IN THE FOURTH JUDICIAL DISTRICT COURT
IN AND FOR UTAH COUNTY, STATE OF UTAH

SOUTH UTAH VALLEY ELECTRIC SERVICE DISTRICT F/K/A/ STRAWBERRY ELECTRIC SERVICE DISTRICT, Plaintiff, v. UTAH STATE TAX COMMISSION, Defendant.	FINDINGS OF FACT AND CONCLUSIONS OF LAW Civil No. 030403263 Judge SAMUEL D. MCVEY

This case came before the Court, sitting as a division of the State Tax Court, for de novo review pursuant to Utah Code Ann. section 59-1-601. The Court reviewed the Formal Hearing Decision and Order ("Formal Ruling") of the Utah State Tax Commission (the "Commission"), in *Strawberry Electric Service District v. Auditing Division of the Utah State Tax Commission*, Appeal No. 02-1734 (June 30, 2003). The Commission reached its decision after a formal hearing before an Administrative Law Judge ("ALJ"), where the parties presented (or had the opportunity to present) evidence including documentary and witness testimony. The ALJ ruled in favor of the Commission, and Commissioners Pam Hendrickson, R. Bruce Johnson, Palmer DePaulis, and Marc B. Johnson adopted the ALJ decision. South Utah Valley Electric Service District (the "District") timely filed this appeal. The parties stipulated to the Court reaching a decision based solely on the evidence presented in the record after arguments of counsel.[1] The Court heard the matter on August 20, 2007. Plaintiff was represented by Michael R. Carlston, Esq. and D. Jason Hawkins, Esq.; defendant's counsel were John C. McCarrey, Esq. and Jason Oldroyd, Esq. Pursuant to Utah Code Ann. § 59-1-604, the Court enters its findings of fact and conclusions of law:

FINDINGS OF FACT

1. Strawberry Water User's Association ("SWUA") is a private, non-profit corporation incorporated in 1924. *See* R. 397 (Articles of Amended and Restated Articles of Incorporation of SWUA); R. 376 (Agreement to Purchase Distribution System and the Sale of Power ["Purchase Agreement"]); T. 79 (testimony of Gary Aitken). SWUA is governed by a board of directors, which hires SWUA management. *See* T. 76.

[1] The Utah State Tax Commission assembled a record numbered pages 1 through 411, which includes documents produced in discovery and pleadings of the parties. Citations to the record will appear herein as follows: R. __. Page 411 of the record is the first page of the transcript of the Formal Hearing of the case before the Utah State Tax Commission, which, following the first page, is numbered 2 through 125. Citations to the transcript will appear herein as T. __.

2. Through contracts with the United States government in 1926, 1928, and 1940, SWUA agreed to "repay the United States for the reimbursable costs of constructing the Strawberry Valley Project . . . as the duly authorized representative of the water users involved in the Strawberry Valley Project[.]" R. 377 (Purchase Agreement). SWUA also agreed to "assume the care, operation, and maintenance of the Strawberry Valley Project[.]" *Id.*

3. As agreed, SWUA repaid the United States and assumed the care, operation, and maintenance of the Strawberry Valley Project facilities. *Id.* at 377-78.

4. In 1940, an electric distribution system was constructed, which was owned and operated by SWUA. R. 351 (Distribution System Operation Agreement of March 25, 1986 ["Operation Agreement"]).

5. SWUA continued to operate the electric distribution system and act as an electric utility in southern Utah County until 1986. *See* R. 351 (Operation Agreement). SWUA continues to provide irrigation water to southern Utah County. T. 76.

6. In the 1980s, changes in federal law introduced a system of preferences for sale of electrical power to public agencies. Power would be sold to non-public entities only after being offered to public entities. T. 64-65.

7. As a private organization, SWUA did not qualify for preferential power assignments under federal law. *See* R. 377-78 (Purchase Agreement) (describing the SWUA and then noting that "in order to participate in the benefits of federal power extended to preference customers it was necessary to establish a public corporation"); T. 64-65 (testimony of Gary Aitken).

8. To ensure future preferential assignments and lower electrical power rates, the Utah County Commission created the Strawberry Electric Service District (the "District") in 1985, pursuant to Utah Code Ann. § 17A-2-301 *et seq.* R. 12 (Petitioner's Responses to Respondent's First Set of Interrogatories and Requests for Production of Documents to Petitioner ["Petitioner's Responses to Interrogatories"]; R. 378 (Purchase Agreement).

9. The District, now known as the South Utah Valley Electric Service District, is a political subdivision of the State of Utah. *Id.* at 1; R. 12 (Petitioner's Responses to Interrogatories); Respondent's Brief at 2. The District is governed by an elected board of trustees. T. 65.

