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Jerry Sine and Dora Sine v. State Tax Commission of Utah : Brief of Appellants

Utah Supreme Court

Ronald C. Barker; Wesley Sine; Attorneys for Appellants;
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IN THE SUPREME COURT OF THE STATE OF UTAH

JERRY SINE AND DORA SINE,
Appellants,

vs.

STATE TAX COMMISSION OF UTAH,
Respondent.

No. 10012

APPELLANTS' BRIEF

Appeal from findings of the
State Tax Commission pertaining to
Use and Sales Tax Audit.

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STATEMENT OF THE KIND OF CASE

This is an action to reverse certain findings of the State Tax Commission that particular items purchased by Appellants for use in their motel are subject to Sales and/or Use Tax.

DISPOSITION BY TAX COMMISSION

An informal hearing was held, followed by the issuance of an amended audit. Certain facts were then stipulated to by both parties and, based upon said stipulations, a formal decision was handed down affirming the decision reached at the informal hearing. The decision found against the taxpayer, and the Sales and Use Taxes were assessed upon the theory that said items taxed were not exempted under the Sales or Use Tax exemptions.

RELIEF SOUGHT ON APPEAL

Appellant, Jerry and Dora Sine d/b/a Jerry Sine Investments, seeks an order vacating the decision of the State Tax Commission which found that the items, as set forth, are subject to a sales and/or use tax levy; and an order to the Tax Commission to cease future assessments of sales and/or use tax upon the Appellant for the property as set forth under the Statement of Facts.

STATEMENT OF FACTS

This Lawsuit is concerned with a Sales and Use Tax audit made upon the Appellants Jerry and Dora Sine, d/b/a Jerry Sine Investments, by the State Tax Commission of Utah. Jerry Sine Investments operates several Motor Hotels in Salt Lake City. These Motor Hotels rent rooms on a daily basis for a cash consideration to parties wishing to so rent.

In order to rent these rooms, certain items must be furnished to the customer. Among these items are freshly cleaned linens, towels, wash rags, plastic mattress covers (A-15), sanitary glassine bags for glasses (A-17), soap (A-14), sanitary toilet bands, postcards (A-16), and stationery (A-18). Due to the constant use by the customer and the cleaning necessary to meet Board of Health Regulations, the following items have the stated life expectancies: (a) Towels, 1 year; (b) Linens, 1 year; (c) Blankets, 3 years; (d) Wash rags, 3 months.

The soap, sanitary glassine bags for glasses, sanitary toilet bands, postcards, and stationery are consumed daily by each guest in occupying his rented room.

A considerable number of publications were also received by the Appellants upon which a Use Tax was charged by the Commission. The publications consist of the following: *Hotel Monthly* (A-12), *Institutional Magazine* (A-1), *Baxter Economic Research* (A-4), *Consumer Research* (A-6), *Kiplinger Washington Letter* (A-5), *Tourist Court Journal* (A-2), *World Review of Hotels* (A-3), *American Hotel Journal* (A-7), *Guide Posts* (A-8), *Journal of Accounting* (A-9), *Sunset Magazine* (A-10), and *Hospitality* (Patterson Publishing Co.) (A-11).

The above mentioned audit pertains to the years January 1st, 1958 thru December 31st, 1961. The original deficiency as determined by the Tax Audit was as follows: Sales Tax deficiency in the amount of $12.85, together with penalties in the amount of $2.50, interest in the amount of $4.40, and a use tax deficiency of $319.30 with penalties of $31.93, and interest in the amount of $66.26. Subsequent to the audit, a petition for an informal hearing was filed by the Appellants on or about December 3rd, 1962, and as a direct result of said hearing, that portion of the deficiency representing use tax liability on sales by the Admiral Sales Corp. to Appellants was deleted and was no longer contested by the Tax Commission. Also as a direct result of that hearing, that portion of the use tax deficiency represented by the purchase of the Wall Street Journal was deleted and is no longer contested by the tax commission.

An amended audit report bearing the date of January 3rd, 1963, was thereafter issued indicating a total sales tax deficiency in the amount of $12.85, together with penalties

in the amount of $2.50 and interest in the amount of $5.52. This report also indicated a use tax deficiency in the amount of $288.18 with penalties in the amount of $28.11 and interest in the amount of $86.54 for a total sales and use tax deficiency of $416.70 including interest to January 3rd, 1963.

Subsequently a formal decision was handed down on or about the 24th day of September, 1963, by which the Commission sustained the audit report of January 3rd, 1963.

ARGUMENT

POINT I

APPELLANTS ARE EXEMPT FROM PAYING A USE TAX ON LINENS, TOWELS, MATTRESS COVERS, BLANKETS AND WASH RAGS, SOAP, POST CARDS, SANITARY GLASSINE BAGS FOR GLASSES, SANITARY TOILET BANDS, AND STATIONERY UNDER SECTION 59-16-4 U.C.A.

