

1992

Thorup Brothers Construction, Inc. v. Auditing Division of the Utah State Tax Commission : Reply Brief

Utah Supreme Court

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UTAH SUPREME COURT
DOCUMENT
BRIEF
9
DOCKET NO. 920184

IN THE SUPREME COURT

STATE OF UTAH

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:
THORUP BROTHERS CONSTRUCTION,
INC., :
:
Petitioner and :
Appellant, : Case No. 92-0184
:
-vs- :
:
AUDITING DIVISION OF THE :
UTAH STATE TAX COMMISSION, :
:
Respondent and : Priority 15
Appellee. :
:
--oo0oo--

REPLY BRIEF OF APPELLANT

APPEAL FROM THE ORDER OF THE UTAH STATE TAX COMMISSION
DATED MARCH 10, 1992

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FILED

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UTAH

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STATEMENT OF FACTS

1. The tax in question is sales and use tax and the period in question is July 1, 1986, to June 30, 1989. R. 7.

2. The Catholic Diocese of Salt Lake City is organized as the Roman Catholic Bishop of Salt Lake City, a corporation sole (the "Diocese"). The Diocese owns and operates Judge Memorial Catholic High School ("Judge Memorial"). Judge Memorial is not separately incorporated, but does have a Board of Financial Trustees which oversees the funding and non-academic operation of the school. R. 8.

3. On July 8, 1987, the Diocese entered into a contract with petitioner for the construction of an addition to Judge Memorial, which included an auditorium, music room and locker rooms. R. 8.

4. An engineer who was a member of the Board of Financial trustees, James Maher, volunteered to oversee the project, at times making his own engineering calculations and offering engineering suggestions regarding construction. R. 8.

5. As part of the contractual arrangement, Judge Memorial reserved the right to donate materials to be used in the construction of the facility. R. 8.

6. Addendum No. One to the contract provides, in pertinent part:

General - Cost savings: The Contractor shall assist and coordinate as necessary with the

Owner [Judge Memorial] as a tax-exempt organization, may wish to purchase major items of equipment or materials to gain credit for sales tax. The Contractor [petitioner] shall consider the use of any donated equipment or services if they meet the requirements of the contract documents.

R. 48.

7. Judge Memorial exercised its contract option on the project to furnish materials. R. 8.

8. Judge Memorial secured lists and specifications from the contractor and Judge Memorial then issued its own purchase orders to the vendors for the materials. R. 8-9.

9. Purchase orders totaling \$374,102 were issued by Judge Memorial. R. 8.

10. With regard to materials purchased, the vendor delivered the materials to the construction site, where they were received, inspected, and stored by petitioner or a subcontractor and by Judge Memorial prior to use. The vendor then sent invoices to either the petitioner or subcontractor for approval. Upon approval, the invoices were sent to Judge Memorial and a check was issued directly by Judge Memorial to the supplier. R. 9.

11. Judge Memorial issued checks totaling \$422,226 for materials purchased in this manner. The petitioner credited Judge Memorial with payment of \$447,580, representing the amount actually paid for materials, plus sales tax, which petitioner had included

in its bid for the contract. R. 9.

12. Change orders were not issued reflecting these credits for material purchased. R. 9.

13. Warranties on the purchased materials ran to Judge Memorial. Judge Memorial is responsible for enforcing these warranties. R. 9.

14. Judge Memorial hired E.W. Allen and James S. Bailey, independent structural engineers, to work directly for Judge Memorial to perform structural engineering for the project. Scott, Louie & Browning, Architects, retained the services of The Rhoads Company, Inc., Joe Rhoads and Paul Horton, masonry inspectors, to conduct an ongoing inspection of the masonry work on the project. R. 9.

15. Prime contracts existed between Judge Memorial and Scott, Louie & Browning Architects, and petitioner. Subcontracts were entered into by both prime contractors. R. 10.

16. Judge Memorial obtained insurance to protect against the risk of loss of the materials through Pacific Employers Insurance Company, which named as insured, Judge Memorial and which contained an endorsement which provided:

We will also cover materials, equipment, supplies and temporary structures on your "premises" or in the open (including property inside vehicles) within 100 feet (30.5 meters of your "premises" used for making additions, alterations or repairs to your "real property"

at "covered locations".

R. 10.

17. Surplus materials were retained by Judge Memorial, and have been stored at Judge Memorial for use in repairs and replacements on the building. R. 10

18. Petitioner purchased and paid sales tax on materials used in the construction of the Judge Memorial addition with the exception of those materials purchased directly by Judge Memorial.

