2000

Hercules Incorporated v. Utah State Tax Commission : Reply Brief

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

HERCULES INCORPORATED, Petitioner/Appellant, vs. UTAH STATE TAX COMMISSION, Respondent/Appellee.	Court of Appeals No. 2000105-CA Tax Commission No. 98-0707 Priority No. 15

REPLY BRIEF OF PETITIONER/APPELLANT

On Petition for Writ of Review of the Utah State Tax Commission's Final Decision in Appeal No. 98-0707

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ISSUE

Does the term "gas" as used in the statute [Utah Code Ann. § 59-12-103(1)(c)(1994)] mean "gas" as contended by Hercules, or does it mean "natural gas" as contended by the Tax Commission?

ARGUMENT

A. The Tax Commission's Final Decision should be reversed because it is arbitrary

Hercules' initial argument in its opening brief is that the Final Decision's failure to state any reason for its holding is itself sufficient grounds for reversal. See Utah Code Ann. § 63-46b-10(1)(c) (requiring the agency to include a "statement of the reasons" for its decision), and Utah Code Ann. § 63-46b-16(1)(h) (requiring the appellate court to "grant relief" if the agency action is "arbitrary"). Brief of Appellant at 8.

The entire Final Decision is less that two pages long, and the relevant portion of the Decision and Order less than a paragraph. There is no analysis whatsoever. Relying, in part, on *First Nat'l Bank of Boston v. County Bd. of Equalization*, 799 P.2d 1163, (Utah 1990)(reversing the Tax Commission's decision because it was "a creation of fiat" having no evidentiary basis) Hercules' opening brief urged this Court to reverse the Tax Commission for failure to comply with its statutory duty to state the reasons for its Final Decision. Id. at 10.

In response, the Tax Commission merely restates the arbitrary language of the Final Decision. The supposed "statement of the reasons" is, *in its entirety*, that "the position of the Commission [is] that nitrogen gas purchased by [Hercules] for use in its graphite fiber manufacturing process does not constitute a gas within the meaning of the statute [Utah Code Ann. § 59-12-103(1)(c)(1994)] and is, therefore, subject to sales tax." Brief of Appellee at 21. This is a restatement of the Tax Commission's conclusion , and cannot objectively, rationally or honestly be called a "statement of the reasons," which Section 63-46b-10(1)(c) of the Utah Administrative Procedures Act ("UAPA") *requires*.

The Tax Commission's Final Decision explains nothing. Why, for instance, is nitrogen gas not a "gas" within the meaning of Section 59-12-103(1)(c) (1994)? How does the Tax Commission distinguish legislative history confirming that "gas," as used in Section 59-12-103(1)(c)(1994)" or its predecessors, *is not limited to "natural gas*? Is the Tax Commission's Rule R865-19S-35 and its prior decisions, which limit the scope of non-taxable industrial inputs listed in Section 59-12-103(1)(c)(1994) to "fuels," out of harmony with the plain language of the statute which excludes such industrial inputs as "electricity" and "heat" from the tax base even though they are not fuels? Why does the Final Decision never even mention Hercules' arguments, much less rebut them? Is it

because the Tax Commission cannot rebut Hercules' arguments, so, instead, it ignores them and simply issues a Final Decision without "a statement of the reasons" to justify it.

Precisely because the Tax Commission failed to comply with the UAPA in stating the reasons for its Final Decision, Hercules was obliged to guess what the Tax Commission's reasons might be, and address all the arguments the Tax Commission's Auditing Division raised below. The arbitrariness of the Tax Commission's Final Decision is all the more apparent given the Commission's post-hoc rationalizations that comprise the major portion of its brief. The UAPA's *requirement* that an agency advise litigants of the reasons for its action in a final decision is presumably meant to foreclose the agency from issuing arbitrary and biased decisions. If agencies can issue orders without stating the underlying reasons for them, without fear of having such arbitrary orders reversed, the UAPA's requirement of fairness becomes toothless rhetoric. Nor is the UAPA's requirement to include a "statement of the reasons" in an agency order satisfied when a taxpayer learns of the putative reasons for a ruling against it *for the first time in an appellate brief* the Attorney General writes months later.

In attempting to distinguish *First Nat'l Bank of Boston* in its brief, the Tax Commission argues the Final Decision was based "squarely on [stipulated] facts." Brief of Appellee at 21. That is true, but totally irrelevant. Hercules cited *First Nat'l Bank of*

Boston for the proposition that Tax Commission decisions cannot be a "creation of fiat." The parties' stipulation of facts does not excuse the Tax Commission's failure to provide a "statement of the reasons" in its Final Decision. The Tax Commission's Final Decision must be reversed because the Commission's failure to explain the reasons for its order violates the UAPA's requirements of fair dealing with taxpayers.

