

1995

Vermox of Florida v. Auditing Division of the Utah State Tax Commission : Reply Brief

Utah Court of Appeals

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IN THE UTAH COURT OF APPEALS

VERMAX OF FLORIDA, INC.)	
)	REPLY BRIEF OF PETITIONER
Petitioner,)	VERMAX OF FLORIDA, INC.
)	
v.)	
)	
AUDITING DIVISION OF THE)	Account No. D46403 - Sales Tax
UTAH STATE TAX COMMISSION,)	
)	Docket No. 950125-CA
Respondent.)	Priority No. 14

UPON A WRIT OF REVIEW TO THE UTAH STATE TAX COMMISSION

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INTRODUCTION

Petitioner Vermax of Florida, Inc. ("Vermax of Florida"), pursuant to Rule 24(c) of the Utah Rules of Appellate Procedure, respectfully submits its Reply Brief in response to the Brief of Respondent Utah State Tax Commission ("Tax Commission"). Now that the Tax Commission has identified the allegedly taxable transactions as in-state sales of component parts that Vermax of Florida incorporates into products for resale, this Court should reverse and remand the Tax Commission's determination that Vermax of Florida is liable for those taxes. Such sales are exempt, and the Tax Commission's effort to tax those component sales by claiming that Vermax of Florida owned those components at the time they were ultimately made a part of real property outside of this State is neither based on fact nor supported by the record.

STATEMENT OF THE CASE

Because the Tax Commission incorrectly characterized certain portions of the record, Vermax of Florida must reply here by setting forth those portions of the record that have been misinterpreted. The most apparent misinterpretation is evident where the Tax Commission states that Vermax of Florida "argued" that its "'furnish and install'" contracts were statutorily exempt. (Tax Commission Brief, at 5). In fact, Vermax of Florida did not and does not enter into "furnish and install" contracts and accordingly never made such an argument. Such a characterization is a legal conclusion ultimately to be determined by this Court. Instead, Vermax of Florida entered into sales contracts

by which it sold its products to out-of-state purchasers. In certain infrequent instances at issue here, Vermax of Florida was also asked to provide a bid for the installation of the products already sold or to be sold to the out-of-state customer. At the time that those products were installed by Vermax of Florida's local subcontractors, they were not owned by Vermax of Florida. The sale was complete, and those products could have been installed by entities based in Nova Scotia or Tierra del Fuego, all without tax consequences to Vermax of Florida. The separate sale and installation of the products at issue are factually and legally distinguishable from "furnish and install" contracts, by which a seller agrees in one contract to sell and install a product, with title to pass only after the installation is completed. That did not occur here, and thus this Court should reverse and remand.

STATEMENT OF FACTS

Vermax of Florida incorporates its Statement of Facts set forth in its Brief and responds to the Tax Commission's Statement of Facts as follows.

Section A of Tax Commission's Statement of Facts

The Tax Commission asserts that "[i]n 1986, Vermax was previously assessed for failure to collect tax on 'furnish and install' contracts." (Tax Commission Brief, at 6). This statement is inaccurate in two respects. First, as set forth in Vermax of Florida's Brief (the "Brief"), the entity assessed in 1986 was Vermax Corporation, a Utah corporation that was completely separate and distinct from Vermax of Florida, a Florida

corporation that merely purchased certain assets from Vermax Corporation. Pursuant to a Stipulation to Amend Record, this Court should note that the subject of the previous audit, Vermax Corporation, changed its name on August 31, 1987 to G. Hawke Manufacturing Co., Inc., which continued in existence until it was involuntarily dissolved on May 1, 1992. It is also a fact that Vermax of Florida, Inc., the Petitioner here, is a Florida corporation that, prior to 1987, was called Trespo, Inc. As will be described in greater detail below, the distinction between the two entities is far more significant than a mere difference in name. By failing to acknowledge that a distinct corporation with different owners was assessed in 1986, the Tax Commission's Statement of Facts gives the incorrect impression that Vermax of Florida has blatantly ignored prior tax decisions and treatments directed at it. There were none.

Second, the statement once again erroneously characterizes the transactions at issue as "furnish and install" contracts. That error is repeated throughout the Statement of Facts and throughout the argument portion of the Tax Commission's Brief. As explained at pages 23-25 of Vermax of Florida's Brief, that erroneous characterization also contradicts the express stipulation of the parties, which fact stipulations the Tax Commission ignored or overlooked when it rendered its decision. (R.0021-23, attached to the Brief as A.8).

