it manufactures into similar, albeit larger, tanks, simply because its tanks are larger than home hot water tanks.

B. THE POSITION OF THE TAX COMMISSION IS INTERNALLY INCONSISTENT AND WILL SUBJECT CBI TO DOUBLE TAXATION.

The position of the Tax Commission also subjects CBI to double taxation because, since 1941, the State of California has required CBI to pay California use tax on materials purchased to be manufactured into tanks, spherical pressure vessels, storage containers, etc. that are used, stored or otherwise consumed in California. See Chicago Bridge & Iron Co. v. Johnson, 19 Cal.2d 162, 119 P.2d 945 (1941).

In that case, the California Supreme Court ordered CBI to pay use tax to California on tanks, spherical pressure vessels, storage containers, etc. that were assembled and installed in California. The California Supreme Court stated:

Plaintiff, Chicago Bridge & Iron, is primarily a manufacturer of tanks. It purchases the raw material such as steel outside of California, and manufactures the same into completed tanks at one of its plants, also outside of California. It sells those tanks to its customers in many parts of the United States. The tanks are of such size, they cannot be transported in a single unit, and for that reason, they are shipped, "knocked down" and assembled and installed at their destination. Due to the nature of the business and other factors, the plaintiff finds it necessary in making a sale of a tank to include the assembly of the completed parts and the installation thereof on the customer's premises. As expressed in the stipulation of the parties, "the requirement of each * * * contract (for a tank) that (plaintiff) assemble and install the tank described in that contract * * * was relevant and appropriate to and essentially connected with the subject matter of that contract and inhered, and was properly made to inhere, in the duty of performing the contract". The "knocked down" tanks are shipped in interstate commerce to plaintiff's representatives in California, and are assembled and installed by crews of skilled workmen which plaintiff sends from state to state for that purpose. Under the typical contract between plaintiff and one of its patrons the tanks are to be assembled and attached to the buyer's real property and title to the tank and all parts thereof remain in the plaintiff until the contract price is paid; the last payment on the price is to be made when the tank has been completely installed and tested. The tanks are manufactured by plaintiff pursuant to the special order of plaintiff's customers.

119 P.2d at 946.

The California Supreme Court went on to find that:

It cannot be doubted that those materials which were purchased by [CBI] to fabricate tanks specifically to fulfill contracts or orders for tanks in California, were purchased for use, storage, or other consumption in this state.

Id. at 948.

The California Supreme Court went on to hold that the purchases of steel plate and raw materials for tanks installed in California were subject to California use tax.

> We conclude therefore that the materials were purchased for use in California.

Id. at 949.

Because of this case, CBI had no choice but to pay use tax to California on purchases of materials for manufacture into tanks and other items that would be shipped to California for assembly and installation. The Tax Commission seeks to tax these purchases a second time. Such treatment is contrary to Utah Code Ann. § 59-16-4(h); accord Utah Code Ann. § 59-12-104(28).

Further, the decision of the Tax Commission is internally inconsistent with its own position of taxing purchases of personal property made outside Utah where such personal property is shipped to Utah for use, storage or other consumption in Utah. In such cases, the Tax Commission would levy a use tax on such purchases pursuant to Utah Code Ann. § 59-12-103(1)(l) (Supp. 1991) (formerly Utah Code Ann. § 59-16-3(a)). See, e.g., Butler v. State Tax Comm'n of Utah, 13 Utah 2d 1, 367 P.2d 852 (1962); Chemical & Indus. Corp. v. State Tax Comm'n, 11 Utah 2d 406, 360 P.2d 819 (1961).

This approach is also contrary to established federal constitutional law. See Goldberg v. Sweet, 109 S.Ct. 582 (1989);

see also, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977). As established in Complete Auto Transit, to be constitutionally valid, a state excise tax must be fairly apportioned. 430 U.S. at 279. In determining whether a tax is fairly apportioned, the Court will examine whether it is internally consistent. Goldberg v. Sweet, 109 S.Ct. at 588. "To be internally consistent, a tax must be structured so that if every State were to impose an identical tax, no multiple taxation would result." Id. at 589, citing Container Corp. of America v. Franchise Tax Bd., 463 U.S. 159, 169 (1983). "[T]he internal consistency test focuses on the text of the challenged statute and hypothesizes a situation where other states have passed an identical statute." Goldberg v. Sweet, 109 S.Ct. at 589. To be internally consistent, under a state's taxing scheme, only one state may tax each transaction. In this case, the Tax Commission's application of Utah's sales and use tax provisions is internally inconsistent because the Tax Commission will tax both: (1) purchases of steel plate and raw materials outside the State of Utah that become component parts of tanks that are assembled and installed inside the State of Utah, and (2) purchases of steel plate and other raw materials within the State of Utah that become component parts of tanks that are assembled and installed outside the State of Utah.