10. In late December, 1985, the District obtained a Certificate of Convenience and Necessity from the Utah Public Service Commission. This Certificate authorized the District to purchase SWUA's electric distribution system. R. 12 (Petitioner's Responses to Interrogatories).

11. The District purchased the electric distribution system from SWUA through the Operation Agreement of March 25, 1986. In addition to noting SWUA "has sold and the District has purchased an electric distribution system[,]" the Operation Agreement stated the District "plans to, but does not now have employees." R. 312.

12. The Operation Agreement noted employees of SWUA had been operating the electric distribution system, and stated, "[a] significant savings in costs of personnel, equipment, billing, meter reading, and system maintenance can be achieved by utilizing the same equipment and personnel to perform functions for the District as well as for the Association [SWUA]." R. 313 (Operation Agreement ¶ 5). The parties then agreed as follows:

> 6. The parties agree that, for the term of this agreement, the Association [SWUA] shall be responsible for the operation and the maintenance of the District's distribution system. The Association shall employ the necessary employees and furnish the necessary equipment to operate, maintain, service, add to, and if necessary replace the distribution system of the District. . . . The Association shall be responsible for reading the meters of the District's customers; the Association shall bill the District's customers in the name of the District, collect the amounts owed to the District, and remit the amount collected by depositing such amounts in the District's appropriate bank account. . . . Association employees shall . . . in general do all things, as directed by the District trustees or other designated District employees, so that a . . . business-like accounting of District business activity shall be available to District officers or employees.
> 7. The Association employees who perform services for the District may also perform services for the Association. Such an arrangement is necessary to achieve the most efficient use of Association employees and the lowest cost for services to the District's customers. The Association agrees to furnish the necessary personnel and equipment and services to the District at the Association's actual cost. By this it is intended that the Association will be reimbursed all of its actual costs, including . . . costs of management personnel, . . . costs of equipment, . . . and the costs of all other services requested to be performed by the Association for the District. It is the intent of the parties that the Association will not profit from the operation of the distribution system.
> 8. The District and the Association agree that the Association and its employees and agent should be insured against negligent acts . . . . It is agreed that the existing Association policies shall be extended so that all Association employees are insured against acts performed by them in the course of their employment for the Association and the District. . . .
> 9. The parties agree that the Association will continue to operate the distribution system until the operation is transferred to the District. . . .
> * * *
> 11. The Association shall cause its employees who are authorized to collect and transmit money for an to the District to be bonded with a suitable bonding company . . . that such employees will faithfully and honestly discharge their

duties.

12. The parties hereto understand that the Association's employees wages paid by the Association have been based by policy upon wages for similar work paid by Utah Power & Light Company.

R. 313-17 (Operation Agreement ¶¶ 6, 7, 11, 12).

13. Approximately two weeks after signing the Operation Agreement, the same parties entered another agreement in which SWUA sold the electric distribution system to the District and agreed to sell power to the District. R. 376, 378-79, 381, 384 (Agreement to Purchase Distribution System and the Sale of Power ("Purchase Agreement")). The Purchase Agreement stated, *inter alia*:

> The Association [SWUA] and the District have mutually agreed that while the Association shall continue to care for, operate, and maintain the works of the Strawberry Valley Project . . . , it will no longer be responsible for serving the retail customer's electricity, and the District shall become the holder and owner of properties . . . for the distribution of power, . . . and shall operate and maintain the system and serve the electric customers in the Strawberry Project service area.

R. 378-79. The Purchase Agreement contains no reference to the Operation Agreement.

14. The District's activities and number of customers increased. "In spite of [the District's] growth, [the District] and SWUA continued to utilize the Operation Agreement in an effort to minimize costs and expenses." Initially a ten-year contract, the Operation Agreement remains in effect today, and there have been no written amendments to it. *See* T. 70, 81, 82 (testimony of Gary Aitken).

15. In 2002, the Utah State Tax Commission (the "Commission") audited the financial records of the District and informed the District it owed over $61,000.00 in unpaid sales taxes for the audit period of June 1, 1999 to May 31, 2002. District's Opening Brief, Exhibit B (Utah Sales and Use tax Audit Summary ["Audit Summary"]). In its Audit Summary, the Commission gave the following explanation for the tax:

> Purchases of construction materials by the state, its institutions, or its political subdivisions are subject tot he sales and use tax. However, state and local government entities may purchase construction materials tax-exempt if those materials are installed or converted into real property by employees of the government entity. The audit report includes such unreported taxable materials that were not converted into real property by employees of Strawberry Electric Service District. *See* Utah Tax Code Annotated, Section 59-12-104(2), and Tax Bulletin 31-94.