B. The Tax Commission's Final Decision should be reversed because it disregards applicable rules of statutory construction.

Hercules opening brief argued that the words of Section 59-12-103(1)(c)(1994) should be interpreted according to their plain and ordinary meaning. *Jensen v. Intermountain Health Care, Inc.,* 679 P.2d 903, 906 (Utah 1984)("in matters of statutory construction, the best evidence of the true intent and purpose of the Legislature in enacting an Act is the plain language of the Act.)" By application of this rule, nitrogen gas qualifies as one of the non-taxable inputs in the industrial process under Section 59-12-103(1)(c)(1994) because it is indisputably a "gas." To avoid this sensible application of the "plain language" rule of statutory construction, the Tax Commission offers three excuses.

First, the Commission quotes its own previous decision holding that "gas means natural gas." Brief of Appellee at 10. That prior administrative decision was never reviewed for its correctness. This argument is a meaningless tautology. The argument

proves nothing and compounds the arbitrariness. This is akin to arguing the Tax Commission is correct simply because it says so. Without any "statement of the reasons" for an order, as in this case, an appellate court has nothing upon which to decide whether the Tax Commission's Final Decision is correct or incorrect. Citing a Tax Commission precedent to the Tax Commission may carry some weight before the Tax Commission, but has none before this Court. The standard of review in cases like this, in which the only issues are legal, is that the appellate court "shall grant the commission no deference concerning its conclusions of law, applying a correction of error standard. . ." Utah Code Ann. § 59-1-610(1)(b). Consequently, the Tax Commission's ruling that "nitrogen gas" is not "gas" is neither binding nor relevant to this Court's review. Section 59-1-610(2) instructs Utah appellate courts to "give no deference" to the Tax Commission's conclusions of law.

Second, the Tax Commission invokes the doctrine of *noscitur a sociis* ("known for its associates") and the related rule of *ejusdem generis* ("of the same kind") to conclude that the "plain and ordinary meaning of the word 'gas' is combustible natural gas when considered in relation to the other forms of fuel and energy listed in the statute." Brief of Appellee at 11. This argument not only fails to follow the rules of statutory construction upon which it claims to rely, it is a sleight-of-hand at odds with the Tax Commission's

own administrative rule to the contrary. As noted in Hercules' opening brief, the common feature to the list of non taxable purchases in Section 59-12-103(1)(c)(1994), especially evident in light of the statute's legislative history, is not that each are fuels since two of the commodities (electricity and heat) are indisputably not fuels. R. at 000241, Tr. at 16. Instead, the common feature is that they are industrial inputs into the manufacturing process. This latter reading of the Section 59-12-103(1)(c) (1994) is consistent with the rules of statutory construction the Tax Commission cites, but does not follow; and is inconsistent with the Commission's argument that "the drafters [of Section 59-12-103(1)(c)] were intending that subsection (c) apply to natural gas or gases which were fuels." R. at 000077, Division Memorandum at 8. Obviously, such an argument cannot be correct because non fuels like "electricity" and "heat" would be taxable notwithstanding Section 59-12-103(1)(c)(1994)'s express exclusion of these inputs from the tax base.

Implicitly recognizing these logical inconsistencies, the Tax Commission 's brief for the first time in the course of proceedings to date attempts to justify the Final Decision by arguing that the common feature of the list of non taxable purchases in Section 59-12-103(1)(c)(1994) is that they are fuel or energy inputs. Brief of Appellee at 14. This is another post-hoc rationalization and is completely disingenuous. The Tax Commission's

own Rule R865-19S-35 plainly limits coverage of Section 59-12-102(7) to "fuels used in a combustion process." The Tax Commission's arguments implicitly concede Rule R865-19S-35 is out of harmony with its governing statute. To save what otherwise would be an obvious losing position, the Tax Commission must add language the legislature did not to obtain its desired result. The Tax Commission's appellate brief introduces a new, never before asserted, statutory interpretation of Section 59-12-103(1)(c) (1994), which is that the statute covers energy inputs, not just fuels. To make such a dramatic change now, on appeal, is totally improper. Instead, the Tax Commission would have to promulgate another rule. *See* Utah Administrative Rulemaking Act, Utah Code Ann. § 63-46a-3(3)("Rulemaking is also required when an agency issues a written interpretation of a state or federal legal mandate.") Moreover, in order to apply this new rule in this case, the Commission would have to delete the words "used in the combustion process" as found in the old rule since the parties here stipulated that injection of nitrogen gas is "used in the combustion process." In sum, the Tax Commission's arguments are result-oriented, non sequiturs, advanced to sustain taxation, no matter the inconsistencies.