Section B of Tax Commission's Statement of Facts

With respect to the installation of products purchased by out-of-state customers, the Tax Commission labeled installation "a component part of the agreement," citing page 44 of the Formal Hearing Transcript. (Tax Commission Brief, at 9). Page 44 of that transcript does not contain such testimony, nor does any other portion of the transcript. There was more than one agreement. Installation was a component part of the installation agreements entered into by Vermax of Florida, which agreements contemplate only the installation of goods, the title to which had already passed to out-of-state purchasers. (See A.8 of Brief). With or without installation, Vermax sold its products to out-of-state purchasers, and the only "component" of those agreements was the sale in interstate commerce. Installation was a separate matter, covered by a separate agreement that could have been cancelled, terminated, breached, or otherwise avoided with no effect whatsoever on the separate sale agreement.

Section C of Tax Commission's Statement of Facts

The numerous problems with the Tax Commission's recitation of the history underlying the negligence penalty are set forth in the Argument section of this Reply Brief.

Section D of Tax Commission's Statement of Facts

The Tax Commission repeats its incorrect description of the separate and legally distinct purchase and installation agreements as "components" instead of two separate and distinct contracts, as indicated in the stipulation filed with the Tax Commission. (See A.8 of Brief; R. 0021-23).

SUMMARY OF VERMAX OF FLORIDA'S TRANSACTIONS

The following table, Figure 1, demonstrates that Vermax of Florida sells its products in one of two ways: in-state and out-of-state. The first type of sale involves wholesale, in-state purchases of components which are tax exempt, because the components go into products manufactured for resale, followed by sales of the final product that take place in Utah. A sales tax is applied to those retail sales of final products here in Utah, and those sales are not at issue here. The second type of sale involves the same tax exempt, in-state purchases of components, followed by final product sales that take place in interstate commerce, and are thus exempt from sales tax. The Tax Commission has invented a third type of transaction from the out-of-state sales, one in which Vermax of Florida has also agreed, via separate bid and contract, to be responsible for the installation of the products it has already sold to out-of-state customers. The mere fact that Vermax of Florida, as opposed to anyone else, is responsible for installing the products that are already owned by the out-of-state customer does not translate into a tax liability that relates all the way back to the in-state

made its Findings. Because Vermax of Florida sold and sells its products to out-of-state customers without any requirement or other condition tying those sales to a subsequent installation contract, this Court should treat those transactions accordingly, and not penalize Vermax of Florida with component sales taxes merely because it helps its customers install products that it no longer owns.

I. BECAUSE VERMAX OF FLORIDA DOES NOT OWN THE PRODUCTS IT HAS SOLD TO OUT-OF-STATE CUSTOMERS AT THE TIME THEY ARE INSTALLED INTO REAL PROPERTY, IT HAS NO SALES TAX LIABILITY.

In all of Vermax of Florida's sales to out-of-state customers, the out-of-state purchaser takes title to the products at the time of delivery in the other state. Regardless of what happens after that point, Vermax of Florida no longer owns, controls, or is responsible for that personal property. Even where Vermax of Florida arranges installation, and even if this Court concludes that Vermax of Florida is the installer, the fact remains that Vermax of Florida does not arrange or effect the installation of any products that it still owns.

Because Vermax of Florida does not own the property when it is installed, Vermax of Florida is in the identical position to that of the contractor in Thorup Brothers Construction v. Auditing Division, 860 P.2d 324 (Utah 1993). The Utah Supreme Court in Thorup articulated the rule that if a contractor does not own the personal property it is converting into real property, there is no sales tax consequence to the installer or to the

manufacturer/seller of the products (provided the purchaser is a tax exempt entity). Id. at 328-39. The Thorup contractor was not liable for tax on items installed into real property because it, like Vermax of Florida, did not own the property it installed and thus could not be the ultimate consumer of tangible personal property converted into real property. Id. Because of the interstate nature of the sales at issue here, Vermax's out-of-state customers are tax exempt entities, just as the Thorup contractor's school was a tax exempt entity. Thus, this Court should reverse and remand.

As the facts of this case are analogous to Thorup, they are unlike the facts in Tummurru Trades v. Utah State Tax Commission, 802 P.2d 715 (Utah 1990), relied upon by the Tax Commission. In Tummurru, the company bought raw materials, manufactured its products in one arm of the company, and sold the products to another arm of the company that installed the products. The taxable event in Tummurru was the intra-state sale of those final products between arms of the company before they were shipped out of state for installation. And at all times, Tummurru owned the products right up to the point they became fixtures in real property. As such Tummurru was responsible for converting personal property it owned into real property. Tummurru is not concerned with the purchase of raw materials (the allegedly taxable event here), but with an in-state sale of final products occurring between two arms of the same company. Simply stated, Tummurru does not speak to tax liability on the initial purchase of raw

materials, and the fact that it involves an intermediate sale to itself and a subsequent installation of property it owns makes it inapposite to this case.