Id. Thus, the Commission claimed certain construction materials were not installed by employees of the District, disqualifying the purchase of the construction materials from the sales tax exemption provided in Utah Code Ann. § 59-12-104. (The relevant portions of § 59-12-104 state the following:

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

* * *

(2) sales to the state, its institutions, and its political subdivisions; however, this exemption does not apply to sales of:

(a) construction materials except:

* * *

(ii) construction materials purchased by the state, its institutions, or its political subdivisions which are installed or converted to real property by employees of the state, its institutions, or its political subdivisions[.])

The Commission claimed SWUA employees installed the materials and SWUA is a non-exempt entity. The parties agree to the identities of the individuals who installed the construction materials in question; they disagree only as to whether those individuals were employees of the District for purposes of § 59-12-104. (This is an important stipulation because the ALJ's Formal Ruling adopted by Commission failed to find who actually did the installation and thus omitted a key fact essential to justify the Ruling. The ALJ and Commission did find, however, "There is no dispute SESD and SWUA continue to share employees, including the line crew supervisor, the accountant and her supervisor." T. 2 (Finding of Fact 9 of Formal Ruling). Based on this finding and omission, the Court might possibly have had to reverse the Formal Ruling even if this were not a de novo review, because the ALJ and Commission said the employees were shared which would support an inference they were District employees even if not exclusively so. The Court raised this point with counsel when the appeal was first filed and counsel accommodated with the stipulation, which the Court appreciates.)

16. The parties also agree the District purchased the construction materials in question. Respondent's Brief at 2, 8.

17. Evidence from the Formal Hearing before the ALJ, which counsel stipulate constitutes the evidence before the Court, consists of witness testimony and documentary evidence. Regarding witnesses, the District called three: Burt S. Mikesell, Mary Ann James, and Gary Aitken. T. 23, 33, and 62. The Commission called none.

18. Mikesell has worked for the District since 1985 and his title is assistant planner. T. 23. Mikesell receives orders to carry out particular construction projects, determines appropriate materials and schedules for the projects along with one of the District Trustees, and supervises a line crew who install the materials under his direction. T. 24-25. A line crew under his on-site supervision installed all materials in this case, between 1999 and 2001. T. 27-28, 30. The line crew was made up of Blake Anderson, Duane Curtis, Brook Christensen, Greg Stanton, and Steve Wilson. R. 13 (Petitioner's Responses to Interrogatories, Answer to No. 3). The crew installed the materials to upgrade existing electric distribution lines and build extensions to new customers. *See* T. 24 (testimony of Burt S. Mikesell).

19. The process the District follows for its projects is: First, a decision is made to upgrade or extend a particular line. Second, Mikesell determines needed materials and the timetable for the project. Third, a work order is created and given to a line crew; it includes a list

of materials needed to carry out the project. T. 24. Fourth, the line crew executes the project under Mikesell as the on-site supervisor. T. 25. In the process, Mikesell "answer[ed] to the [District's] board of trustees as far as construction and the new lines[.]" T. 30. Mikesell lacked authority to terminate persons on the line crew. T. 31. Additionally, Mikesell had never been involved in discussion related to a worker's compensation claim with employees of SWUA. T. 33. He had no general supervisory control over SWUA employees. T. 31.

20. James provides accounting services for both the District and SWUA and has since 1986. T. 34, 51 (testimony of Mary Ann James). In her opinion, the line crew was "for the benefit of" the District because they are journeymen linemen and their work is on the District's installations. T. 36. SWUA directly made contributions to the employees' pension system; cut checks to the insurance company for employees' health insurance benefits; directly paid for employees' workers compensation expenses; and calculated employee FICA expenses. T. 52, 55. SWUA appears as the employer of the line crew on their W-2s. T. 36 (indicating that the names of the individuals on the line crew appear in Exhibit 1), T. 55 (affirming SWUA appears as the employer on the W-2s of the individuals listed as Exhibit 1). SWUA and the District are separate entities for accounting purposes. T. 56.

21. After SWUA paid labor and other expenses associated with construction projects, it billed the District to be reimbursed for its costs along with costs for accounting services. T. 40-41; *see, e.g.*, R. 210, 263-87 (Plaintiff's Exhibit 4). The District reimbursed SWUA for its costs with checks. *See* R. 232-61, 288-311 (Plaintiff's Exhibits 3 and 5). The dollar amounts of the checks coincided with the amounts SWUA billed to the District in its invoices. T. 40-41.

22. Members of the line crew appeared on the District's book records as its own employees. T. 44. However, the actual foreman of the line crew does not appear on the books and records of the District. T. 51. Although generally an employer must file Form 941, the employer's quarterly tax withholding for employees, the District was not required to file Form 941 with the federal government based on the nature of its relationship with SWUA. *See* T. 45-46.

23. Aitken is the District's general manager, secretary, and clerk. He reports to the District's board of trustees. T. 62, 64 (testimony of Gary Aitkin). Aitken is also secretary, treasurer, and general manager for SWUA and reports to its board of directors. T. 63-64. Aitken has been associated with the District since its formation in 1985. T. 63. He has worked for both organizations since approximately June 1989. T. 62, 64. He is responsible for day-to-day operations of both the District and SWUA. T. 63-64.