R. 10.

SUMMARY OF ARGUMENT

In its opening brief, appellee argues that appellant is the "ultimate consumer" of the property upon which the Utah State Tax Commission (the "Commission") seeks to impose sales and use tax. Appellant contends that Judge Memorial High School, a tax exempt entity, is the ultimate consumer and is, therefore, exempt from sales and use tax on the property. The authority relied upon by appellee is not controlling in this case and is not dispositive of the issues before this court.

ARGUMENT

POINT I

**JUDGE MEMORIAL HIGH SCHOOL, NOT APPELLANT,
IS THE "ULTIMATE CONSUMER" OF THE PERSONAL PROPERTY**

In its brief, appellee argues that the general contractor is the "ultimate consumer" under Utah law because contractors are the last persons or entities to deal with tangible personal property before they are incorporated into a separate entity and before such properties lose their identity as personal property. The facts in this case, however, refute the presumption that appellant is the "ultimate consumer" and, therefore, liable for the tax the Commission seeks to impose.

Appellee argues that the form of the contract between appellant and Judge Memorial is a "lump sum" contract, which imposed upon appellant direct responsibility for ultimate completion of the project, citing Section 3.3.1 (general conditions) of the contract. Appellee's argument completely ignores other portions of the contract which modify appellant's responsibilities under the contract. For example, Judge Memorial reserved the right under the contract to perform the construction itself, using its own labor and to award separate contracts, irrespective of

appellant's approval. R. 190.¹ The contract also reserved to Judge Memorial the right to accept work not in accordance with the contract requirements. R. 198.²

The contract between appellant and Judge Memorial reserved to Judge Memorial the ultimate right to determine the methods, means, and techniques by which the project would be completed and reserved to itself the right to purchase materials to be used in construction of the project. Having retained ultimate responsibility for the project, Judge Memorial directly purchased certain materials which were incorporated into the project.

Judge Memorial was the ultimate consumer of the property. It is undisputed that Judge Memorial issued purchase orders to vendors for all materials and supplies for which sales tax was not paid. It is undisputed that Judge Memorial made direct payment to the vendors. The facts in this case establish that Judge Memorial directly purchased the materials, taking title in its own name (R. 8-9); that Judge Memorial insured those materials after delivery

¹ The Owner [Judge Memorial] reserves the right to perform construction or operations related to the Project with the Owner's own forces and to award separate contracts in connection with other portions of the Project or other construction or operations on the site under Conditions of the Contract identical or substantially similar to these including those portions related to insurance and waiver of subrogation. If the Contractor [appellant] claims that delay or additional cost is involved because of such action by the Owner, the Contractor shall make such Claim as provided elsewhere in the Contract Documents.

² If the Owner [Judge Memorial] prefers to accept Work which is not in accordance with the requirements of the Contract Documents, the Owner may do so instead of requiring its removal and correction, in which case, the Contract Sum will be reduced as appropriate and equitable. Such adjustment shall be effected whether or not final payment has been made.

(R. 10); that the warranties associated with those materials ran to Judge Memorial and not to petitioner (R. 9); and that Judge Memorial and its agents, as well as petitioner, were responsible for receiving, inspecting, approving and storing the materials (R. 38, Answer to Interrogatory No. 7). Those materials were then incorporated into the project, under the supervision of Judge Memorial. Reviewing the circumstances of the transaction, in their entirety, it is clear that Judge Memorial and not the appellant is the ultimate consumer of the property.

POINT II

APPELLANT SHOULD NOT BE CONSIDERED TO BE THE ACTUAL PURCHASER OF THE MATERIALS

Appellee makes the argument that, even though Judge Memorial issued purchase orders for materials, took title in its own name, insured those materials, and inspected and stored the materials on its own property, appellant should be considered the actual purchaser. Underlying appellee's argument is the premise that Judge Memorial should not be allowed to benefit from the exemption from sales tax that is conferred upon charitable and religious organizations by statute.

Section 59-12-104, Utah Code Annotated, provides, in pertinent part, as follows:

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

* * *

(8) sales made to or by religious or charitable institutions in the conduct of their regular religious or charitable functions and activities

Appellant argues that Judge Memorial merely used its tax exempt status to purchase materials for a non-exempt third party and that the purchase of these materials does not fall within the "conduct of their regular religious or charitable functions and activities." Judge Memorial directly purchased materials to be used in the construction of improvements to Judge Memorial High School. Utilization of the buildings at the high school is, indeed, conduct of Judge Memorial's regular functions and activities. Judge Memorial elected to structure its contract with appellant in such a way as to benefit from its tax exempt status. Contrary to appellee's assertion that appellant improperly benefitted from this transaction, it was Judge Memorial which benefitted exactly as the legislature intended that it would benefit when the statute granting the exemption was enacted.