Here, in contrast to Tummurru, Vermax of Florida bought the raw materials, manufactured the products from those materials for resale, and sold the products in the form of tangible personal property to third parties -- the out-of-state purchasers. There was no intra-state transaction, except for the purchase of raw materials that the Tax Commission is trying to tax here. But raw material purchases like those here are exempt as wholesale transactions under Utah Code Ann. § 59-12-103(1)(a) (1994) and Utah Admin. Code Rule R865-19-29S. Vermax of Florida lost ownership of the manufactured products at the point of delivery across state lines, and its subsequent involvement, if any, was solely to arrange for the installation of property it did not own. Thus, Vermax of Florida is no different from the contractor in Thorup who was not liable for sales taxes on property it installed, but did not own.

The Tax Commission thus has not demonstrated any legal basis for imposing taxes on Vermax of Florida's purchases of raw materials, the only transactions for which it is seeking taxes. (Tax Commission Brief, at 9, 14). Applying the nondeferential correction of error standard that applies to this issue of law, Utah Code Ann. § 59-1-610(b) (1994), this Court should reverse the Tax Commission's assessment of additional sales tax.

II. THE TAX COMMISSION IMPROPERLY DENIED VERMAX OF FLORIDA'S REQUEST FOR ABATEMENT OF THE TEN PERCENT NEGLIGENCE PENALTY.

A. Vermax of Florida Is A Separate And Distinct Entity With Different Owners From The Entity That Was Subject To Prior Audits.

In its brief, the Tax Commission persistently mistakes Vermax of Florida for Vermax Corporation. As a result of that misapprehension, the Tax Commission continues to insist that the 10% negligence penalty was warranted.

The Tax Commission accuses Vermax of Florida of "reinventing itself," yet ignores the fact that the only evidence in the record demonstrates that Vermax of Florida is a different entity from the subject of the prior audit. In addition to those facts added to the Record by stipulation, Mr. Lindsay, a Vermax of Florida employee, testified at the hearing as follows:

Q: Okay. Has the Vermax Corporation always been owned by the same people or entities?

A: No.

Q: When, if ever, did that change, if you know?

A: The latest change is August, 1987.

Q: And what happened in August of '87?

A: That's when Vermax was purchased from Jerry Hawk and/or whoever was -- they may not have been an individual himself; he and his family then incorporated into Vermax of Florida.

Q: Okay. Before the Florida corporation bought it, to your knowledge, was it a Utah corporation?

A: To my knowledge, yes.

(Formal Hearing Transcript, Page 16, Lines 9-21). Mr. Lindsay later testified that Jerry Hawk left Vermax shortly after the 1987 change in ownership. (Id., Page 40, Lines 11-20).

The documents supporting the current audit clearly indicate that the taxpayer is "Vermax of Florida, Inc., a Florida corporation doing business in Utah," rather than the Vermax Corporation (a Utah corporation) that was the subject of prior audits. (See, e.g., R. 0030, 0043). Once the unique and independent status of Vermax of Florida was shown at the hearing, the burden shifted to the Tax Commission to establish reasons, e.g. notice or actual knowledge, why one corporation should be penalized for the negligence of a corporation from which it merely purchased assets. There is no evidence, and there was no finding, that Vermax of Florida knew about the Tax Commission's prior treatments of Vermax Corporation.

The Tax Commission improperly assumes that Mr. Lindsay had knowledge of the prior audit and then erroneously imputes that knowledge to the corporation. That

reasoning is flawed for several reasons. First, there is no evidence that Mr. Lindsay had any knowledge of the prior audit. In fact, Mr. Lindsay's job responsibilities did not include the collection of taxes; instead, he worked in manufacturing, setting up a contracting division, and sales management. (Formal Hearing Transcript, Page 16, Lines 3-8). His current position is director of installation. (Id., Page 16, Lines 22-23). Nothing in the record indicates that Mr. Lindsay would have had reason or opportunity to learn of the prior audit. If he had no such knowledge, there is simply no record knowledge to impute to Vermax of Florida.