24. Aitkin was involved with formation of the Operation Agreement in 1986 when SWUA provided personnel and equipment to operate the distribution system because "there was an understanding that it would not be in the best interest of the consumers of [the District] nor the shareholders of [SWUA] to have separate functions and activities. So essentially the two organizations worked "synergistically" with respect to the employees, the equipment, and all of

the functions related to both parties, essentially acting as one[.]" T. 66-67. The District did not have capacity to maintain full-time personnel. T. 67.

25. The Operation Agreement remains in effect and has not been modified in writing. T. 70, 81-82. However, since 1986 the relationship between the District and SWUA has changed. T. 83. The District's annual sales in kilowatt hours have greatly increased and the District has experienced a corresponding need for its own personnel. T. 71. The District has acquired "more of [its] own equipment such as bucket trucks and other trucks used in the electrical utility business." T. 68.

26. SWUA's board of directors is responsible for hiring the management of SWUA, and Aitken hires employees for SWUA and the District. T. 76. The District and SWUA are involved in the hiring process depending on the function or type of work the employees are to perform. T. 76. "If this is a function to be performed, the two boards would have a role to play with respect to the hiring of any individual." T. 77.

27. Aitken is Mikesell's supervisor and directed Mikesell in performing the audited line installation.. Aitken had responsibility to ensure the line crew did its work in a satisfactory manner. T. 69. He had authority to discipline and terminate crew members. T. 69-70.

28. Aitken had control over hiring line crew members. T. 96. However, members of the line crew were performing the function of the line crew before the District was created. T. 97. Thus, prior to formation of the District, line crew members were SWUA employees because SWUA operated the distribution system then. *See* T. 97; R. 312 (Operation Agreement ¶ 4 ("The distribution system . . . has been constructed since October 9, 1940 . . . and has been operated by the Association [SWUA].") Aitken's opinion is the line crew members have, over time, become employees shared between SWUA and the District. T. 69, 88, 97.[2] The foundation for his opinion is: (1) the District was dedicated to electric distribution functions; (2) the need for labor on distribution functions increased over time until most line crew labor performed was for distribution purposes, and hence for the District;[3] (3) because the line crew worked on projects within the electric distribution function, they became employees of the District;[4] (5) "the service

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[2] *See* T. 83 ("Q. Do you believe the service district now has its own employees in attempts of controlling and paying for these personnel? A. Yes.") (testimony of Gary Aitken); T. 85-86 ("the service district board of trustees has control over the employees in terms of the functions they perform, in terms of the wages and benefits they receive") (same).

[3] For example, Aitken testified that about 90% of Mikesell's work is related to the District, whereas about 10% is for SWUA. T. 96.

[4]

Q: So they [the line crew] were already employees since the time the service district was created?
A: That's correct.
Q: Evolved into employees of the service district and the service district's need increased or how did that happen?

[D]istrict board of trustees has control over the employees in terms of the functions they perform, in terms of wages and benefits they receive." T. 86.

29. There is also an ongoing relationship between the line crew members and SWUA and SWUA maintains some control over the crew, who as well perform some functions for SWUA. T. 88. The majority of their work is performed for the District and their direct supervisor, Mikesell devotes about 90% of his work to the District with the remaining 10% devoted to non- electrical distribution functions for SWUA.. T. 96-97. The Operation Agreement is still in effect and states, "[t]he Association employs the necessary personnel and owns the necessary equipment to operate, service, and maintain the distribution system[.]" T. 81. Page 7, note 5 of the District's financial statements prepared by its auditors for years ended September 30, 2000 and 1999 reads, in relevant part: "The Association, a related party, provides the District with operating personnel, equipment and administrative services at cost. During the years ended September 30, 2000 and 1999, such services totaled $766,786 and $1,082,035, respectively." R. 369; T. 47.

30. Pertinent minutes from meetings of the District board of trustees during 2000 are::

a. "Gary Aitken asked who would be representing SESD when talks begin with the employee representatives concerning wages and benefits. It was decided that John Youd and Melvin Meredith would meet with the employees and the SWUA Finance and Personnel Committee." R. 11; T. 87. (Certain "employees perform functions for [SWUA] as well." T. 88.)

b. "Lynn Poulter made a motion, seconded by George Money, recommending to SWUA to stay with the current health plan that will increase 12%. It was unanimously approved." R. 392, T. 88.

c. "Gary Aitken handed out a spreadsheet on the proposed wage increase with SWUA employees. Gary said that the SWUA board approved the proposed wage increase at their board meeting on March 16th." R. 393; T. 89.

d. "Ray Loveless made a motion, seconded by Kent Haskell, approving the recommendation of 3.25% of the total SWUA payroll be made available for SWUA employee wage increases of which SESD [the District] would pay part of. It was unanimously approved." R. 394; T. 89.

e. "SWUA Health Insurance Premium Increase. Gary Aitken reported that the health insurance premium for SWUA employees would increase by 20%." R. 395; T. 90. "John Youd made a motion, seconded by George Money, directing staff to report to SWUA their support of retaining the same employee health insurance program. It was unanimously approved." R. 395; T. 90.