CBI respectfully submits that the Tax Commission simply cannot have it both ways; that is, tax both purchases of materials for items that are manufactured in Utah and assembled in other states, and items that are manufactured in other states and assembled in Utah.

Finally, CBI believes that it is important to consider that the Utah Legislature apparently recognized the very inconsistency now represented by the Tax Commission's position when in 1989 the Legislature enacted what is now Utah Code Ann. § 59-12-104(33). That section provides an exemption from sales and use taxes for the very purchases at issue in this case. It exempts:

> sales of tangible personal property to persons within this state that is subsequently shipped outside the state and incorporated pursuant to contract into and becomes a part of real property located outside of this state, except to the extent that such other state or political entity imposes a sales, use, or gross receipts, or other similar transaction excise tax thereon against which such other state or political entity allows a credit for taxes imposed by this chapter.

Had the facts presented in this case occurred in 1991 rather than 1983-1985, CBI submits that it is uncontested that the purchases which the Tax Commission seeks to tax would be exempt.

C. CBI SHOULD NOT BE SUBJECT TO PENALTIES ON ANY DEFICIENCIES ULTIMATELY DETERMINED TO BE DUE.

Section 59-1-401(3) of the Utah Code sets forth penalties for underpayment of tax. Those penalties are as follows:

> (a) If any underpayment of tax is due to negligence, the penalty is 10% of the underpayment.
>
> (b) If any underpayment of tax is due to intentional disregard of law or rule, the penalty is 15% of the underpayment.
>
> (c) For intent to evade the tax, the penalty is the greater of $500 per period or 50% of the tax due.
>
> (d) If the underpayment is due to fraud with intent to evade the tax, the penalty is the greater of $500 per period or 100% of the underpayment.

CBI respectfully submits that there are no facts that would support the imposition of penalties against CBI.

The Tax Commission found that the penalties provided in subsections (3)(c) and (3)(d) relating to "intent to evade the tax," and "fraud with intent to evade the tax," were not applicable. (Supplemental Order at page 2.) CBI respectfully submits that where CBI was following established California case law (Chicago Bridge & Iron Co. v. Johnson, 19 Cal.2d 162, 119 P.2d 945 (1941)), and where a statutory basis existed under Utah law for CBI to treat such purchases as exempt purchases (Utah Code Ann. § 59-16-4(g)), there can be no finding of "negligence" or "intentional disregard of law or rule," as are required for

imposing penalties under subsections 59-1-401(3)(a) or 59-1-401(3)(b).

To date, the meanings of "negligence" or "intentional disregard of law or rule," as set forth in subsections (3)(a) and (3)(b) have not been interpreted in Utah. Other states, however, have held that the "negligence" standard in state tax cases should be equated with the federal negligence standard, <u>i.e.</u> "lack of reasonable cause," as set forth in Section 6651(a) of the Internal Revenue Code of 1986, as amended ("Internal Revenue Code"). <u>See</u>, <u>e.g.</u>, <u>Gathings v. Bureau of Revenue</u>, 87 N.M. 334, 533 P.2d 107 (1975); <u>El Centro Villa v. Tax and Rev. Dept. of New Mexico</u>, 108 N.M. 795, 779 P.2d 982 (1989).

Section 6651(a) of the Internal Revenue Code imposes penalties in situations where the taxpayer has failed to file a tax return or to pay tax when due. The section, however, contains a safeguard provision prohibiting the imposition of penalties if "it is shown that such failure is due to reasonable cause and not due to willful neglect." The federal income tax regulations, in turn, test "reasonable cause" by an objective, rather than a subjective standard. That standard is: "Did the taxpayer exercise ordinary business care and prudence?" <u>See</u> Treas. Regs. § 301.6651-1(c)(1); <u>In Re Brown</u>, 743 F.2d 664, 669 (9th Circ. 1984). There is also an immense body of litigation involving taxpayer claims that a failure to file was "due to

reasonable cause and not due to willful neglect." E.g., U.S. v. Boyle, 105 S.Ct. 687 (1985); Walter v. Comm'n of Int. Rev., 753 F.2d 35 (6th Cir. 1985).