Under section 59-16-4 U.C.A., certain items are exempted from the Use Tax. Section (g) of this act exempts the following:

> "*Property purchased for resale* in this state, either in its original form or as an ingredient of a manufactured or compounded product, in the regular course of business and for the purposes of this act, poultry, dairy and other livestock feed, and the components thereof, and all seeds or seedlings are deemed to become component parts of the eggs, milk, meat and other livestock products, plants and plant products, produced for resale; and each purchase of such feed or seed shall be exempt from taxation under this act."

In the particular instance of this case, the linens, towels, mattress covers, blankets and wash rags are purchased in a sense for resale. The rental of items has been found in many instances to be a sale. (*Philadelphia Ass'n of Linen Suppliers et al. v. City of Philadelphia et al.*, 12A(2d)789 where leasing of linens was interpreted as a retail sale since the property passed for a short period of time out of the control of the landlord and into the control of the tenant.)

As a part of the charge for the use of Appellants' facilities, a charge is made for the use of blankets, linens, towels, mattress covers, and wash rags used, and a measurable part of each of these items is consumed by that use. This is evidenced by the fact that after being used for certain lengths of time these items wear out and must be replaced. If the charge made for the use of items consumed were paid separately, the purchase of those items by Appellants would clearly be exempt as a purchase for resale and exempt. One might look at the above mentioned sale as a sale only of the blanket and other items, or it may be looked upon as each of the above items being the direct ingredient of the compounded product in the regular course of business. The compounded product may be looked upon as the service of renting rooms — the above items being the direct ingredients of the compounded product. The legislature in the above act went so far as to include seeds or seedlings as component parts of the eggs and others. This statute was to be broadly interpreted as evidenced by the legislature who in the same breath by which the statute was created, interpreted that statute sufficiently broad to include the seeds as component parts of the egg.

As further evidence of legislative intent in using the word *compound,* one might look at section 59-15-2 as amended where the word *compound* is used in connection with selling a service:

> "... Each purchase of service ... by a person engaged in compounding and selling a service ... and actually used in compounding such taxable service shall be deemed a wholesale sale and shall be exempt from taxation under this act."

Since this statute deals with a service, it is not directly in point to our question of law, but it does show with what broad intent the legislature used the word *compound,* and that our interpretation of this word does not strain the legislative intent.

Certainly it may be said that the rental of rooms is a sale subject to the sales tax. The exemptions to the sales tax and use tax laws were meant to stop a double taxation. In other words so that an item which is subject to the sales tax would not subsequently be subject to the use tax. In this instance the rental of rooms is admittedly subject to the sales tax, and since the items in controversy are intrical parts of the sale, they should not also be subject to the Use Tax. Under Heading 6 of *Union Portland Cement Co. vs. State Tax Commission,* 170 P(2nd) 164, the law in Utah is stated as follows:

> "The intent of Legislature in passing provision of Use Tax exempting, from use tax, property the gross receipts from sale, distribution, or use of which are now subject to a sales or excise tax under laws of state or some other state, was to prevent duplication of taxes and discrimination against property which was already subject to a comparable tax."

In this same area, *Butler vs. State Tax Commission,* 367 P (2nd) 852, also states that if a transaction is subject to sales tax, it is not subject to use tax. We have before us a case where the sale of the compounded product is subject to the sales tax and where this is so, to subject the component parts to a use tax would be a double taxation which has been clearly forbidden both by legislative dictate and judicial interpretation.

POINT II

LINENS, TOWELS, MATTRESS COVERS, BLANKETS, WASH RAGS, POST CARDS, SANITARY GLASSINE BAGS, ETC., COME WITHIN THE PURVIEW OF SECTION 59-16-4(h), AND ARE THEREFORE EXEMPTED FROM THE USE TAX.

Section 59-16-4 (h) exempts the following:

> "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, or the container, label or shipping case thereof."

Under a fairly recent interpretation of this statute by the Utah Supreme Court in 170 (2nd) 164, *Union Portland Cement Co. vs. State Tax Commission,* a test was promulgated — it seems the test is a question of who consumes the property, the manufacturer (compounder) or the ultimate user. This is exemplified by heading Number 9 in this case:

> "Provisions of use tax act, exempting property which enters into and becomes an ingredient or component part of property which a person is engaged in busi-

> ness of manufacturing, exempts, from the use tax, property which enters into and becomes an ingredient or component part of property which a person is engaged in business of manufacturing, exempts, from the use tax, property which enters into and becomes an ingredient or component part of the property manufactured, which is thus passed on to an ultimate user, but it does not exempt property which is consumed by the manufacturer as last user."

In the Portland Cement case, the ingredients in controversy were iron balls which were used to grind the cement ingredients. While it was true that certain particles of the iron balls ended up in the cement, the court found that the iron was not an essential part of the cement — its main task being the grinding of ingredients for the cement, and therefore the manufacturer was the last user.