Third, the Tax Commission manufactures ambiguity in Section 59-12-103(1)(c)(1994), when there is none, then ignores the parties' stipulation to argue that nitrogen gas may not qualify as gas under dictionary definitions. Brief of Appellee at 12.

Citing *V-I Oil Co. v. Dep't of Environmental Quality*, 904 P.2d 214 (Utah Ct. App. 1995), the Tax Commission argues that the word "gas" has multiple meanings, like the meaning of "in use" at issue in *V-I Oil.* By analogy to *V-I Oil*, the Tax Commission argues dictionary definitions of "gas" are unhelpful in deciding what "gas" means in Section 59-12-103(1)(c) and should, therefore, be discarded. Id.

Again, the Tax Commission's arguments are non sequiturs. The issue for this Court to determine is not the meaning of "gas" as used throughout the Utah Code. It is the meaning of "gas" as used in Section 59-12-103(1)(a)(1994). This Court's interpretation of "gas" in Section 59-12-103(1)(a)(1994) necessarily overrides any inconsistency in Rule R865-19S-35 since rules out of harmony with their governing statutes are void. *Sanders Brine Shrimp v. Audit Div., Utah State Tax Comm'n,* 846 P.2d 1304 (Utah 1993).

Hercules' opening brief demonstrated that the Utah Legislature is perfectly capable of using the words "natural gas" when it means "natural gas" and "gas" when it means "gas." In fact, the Utah Code has at least fifty-two references to the words "natural gas." Brief of Appellant at 14. This was true even in 1943 where the identical language at issue in this case first appeared in the Utah Revised Statutes. The 1943 code incorporated

definitions first used in the 1933 Utah Revised Statutes. In turn, the 1933 code expressly made a distinction between "gas" and "natural gas," demonstrating:

(1) the legislature has always been capable of distinguishing "gas" from "natural gas" when it wanted;

(2) "gas" when used in the Section 59-12-103(1)(c) and its predecessor-statutes means "gas," including nitrogen gas, used as an industrial input; and

(3) the Tax Commission has attempted to rewrite Section 59-12-103(1)(c) as if it, rather than the legislature, had written it. Brief of Appellee at 21.

Equally important, the Tax Commission's arguments, which attempt to muddy the issue by offering multiple definitions of "gas," repudiates the parties' stipulation. The parties' stipulation repeatedly uses the word "nitrogen" as an adjective to modify the noun "gas." Having stipulated that nitrogen is a gas, the Tax Commission 's brief argues that any one of five dictionary definitions of "gas" means the word is "too general a term for a dictionary definition to be helpful" in deciding what "gas" means in Section 59-12-103(1)(c)(1994). Brief of Appellee at 13. When dissected logically, this argument is plain silly. The first dictionary definition of the word "gas" as quoted in the Tax Commission's brief ("a *fluid* that has neither independent shape nor volume . . .") excludes "natural gas," which the Tax Commission argues is the one and only meaning of

the word "gas" in Section 59-12-103(1)(c)(1994). That definition cannot, therefore, be correct. The second definition quoted in the Tax Commission's brief ("a gas or gaseous mixture") includes natural gas *but also nitrogen gas*. This definition is not only helpful, it is dispositive because the third definition ("empty talk") excludes both nitrogen gas and natural gas, as does the fourth definition ("gasoline") and the fifth definition (one having "unusual appeal" as someone "skinny-dipping with kindred souls"). Brief of Appellee at 13. Only the first and second definitions can rationally be deemed inputs into the industrial process, and only the second includes natural gas, which everyone agrees is a non taxable input in the manufacturing process.

Therefore, the *only definition* which fits the term "natural gas" also includes "nitrogen gas." The Tax Commission rejects these dictionary definitions of "gas" not because there are "too many to be helpful," but because a logical analysis of them does not give the Tax Commission the result it wants - taxation of an industrial input the legislature said was not taxable. By the Tax Commission's distorted logic, those who are "skinny-dipping with kindred souls" stand on equal footing with Hercules in claming its purchases of nitrogen gas are non taxable under Section 59-12-103(1)(c)(1994).