Further, in 1988, subsection (8) of Utah Code Ann. § 59-1-401 was amended to read: "Upon making a record of its actions, and upon reasonable cause shown, the Commission may waive, reduce, or compromise any of the penalties or interest imposed under this part." (Emphasis added.) Again, this amendment has not yet been interpreted in Utah. However, the Utah Code does list as a collateral reference a citation to an ALR annotation titled "What Constitutes 'Reasonable Cause' Under State Statutes Imposing Penalty on Tax Payer for Failure to File Timely Tax Return Unless Such Failure was Due to 'Reasonable Cause.'" The few cases collected in this annotation support the general understanding that a showing of "reasonable cause" precludes the imposition of a penalty on the taxpayer for failure to file a timely tax return. E.g., Armstrong's Inc. v. Iowa Dept. of Revenue, 320 N.W.2d 623 (Iowa 1982); Genex/London, Inc. v. Kentucky Bd. of Tax Appeals, 622 S.W.2d 499 (Ky. 1981); Du Mont Ventilation Co. v. Department of Revenue, 425 N.E.2d 606 (Ill. 1981).

The "reasonable cause" protection of IRC § 6651(a) is equally applicable to cases involving deficiency in tax, as well as failure to file. Since negligence is the antithesis of

reasonable behavior, a showing of reasonable cause for the underpayment negates the existence of negligence. See Video Tape Exchange v. Indiana Dept. of State Rev., 533 N.E.2d 1302 (Ind. Tax 1989); Matter of Grayco Land Escrow, Ltd., 559 P.2d 264 (Hawaii 1977).

CBI respectfully submits that if it is found not to be negligent, it cannot be liable for "intentional disregard of law or rule." Where established California case law required CBI to pay use tax to California on purchases of steel plate and raw materials manufactured into tanks, etc. that were assembled and installed in California, and where there was statutory authority in Utah for exempting such purchases from Utah sales tax, CBI's payment of use taxes to California cannot be characterized as "negligent" or "due to intentional disregard of law or rule." Indeed, CBI did the only thing a person exercising "ordinary business care and prudence" would do under such circumstances; it obeyed the direct order of the California Supreme Court, which order was in no way contrary to Utah law. CBI submits that the letter from the Tax Commission, dated February 29, 1984, upon which the Tax Commission justified its assessment of penalties, does not constitute established law or rule. Rather, it simply shows that there was an honest difference of opinion. CBI respectfully submits that there are no facts that would support the imposition of penalties against CBI.

CONCLUSION

CBI respectfully submits that based upon the facts and governing legal authority, the ruling of the Tax Commission should be reversed and CBI be given the following relief:

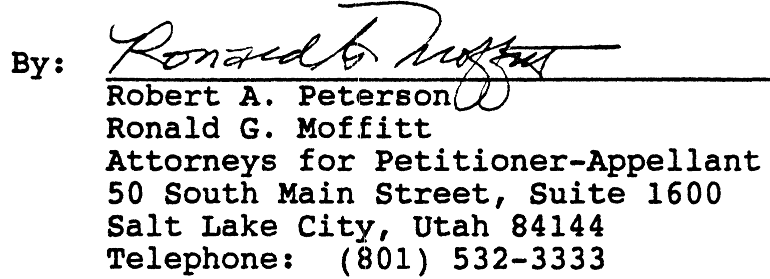
1. The imposition of sales tax by the Tax Commission with respect to the purchase of steel plate and other raw materials that were manufactured into tanks, pressure vessels, and other structures that were then shipped, assembled, and installed outside the State of Utah should be reversed.

2. The case should be remanded to the Utah State Tax Commission with instructions to refund the taxes and penalties, including penalties and interest, previously paid by CBI.

3. If sales tax is determined to be payable on such purchases, the imposition of penalties by the Tax Commission on any sales tax deficiencies should be reversed and the case should be remanded to the Utah State Tax Commission with instructions to refund penalties and interest on penalties previously paid by CBI.

DATED this 16th day of September, 1991.

VAN COTT, BAGLEY, CORNWALL & McCARTHY



By: ______________________________

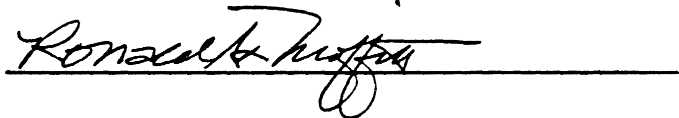
Robert A. Peterson
Ronald G. Moffitt
Attorneys for Petitioner-Appellant
50 South Main Street, Suite 1600
Salt Lake City, Utah 84144
Telephone: (801) 532-3333

CERTIFICATE OF SERVICE

I hereby certify that I caused four true and correct copies of the within and foregoing BRIEF OF APPELLANT to be hand delivered this 16th day of September, 1991, to the following:

Lee Dever, Esq.
Assistant Attorney General
Beneficial Life Tower, Suite 1100
Salt Lake City, Utah 84111

Attorney for Respondent-Appellee



g:\wpc\082\00000134y.w51
09/16/91