A: Well, that's essentially it. Since the distribution functions increased and Strawberry Electric Service District devoted distribution functions. Then essentially the majority of the work performed was distribution of labor with a Strawberry Electric function.
Q: And is that how they, in your mind, became employees?
A: Yes.
T. at 97 (testimony of Gary Aitken).

31. "[B]ecause there was a synergistic relationship of the two companies, both parties are involved in that decision-making process." The two entities in question share control of different aspects of the employer-employee relationship. T. 90-91 (Aitkin Testimony)
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CONCLUSIONS OF LAW

1. The only question before the Court is whether, under Utah Code Ann. § 59-12-104, the electrical distribution construction materials were installed by employees of the District, a state political subdivision, during June 1, 1999 to May 31, 2002. Utah Code Ann. § 59-1-604 provides the procedural basis for disposition of this case, directing the Court to find facts de novo as established by a preponderance of evidence. The burden of proof falls upon the party seeking affirmative relief. Thus, the District has the burden of proving by a preponderance the members of the line crew were its employees of under Utah Code Ann. § 59-12-104(2)(a)(ii).

2. The Court begins with the controlling statute in this case, Utah Code Ann. § 59-12-104, which exempts particular entities from sales tax. First, in construing this provision, the Court follows the well-established principle of statutory construction, "we need not look beyond the plain language of [a] provision unless we find some ambiguity in it." *In re Worthen*, 926 P.2d 853, 866 (Utah 1996) (citing *Schurtz v. BMW of N. Am., Inc*., 814 P.2d 1108, 1112 (Utah 1991)). Second, "[w]hile courts generally construe taxing statutes favorably to the taxpayer and strictly against the taxing authority, the reverse is true of exemptions." *Dick Simon Trucking, Inc. v. Utah State Tax Comm'n*, 2004 UT 11 ¶ 5 (quoting *SF Phosphates Ltd. v. Auditing Div., Utah State Tax Comm'n*, 972 P.2d 384, 386 (Utah 1998)); *see also Hales Sand & Gravel, Inc. v. Audit Div. of the State Tax Comm'n*, 842 P.2d 887, 890-91 (Utah 1992)). Thus, where there is ambiguity in the statute, "[a]ny doubt about the proper application of a sales tax exemption must be resolved against" the taxpayer. *Dick Simon Trucking, Inc. v. Utah State Tax Comm'n*, 2004 UT 11 ¶ 5 (Utah 2004). The Court notes, however, that while an exemption is strictly construed against the taxpayer, it should also be construed "with sufficient latitude to accomplish the exemption's intended purpose." *Eaton Kenway, Inc. v. Auditing Div. Of Utah State tax* Comm'n, 906 P.2d 882, 886 (Utah 1995); *see also Hales Sand & Gravel, Inc. v. Audit Div.*, 842 P.2d 887, 890 (Utah 1992); *Utah County v. Intermountain Health Care*, 725 P.2d 1357, 1359 (Utah 1986).

3. The statute provides in relevant part:

> The following sales and uses are exempt from the taxes imposed by this chapter:
> * * *
> (2) sales to the state, its institutions, and its political subdivisions; however, this exemption does not apply to sales of:
> (a) construction materials except:
> * * *
> (ii) construction materials purchased by the state, its institutions, or its political subdivisions which are installed or converted to real property by employees of the state, its institutions, or its political subdivisions[.]

Utah Code Ann. § 59-12-104(2) (2007).[5]

4. The parties do not dispute the District is a political subdivision of the State of Utah or that it purchased the construction materials. The District argues line members who installed the materials were its employees for purposes of the exemption statute. The District correctly notes the version of Utah Code Ann. § 59-12-104(2) in effect during the audit period did not define "employees." For guidance in construing and applying the term, the District cites several sources: First, the District points to Black's Law Dictionary, which defines employee as "[a] person who works in the service of another person (the employer) under an express or implied contract of hire, under which the employer has the right to control the details of work performance" (Black's Law Dictionary 543 (7th ed. 1999). Second, the District cites Utah workers' compensation law, including Utah Code Ann. § 34A-2-104, which defines the term as a "person in the service of any employer . . . who employs one or more workers or operatives regularly in the same business, or in or about the same establishment under any contract of hire[,] express or implied[,] and oral or written, including aliens and minors, whether legally or illegally working for hire; and not including any person whose employment is casual and not in the usual course of the trade, business, or occupation of the employee's employer." *Id.* § 34A-2-104(1)(b) (statutory subdivisions and some punctuation omitted). In its discussion of Utah workers' compensation law, the District also cites related case law and asserts "the critical factor in this analysis is the employer's right to control the employee." Petitioner's Opening Brief at 2.[6] Third, the District references a 2006 amendment to the Utah Sales and Use Tax Act, § 59-12-102(30), adopting the definition of "employee" set forth in the Individual Income Tax Act, § 59-10-401.[7] The District concedes the 2006 amendment was not in effect during the period in question in the case and is thus not binding here. Petitioner's Opening Brief at 7-8.