Hercules' argument (that purchases of nitrogen gas for industrial use are not taxable) is consistent with the underlying policy of sales and use tax law, which is that the

tax is not imposed on certain inputs to production of tangible personal property, but on the last user or final consumer of a product. *B.J. Titan Services v. State Tax Comm'n*, 842 P.2d 822 (Utah 1992), Brief of Appellant at 11. In response, The Tax Commission claims *B.J. Titan* stands for no such proposition, that Utah tax policy is limited to an exemption for ingredient or component parts for which purchases of nitrogen gas does not qualify. Brief of Appellee at 15.

These arguments are easily rebutted. The Utah Supreme Court in *B.J. Titan* states "Manufacturers [like Hercules] are *not deemed consumers of tangible personal property* [upon whom the tax is imposed] which is transformed into final products." Id at 826 (emphasis added). Ingredients or component parts are obvious inputs in manufacturing a product exempt from taxation. Id. "An exception" to the general rule that inputs are not taxed exists "for property and equipment used in the manufacturing process." Id. However, not all property used in the manufacturing process, such as coal or gas, is subject to taxation.

From these examples, it is evident the underlying tax policy, is to avoid taxation of many inputs to manufacturing, such as ingredients or component parts and industrial inputs because (1) those are integrated with the saleable product taxed on retail sale; and/or (2) the final user or consumer is not the manufacturer.

In this case, Hercules *does not claim nitrogen gas is a component part of its saleable product.* It does claim, however, that Section 59-12-103(1)(c)(1994) includes a similar concept which the Utah Supreme Court explained in *B.J. Titan.* The Legislature chose not to tax certain consumables or industrial inputs. Their cost is reflected in the final product sold and taxed when purchased by the end user. The words "other fuels" in Section 59-12-103(1)(c) (1994) cannot possibly be a limitation on all the other industrial inputs listed in that section that are not taxable because some industrial inputs are clearly not fuels. The words "other fuels" must then be a "catch-all" or residual. The concept is that itemized industrial inputs used in the combustion process, like natural gas and nitrogen gas, are not taxable.

C. The Tax Commission's Final Decision should be reversed because it incorrectly ruled that Section 59-12-103(1)(c) is an exemption statute rather than a taxing statute.

In its opening brief, Hercules argued that the Tax Commission's reliance on Decision 94-2080 is misplaced because the decision includes a number of plain errors. The Tax Commission mistakenly believed that the issue before it was whether the taxpayer's purchases of nitrogen were "tax exempt." R. at 000084, Decision 94-2080 at 2 and 3. This is wrong because Section 59-12-103(1)(c)(1994) is not an exemption statute to be interpreted narrowly against the taxpayer; it is a tax imposition statute to be interpreted liberally against the taxing authority so as to avoid the imposition of taxes by

implication. *See, e.g., Hales Sand & Gravel v. Auditing Div. of the Utah State Tax Comm'n*, 842 P.2d 887, 890 (Utah 1992). Brief of Appellant at 17.

The Tax Commission's response to this argument is to claim that it is "unfair." Brief of Appellee at 16. The Tax Commission does not explain why it is unfair. Whether Hercules' argument is or is not "unfair," it is certainly accurate. The Tax Commission itself and not Hercules characterized the issue in Decision 94-2080 as whether the taxpayer's purchases of nitrogen were "tax exempt." R. at 00084, Decision 94-2080 at 2 and 3. Again without thought or analysis, the Auditing Division repeated this mistake, claming that Section 59-12-103(1)(c) (1994) is an "exemption provision." R. at 00078, Division Memorandum at 9. The Tax Commission's mischaracterization of Section 59-12-103(1)(c)(1994) as an "exemption statute" is wrong. Only when caught on this mistake, which has significant adverse consequences to the taxpayer, does the Tax Commission claim Hercules' arguments are "unfair." By this reasoning there can never be appellate review of an agency decision because, by definition, the burden on appellants is to demonstrate the agency decision is in error.

Implicitly conceding that Section 59-12-103(1)(c) (1994) is not an exemption statute, but a taxing statute, the Tax Commission next attempts to prop up its case by claiming that the sale of nitrogen gas can be taxed as tangible personal property. Brief of

Appellee at 17. Once again, the Tax Commission offers no supporting argument for this conclusion. Ignoring Hercules' arguments to the contrary, the Tax Commission merely says it "has been unable to identify any authorities addressing the proper statutory construction of a statute which operates both to impose a tax on the purchase of an item for some uses and exempt the purchase of the same item for other uses." Id. at 17. There are two flaws in this attempted rebuttal.