In the present case the product manufactured or compounded is a room for rent. This room is made up directly of several items — some of which are totally used and some of which are partially used by each renter. Those partially used by each renter are linens, towels, mattress covers, blankets, and wash rags. These items are consumed by the individuals who rent the rooms — not by the landlord. As each of the above items are used, their life expectancy is shortened. Why is the life expectancy shortened? — because it has been used or consumed to a degree by the tenant. Each of the above items is an essential part of that product which is a room rental. One could not rent the room without furnishing the above items.

The test in *Union Portland Cement Co. vs. State Tax*

Commission for determining who should pay the tax is a reiteration of a prior determination found in *E. C. Olsen vs. Tax Commission Utah,* 168 P (2nd) 324. The court in the *Union Portland Cement Co. vs. State Tax Commission* quoted as follows from the *E. C. Olsen* decision:

> " 'The test is: Are the articles involved consumed by the processor as the last user? If they are so consumed, the (sales) tax must be paid thereon by the processor. On the other hand, if the articles enter into and become an ingredient or component part of what he manufactures, labels, or shipping cases of what he manufactures, the processor does not pay the tax.' "

The court in *Union Portland Cement* went on to say "Our interpretation of subsection (h) of 80-16-4 (59-16-4) is the same as we interpreted subsection (f) of section 2 of the Sales Tax Act in the cases cited above." (Alluding to *E. C. Olsen Co. vs. Tax Commission, Utah*) "The subsection exempts from the use tax property which enters into and becomes an ingredient or component part of the property manufactured, which is consumed by the manufacturer as last user." (170 P (2nd) 171)

The other items used in the rental of the room by the tenant are: soap, glassine bags, sanitary toilet bands, stationery and post cards. These items are consumed in totum by the tenant and are not consumed by a number of consecutive tenants. The same principles as stated above continue to apply in this situation. The test seems to be who consumed the property — the compounder or the purchaser of the product. In this instance the compounder should be seen as the landlord and the purchaser as the tenant. Here, clearly, the tenant consumes the product. The wrapper for the glasses is thrown away after its

removal from the sanitized glass, so is the sanitary toilet band; the soap cannot be reused after the tenant has once used it, due to Board of Health Regulations, and the stationery and post cards are mailed away from the landlord's possession by the tenant, never to be seen again. Therefore, these items are clearly consumed by the tenant and not by the landlord as the last user.

In a recent case determined by the Utah Supreme Court, *Nickerson Pump and Machinery Co. vs. State Tax Commission of Utah* (361 P (2nd) 521) (12 Ut (2nd) 30), the test of the ultimate consumer was again reaffirmed in determining to whom the above exemption is to be applied.

POINT III

THE PUBLICATIONS IN CONTROVERSY FALL WITHIN THE DEFINITION OF NEWSPAPERS AS FOUND IN SECTION 59-15-4 (b) (1) AND UNDER SAID SECTION ARE EXEMPT FROM THE USE TAX.

The legislature felt that for convenience of enforcement, newspapers should be exempt from the Sales and Use Tax Laws. This is demonstrated by section 59-15-4 under the title EXCISE TAX-RATE where it states as follows: "... Provide, that said tax, shall not apply to intrastate movements of freight and express or to street railway fares or to the sale of newspapers and newspaper subscriptions." The question next becomes *what is a newspaper?* The American College Dictionary (Random House, N.Y.) defines a newspaper as a "printed publication issued at regular intervals, usually daily or weekly, and commonly containing news, comment, features and advertisement."

In 39 Am Jur section 2 found on page 3, a newspaper is defined as being of so many varieties as to difficult to give anything but a general definition. "... a newspaper is a publication appearing at regular or almost regular, intervals at short periods of time, as daily or weekly, usually in sheet form, and containing news, that is reports of happenings of recent occurrence of a varied character, such as political, social, moral, religious, and other subjects of a similar nature, local or foreign, for the information of the general reader." "Thus, if a publication gives the general current news of the day, it comes within the definition of a newspaper, although it may be devoted primarily to special interests, such as financial, moral, social, and the like."

Clearly the publications, in controversy, come within the above definitions. They are in sheet form, have advertising, reports of current events, event though these are mostly of a special interest variety.

The legislature, when they promulgated this law, by either definition meant to include the publications which are now before the court in the exemption mentioned above. As to why, one may only speculate, but possibly it was due to the difficulty of enforcing such a law where newspapers are not exempt. The burden of going to practically every citizen of the state of Utah would be an unconsciencable task — extremely difficult, if not impossible. Since most publications such as are before the court came from without the state, the above task would be necessary. Therefore seeing the impossibility, the Legislature exempted the publications.

CONCLUSION

Appellants are entitled to a decree nullifying the State Tax Commission's deficiency assessment as to the Use Tax since there is no question that the items in controversy are exempted under the various statutes as expounded under Points I and II. The above mentioned items are clearly consumed or used by the individual renting the room and not by the Landlord, and they therefore are exempt under this courts test of who is the user. The publications as outlined are clearly within the exemption as stated above and, therefore, should not have a use tax deficiency against them.

The formal decision of the State Tax Commission should be reversed with instructions that these types of items are exempt from the use tax when used as in this case and in the future should not be assessed.

Respectfully submitted,

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