The Commission's decision in this case operates to deny a religious organization the exemption conferred upon it by statute. If the Commission's reasoning is adopted, a contractor which utilizes tangible personal property previously donated to a church to complete improvements to church property would also be liable for a tax on the use of that property. This result is clearly not

the intention of the legislature in granting tax exempt status to religious and charitable organizations.

The decisions relied upon by appellee and the Commission³ were discussed in appellant's opening brief and need not be revisited here in detail. It suffices to say that none of these cases involved a situation where materials were directly purchased by a tax exempt entity for use in construction of improvements to property owned by the tax exempt entity, under a contract reserving to the tax exempt entity ultimate responsibility for the manner in which the improvements were to be completed. Those decisions are simply not controlling in this case.

CONCLUSION

The Commission's decision has effectively changed a sales-use tax into a labor-related taxable incident as a transaction tax, arbitrarily applied to a limited class of contractors. The Commission's administrative rule appears to be designed to reach purchases of exempt entities. If that is the case, the rule is void as in contravention of § 59-12-104. The Commission's decision seeks to impose a use tax on petitioner on the basis that appellant utilized materials purchased directly by a tax exempt entity to

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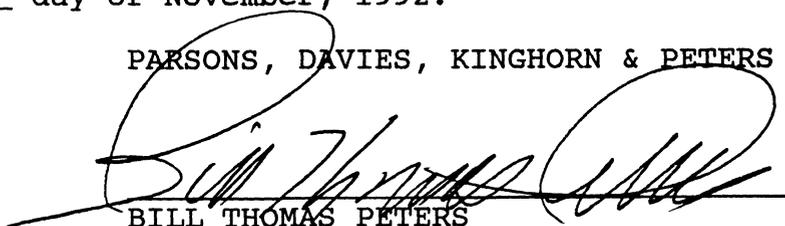
Utah Concrete Products Corp. v. State Tax Comm'n., 101 Utah 513, 125 P.2d 408 (1942); Tummurru Trades, Inc. v. Utah State Tax Comm'n., 802 P.2d 715 (Utah (1990)); Ford J. Iwaits Co. v. Utah State Tax Commission, 106 Utah 343, 148 P.2d 343 (1944); and Olson Construction Company v. State Tax Commission, 12 U.2d 42, 361 P.2d 1112 (1961).

construct improvements on real property also owned by a tax exempt entity. The Commission's decision results in appellant becoming the agent of Judge Memorial, the property owner, to create a taxable incident, but not to maintain the tax-exempt status.

The language of § 59-12-104 is clear and unambiguous. If a tax-exempt owner acquires materials from whatever separate source, the transactions are tax free. Judge Memorial is a tax exempt organization and properly arranged its dealings with petitioner to take advantage of that exemption. The Commission's decision, which negates that exemption, should be reversed and this case remanded with instructions to the Commission to rescind the sales tax assessment against appellant.

DATED this 9th day of November, 1992.

PARSONS, DAVIES, KINGHORN & PETERS

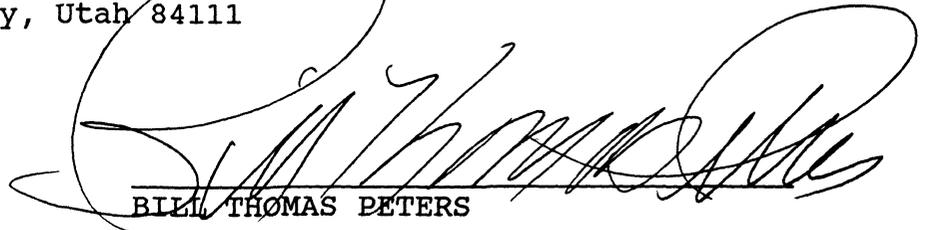
A large, stylized handwritten signature in black ink, appearing to read "Bill Thomas Peters", is written over the printed name below.

BILL THOMAS PETERS
Attorneys for Petitioner

CERTIFICATE OF SERVICE

The undersigned hereby certifies that four true and correct copies of the foregoing Reply Brief of Appellant were mailed, postage prepaid, this 9th day of November, 1992, to the following:

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