Second, the Tax Commission erroneously asserts that "no changes in personnel are in evidence." In so arguing, the Tax Commission misunderstands its burden. Once the separate corporate existence is established, it is not Vermax of Florida's burden to prove a negative, i.e., no continuity of persons with knowledge. Rather, it is the Tax Commission's burden to prove that a Vermax Corporation employee with knowledge of the prior audit continued in a position of responsibility with Vermax of Florida. See Johnson v. Bell, 666 P.2d 308, 310 (Utah 1983) (imposing on party claiming interest in property burden of proving actual notice on part of trustee under a deed of trust of predecessor's interest in land).

Mr. Lindsay testified that Gerry Hawk, the owner of Vermax Corporation, left the company shortly after the ownership changed. (Formal Transcript Hearing, Page 40, Lines 11-20). No carryovers in personnel are in evidence, other than Mr. Lindsay, who

had no knowledge of the prior audit. There is no evidence, let alone substantial evidence in the record, to support the Tax Commission's mistaken premise that Vermax Corporation personnel with knowledge of the prior audits continued to be employed by Vermax of Florida. Consequently, the conclusion the Tax Commission draws from that premise is incorrect, and there is no reason why Vermax of Florida should be "deemed" to have notice of the prior audit of a separate corporate entity. Nor has the Tax Commission demonstrated any actual notice or knowledge on the part of Vermax of Florida.

The Tax Commission has thus failed to put forth any evidence showing that Vermax of Florida "clearly had knowledge of the rules" at issue here. Vermax of Florida, on the other hand, has demonstrated (1) a change in ownership as the result of a purchase of assets in 1987, (2) the departure of the prior owner, Gerry Hawk, from the employment of Vermax of Florida shortly after the change in ownership, and (3) the existence of a separate corporate entity, Vermax of Florida, doing business in Utah. On these facts, no evidence exists to support the Tax Commission's assessment of a negligence penalty. Even if this Court found some evidence to support the penalty, any such evidence does not rise to the level of substantial evidence to support the finding. Utah Code Ann. § 59-1-610(1)(a) (1994).

B. Even If This Court Affirms The Assessment Against Vermax of Florida, A Negligence Penalty Is Inappropriate Under The Prevailing Legal Standard.

Under the prevailing standard, a negligence penalty:

is appropriate when the taxpayer has failed to pay taxes and a reasonable investigation into the applicable rules and statutes would have revealed that the taxes were due [T]he taxpayer can escape the penalty if he or she can show that he or she based the nonpayment of taxes on a legitimate, good faith interpretation of an arguable point of law.

Hales Sand & Gravel v. Audit Div., 842 P.2d 887, 895 (Utah 1992). As set forth above, Vermax of Florida was not liable for sales taxes in any event. And, if it is liable, it was not negligent because it based its nonpayment on a good faith construction of the sales tax law, which acknowledges that "[w]hether a taxpayer is a real property contractor for sales tax purposes usually is fact sensitive." Chicago Bridge & Iron Co. v. Tax Comm'n, 839 P.2d 303, 309 (Utah 1992).

If Vermax of Florida is a real property contractor, if it owned the products it was installing as a real property contractor, and if its interpretation of the relevant rules and statutes is proven incorrect on appeal, the fact of its error does not require imposition of a penalty. Id. (construing penalty imposed for intentional disregard of rule¹ and noting that taxpayer's arguments as to liability demonstrated good faith dispute, although position was ultimately deemed wrong); accord Hales, 842 P.2d at 895 (reversing negligence

¹A penalty assessed due to intentional underpayment implicates the same standard as a negligence penalty. See Hales Sand & Gravel v. Audit Div., 842 P.2d 887, 895 (Utah 1992).

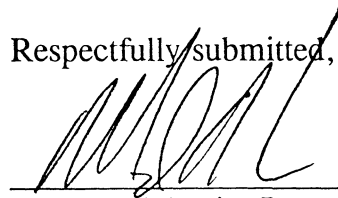
penalty because of good faith argument based on understandable confusion, despite ultimately rejecting petitioner's arguments and affirming Tax Commission on the merits). Thus, this Court should reverse the Tax Commission's imposition of a penalty, even if this Court ultimately concludes Vermax of Florida's in-state component purchases were taxable.

CONCLUSION

For the foregoing reasons, Vermax of Florida respectfully requests that this Court reverse the Commission's assessment of additional sales tax and negligence penalty, and remand for findings not inconsistent therewith.

DATED this 25th day of May, 1995.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I hereby certify that I caused to be mailed, postage prepaid, two true and accurate copies of the foregoing **REPLY BRIEF OF PETITIONER VERMAX OF FLORIDA, INC.** on this the 25th day of May, 1995, to each of the following:

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