First, the Tax Commission simply assumes, without analysis or proof, that nitrogen gas is taxable as tangible personal property. This is logically impossible for reasons Hercules explained in its opening brief. In summary, Hercules un-rebutted argument is that Section 59-12-103(1)(c) (1994) cannot be a restatement of the general proposition that purchases of tangible personal property are taxable because "heat," which is taxable only if sold for commercial purposes, is not tangible personal property. If the Legislature had intended its tax on tangible personal property in Section 59-12-103(1)(a) (1994) subsumed transactions in Section 59-12-103(1)(c) (1994) (the Tax Commission's argument), the latter section would have been unnecessary and its enactment superfluous. Brief of Appellant at 24.

Second, the issue in this case cannot possibly be how to construe a statute that is both a tax imposition statute and a tax exemption statute, as the Tax Commission claims.

Brief of Appellee at 17. Prior to 1996, Section 59-12-103(1)(c) (1994) was a tax imposition statute. In 1996, the Legislature chose to replace the term "gas" with "natural gas" in Section 59-12-103(1)(c), and, for the first time, codify an exemption statute for purchases of "natural gas, electricity, heat, coal, fuel oil, or other fuels for industrial use." Utah Code Ann. § 59-12-104(42)(2000). There can never be a simultaneous imposition and exemption statute, as the Tax Commission now asserts, because the exemption statute, being enacted later, would control to the extent of any conflict.

The Tax Commission then launches into a discussion of the legislative history of Section 59-12-103(1)(c), making two points, but otherwise ignoring Hercules' opening brief. The Tax Commission claims that Hercules has misrepresented *Union Pacific Railroad v. State Tax Comm'n*, 426 P.2d 231 (Utah 1967) and *Ogden Union Ry. and Depot* Co. v. *State Tax Comm'n*, 399 P.2d 145 (Utah 1965) by claiming the statutes there at issue had "identical language to Section 59-12-103(1)(c)(1994)." Brief of Appellee at 18. This is a peripheral point, but one easily disproved by quoting the language from these cases. The statute at issue in *Ogden Union Ry.* was Utah Code Ann. § 59-15-4(1953), which provided that "The sale of coal, fuel oil and other fuels shall not be subject to the tax except as hereinafter provided." The Court continued to explain "But the 'except as hereinafter provided' is that the tax specifically applies to: ' . . . *gas,*

electricity, heat, coal, fuel oil or other fuels sold or furnished for domestic or commercial consumption." *Ogden Union*, 399 P.2d at 146. The above-italicized words are identical to the language in the statute at issue in this proceeding. The statute at issue in *Union Pacific* was the same statute. The effect of these prior statutes was to remove certain industrial inputs from the tax base.

Finally the Tax Commission claims that Hercules' recitation of the legislative history of Section 59-12-103(1)(c) (1994) gave it an "expanded definition." Brief of Appellee at 18. Again that is easily disproved by quoting the language itself of predecessor statutes to Section 59-12-103(1)(c) (1994). In 1937, when the Legislature imposed a sales tax on the purchase of "gas, electricity, or heat, furnished for domestic or commercial consumption," it expressly referenced and incorporated the definitions of "gas" under the "public utilities" provision of the 1933 Utah Revised Statutes. In turn, the 1993 Utah Revised Statutes expressly included "natural or manufactured" gas within the definition of "gas" corporation," thus making it clear that "natural gas" was not the only meaning of "gas" to be applied in the sales tax statute. *See* Brief of Appellant at 21.

The Tax Commission's only rebuttal to this argument is to quote Representative John Valentine, who in 1996 (when the statute at issue was changed from a tax imposition statute to an exemption statute) said that "it is an attempt to codify the existing status

quo." Brief of Appellee at 19. That is precisely correct because the then existing status quo (taxation of "gas" inputs except "natural gas") was unlawful and had no basis in law. To remedy that anomaly, the statute was amended so that the purchase of "natural gas" used as an input in the industrial process is exempt from taxation. Section 59-12-103(1)(c) (1994) (the old statute) and Section 59-12-104(42). Since the latter provision is a subsequent enactment it would control purchases of "natural gas" after 1996, but not before.

CONCLUSION

Hercules' purchases of nitrogen gas during the audit period are not taxable because Utah Code Ann. § 59-12-103(1)(c) (1994) excludes purchases of gas used for industrial inputs from the statutorily enumerated list of taxable transactions. The Tax Commission's Final Decision should therefore be reversed.

DATED this 25 day of September, 2000.

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CERTIFICATE OF SERVICE

I hereby certify that on this 25 day of September, 2000, I caused to be mailed, first class, postage prepaid, two true and correct copies of the foregoing REPLY BRIEF OF PETITIONER/APPELLANT, to:

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