5. The Commission does not attempt to expressly define employee for purposes of § 59-12-104(2). *See generally* Respondent's Brief; Tax Commission's Reply Brief. Instead, it

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[5] The current language of the subsection that controlling in this case–subsection (a)(ii)–is identical to what it was in 1999 through 2002. Because this particular language is the same as during the period in question, and because the other portions of the statute have not changed in any material way since the relevant period, the Court references the present version of the statute.

[6] "[I]t will almost always follow that if the evidence shows that an 'employer' retains the right to control the work of the claimant, the claimant is the employer's employee for workmen's compensation purposes." *Johnson Bros. Const. v. Labor Comm'n*, 967 P.2d 1258, 1260 (Utah Ct. App. 1998) (quoting *Bennett v. Indust. Comm'n*, 726 P.2d 427, 429-30 (Utah 1986) (quoted in Petitioner's Opening Brief at 2)).

7 Utah Code Ann. § 59-10-401 (2007) defines employee:

> "Employee" means and includes every individual performing services for an employer, either within or without, or both within or without the state of Utah, or any individual performing services within the state of Utah, the performance of which services constitutes, establishes, and determines the relationship between the parties as that of employer and employee, and includes offices of corporations, individuals, including elected officials, performing services for the United States Government or any agency or instrumentality thereof, or the state of Utah or any county, city, municipality, or political subdivision thereof.

argues the text of the statute, together with the statute's legislative history, provide sufficient guidance for construing the term. *See* Respondent's Brief at 7-12; Respondent's Reply Brief at 4-5. Additionally, the Commission argues the District incorrectly applies the definitions it cites, Commission's Reply Brief at 5-8. The Commission claims the District, in its argument under the 2006 amendment to the Sales Tax Act, neglected to consider the definition of employer. Commission's Reply Brief at 8-9.

6. Utah Code Ann. § 59-12-104(2)(a)(ii) grants an exemption where materials purchased by the state are "installed or converted to real property by employees of the state." The Court concludes the text of the statute, taken by itself, provides insufficient guidance to decide a close case such as that presented here because the term "employee" when used undefined in statutes lacks a universal definition or test, may vary from the usual common law test of who controls the employee's work and the appropriate definition or test may depend on the particular statute and legal doctrine at hand.[8] The Court thus considers the legislative purpose and case history behind § 59-12-104(2)(a)(ii) for guidance, while noting the statute does not impose a requirement that employees perform exclusively as public servants to be considered public employees.

7. The Legislature adopted subsection (2)(a)(ii) in reaction to a Utah Supreme Court interpretation of the previous version of the statute in *Thorup Brothers Construction v. Tax Comm'n*, 860 P.2d 324 (Utah Sept. 15, 1993), and its progeny, *Arco Electric v. State Tax Comm'n*, 860 P.2d 330 (1993) and *Brown Plumbing & Heating Co. v. State Tax Comm'n*, 861 P.2d 435 (Utah Oct. 22, 1993). In *Thorup Brothers*, the Catholic Diocese of Salt Lake City contracted with Thorup Brothers Construction to construct an extension to Judge Memorial Catholic High School, a tax-exempt entity owned and operated by the Diocese (collectively "Judge Memorial.") Judge Memorial agreed to pay Thorup Brothers for purchased material and labor. Judge Memorial also reserved the right to donate construction materials to the project. Accordingly, Judge Memorial purchased materials and Thorup Brothers installed them. *Id.* at 325-26. The Commission audited Thorup Brothers and concluded under statutes and an administrative rule then in effect, Thorup Brothers should be assessed additional sales tax for materials purchased by Judge Memorial but installed by Thorup Brothers. *Id.* at 326. The Supreme Court reversed, concluding under then-existing law that because Judge Memorial–an exempt entity–purchased, owned, and assumed the risks associated with the materials, no sales tax could be assessed on Thorup Brothers. *Id.* at 327-29. The Supreme Court applied the same

[8] Many differences in the definition or test of employee status exist beyond those under the Utah Workers' Compensation and Individual Income Tax Acts. *Compare, e.g.*, James L Rigelhaupt, Jr., *What constitutes employer-employee relationship for purposes of federal income tax withholding*, 51 A.L.R. Fed. 59 (2007) ("The usual common-law rules applicable in determining the employer-employee relationship serve as the basis for defining that relationship for withholding tax purposes") (internal quotation marks omitted) *with* Debra T. Landis, *Determination of "independent contractor" and "employee" status for purposes of § 3(e)(1) of the Fair Labor Standards Act (29 U.S.C.A. § 203(e)(1))*, 51 A.L.R. Fed. 702 (2007) ("courts have generally indicated that the common law degree of control test is *not* controlling in determining whether an employer-employee relationship exists for purposes of the [Fair Labor Standards Act]") (emphasis added).

reasoning in *Arco* and *Brown*, where non-exempt contractors were protected from sales tax because exempt entities bought the installed materials. *Arco*, 860 P.2d. at 331-32; *Brown*, 861 P.2d at 436-37.

8. Approximately six months after the *Thorup Brothers* decision was handed down, the Legislature amended the Utah Code to narrow availability of the exemption. As of the 1994 version, § 59-12-104 included language stating sales of construction materials to the state were not exempt from sales tax except where materials were "installed or converted to real property by employees of the state, its institutions, or its political subdivisions[.]" Utah Code Ann. § 59-12-104(2) (1994). Addition of this requirement in the wake of *Thorup Brothers* indicates the Legislature sought to prevent persons or entities other than state or political subdivision employees from qualifying for the exemption. Transcripts of related Senate hearings support as much: In one hearing, an apparent sponsor of the bill, Senator Barlow, referenced the *Thorup Brothers* decision and expressed, "if we don't plug this hemorrhage we're going to lose a lot more money." R. 404; Commission's Brief at 11. In a subsequent hearing, Senator Barlow stated under the amendment, "political subdivisions . . . will all be treated the same . . . and only if they are using their own employees to use personal property to improve real estate would be they able to be tax exempt." R. 410; Commission's Brief at 11. As the Commission emphasizes, the legislature sought to limit the exemption to political subdivisions of the state, but then "only if they are using their own employees[.]" *Id.* Government entities using contractors enjoy no exemption.

9. In analyzing the question of whether an employer-employee relationship existed between the line crew and the District in the relevant period, the Court looks to the common law agency definition of employee because: the exemption statute contains no definition and thus implies the legislature intended its common meaning; Utah Code Ann. § 68-3-1 (2007) adopts the common law where it is not in conflict with Utah law; courts adopt the common law definition of employee where a statute uses the term but does not helpfully define it, *see Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318 (1992) (relying on common law meaning of "employee" because ERISA's use of the term was circular and not helpful); and the common law definition calls for weighing a number of factors thus giving a more reliable assurance of who exactly is an employee.

10. A general common-law test for determining the status of "employee" was summarized by the United States Supreme Court in *Community for Creative Non-Violence v. Reid*, 490 U.S. 730 (1989):

> In determining whether a hired party is an employee under the general common law of agency, we consider the hiring party's *right to control the manner and means by which the product is accomplished*. Among the other factors relevant to this inquiry are the skill required; the source of the instrumentalities and tools; the location of the work; the duration of the relationship between the parties; whether the hiring party has the right to assign additional projects to the hired party; the extent of the hired party's discretion over when and how long to work; the method

> of payment; the hired party's role in hiring and paying assistants; whether the work is part of the regular business of the hiring party; whether the hiring party is in business; the provision of employee benefits; and the tax treatment of the hired party.

490 U.S. at 751-52 (citations omitted) (emphasis added). *See also* Restatement (Second) of Agency § 220(2) (1958) (setting forth nonexhaustive indicia of master-servant relationship); Rev. Rul. 87-41, 1987-1 Cum. Bull. 296, 298-99 (listing 20 factors for determining whether an individual is a common-law employee in various tax contexts). Because the common-law test has "no shorthand formula or magic phrase that can be applied to find the answer, . . . all of the incidents of the relationship must be assessed and weighed with no one factor being decisive." *NLRB v. United Ins. Co. of America*, 390 U.S. 254 (1968).

11. "The relation of master and servant as known to the common law is included within the [Utah] Workmen's Compensation Act." *Murray v. Wasatch Grading Co.*, 73 Utah 430, 438 (1929). However, the Workers' Compensation Act may modify or depart from the common law. *See id.* at 436. Indeed, an individual who would be considered an "independent contractor" under agency law may be considered an employee under workers' compensation law. *See Utah Home Fire Ins. Co. v. Manning*, 985 P.2d 243 (Utah 1999) (noting that the Utah Supreme Court "has explained that the 'statutory employee' standard of [the Workers' Compensation Act] cannot be equated with the common law right-to-control standard for distinguishing between employees and independent contractors") (citing *Bennett v. Industrial Comm'n*, 726 P.2d 427, 432 (Utah 1986)). This difference between the common law and workers' compensation law is likely due to the policy "that the Workers' Compensation Act should be liberally construed to effectuate its purposes." *Manning*, 985 P.2d at 249. Accordingly, that Court has explained that it is "proper to resolve doubt as to whether a worker was an employee in favor of [the worker being an] employee." *Id.* (quoting *Bennett*, 726 P.2d at 430). Thus, differences between the two types of law exist: under workers' compensation law, for example, "the *right* to control . . . is determinative." *Manning*, 985 P.2d at 246 (quoting *Bambrough v. Bethers*, 552 P.2d 1286, 1291 (Utah 1976) (emphasis in original)). In contrast, under the common law, "the extent of control the hiring party exercises over the details of the product is not dispositive." *Reid*, 490 U.S. at 752. The right to control, however, is important: indeed, the above factors in common law agency analysis tend to help answer the question of "the right to control the manner and means by which the product is accomplished." *Reid*, 490 U.S. at 751. The common law principles noted above are to be considered alongside the rule that tax exemptions are to be construed strictly against the taxpayer. *Dick Simon Trucking, Inc. v. Utah State Tax Comm'n*, 2004 UT 11 ¶ 5 (Utah 2004). Hence, while in doubtful cases the term "employee" under workers' compensation law is to be construed in favor of a worker being an employee, the term as it is used in § 59-12-104(2)(a) is to be construed *against* a taxpayer being an employee in doubtful cases.

12. To decide whether members of the line crew were the District's "own employees" under the statute rather than contractors employees from SWUA, the Court considers the factors bearing on the relationship between the line crew and the District as established by the Operating

Agreement and conduct of the participants and parties since 1986 and specifically in the period between 1999 and 2002.

13. In construing the Operation Agreement, the Court follows the well-settled rule that "'[i]n interpreting a contract, the intentions of the parties are controlling[,]'" and that "[i]f the contract is written and the language employed is not ambiguous, the parties' intentions are determined from the plain meaning of the language." *Dixon v. Pro Image, Inc.*, 1999 UT 89 (Utah 1999) (quoting and citing *Winegar v. Froerer Corp*., 813 P.2d 104, 108 (Utah 1991)).

14. The Operation Agreement is clearly a contract between two separate entities–one public, one private. From the outset, the District and SWUA agreed to "utiliz[e] the same equipment and personnel to perform functions for the District as well as for the Association [SWUA]." R. 313 (Operation Agreement ¶ 5). The Operation Agreement states SWUA, "for the term of this agreement, . . . shall be responsible for the operation and the maintenance of the District's distribution system." R. 313 (Operation Agreement ¶ 6). SWUA "shall employ the necessary employees and furnish the necessary equipment to operate, maintain, service, add to, and if necessary replace the distribution system of the District." R. 313 (Operation Agreement ¶ 6). Additionally, the Agreement provides SWUA would bill the District for all the work and services SWUA would provide for the District. R. 314 (Operation Agreement ¶ 7). The contract frequently references "Association employees" or personnel or employees of the Association (distinct from employees or personnel of the District). R. 312-17 (Operation Agreement ¶ 2, 5-8, 11-12). The Agreement also acknowledges SWUA's employees may perform services both for the District and for SWUA, and at one point mentions "Association employees . . . in the course of their employment for the Association and the District." R. 315 (Operation Agreement ¶ 8).

15 However, the Agreement further states the District "plans to, but does not now have employees." R. 312 (Operation Agreement ¶ 3). The Agreement also references District employees where it states, "Association employees shall . . . in general do all things, as directed by the District trustees or other designated District employees, so that a complete and satisfactory business-like accounting of District business activity shall be available to District officers or employees." R. 314 (Operation Agreement ¶ 6). The Agreement does not state particular functions to be filled by District employees besides receiving accountings from SWUA but this information does not contradict the intent of the District eventually having employees. R. 314 (Operation Agreement ¶ 6).

16. Following the initial statement in paragraph 6 that SWUA and its employees would be responsible for operating the distribution system "for the term of this agreement," the Agreement states in paragraph 9, "[t]he parties agree that the Association will continue to operate the distribution system until the operation is transferred to the District." R. 315 (Operation Agreement ¶ 9). The parties did not specify when or how that transfer would occur or whether it would occur during or after the term of the Agreement. However, the transfer contemplated in paragraph 9 must be read in light of paragraph 6, which stated SWUA would have responsibility for the operation and maintenance of the distribution system "for the term of this agreement." R.

314. The term of the Agreement probably refers to ten years, but could continue at the pleasure of the District. R. 318 (Operation Agreement ¶ 15).

17. Thus, the plain language of the Agreement indicates the District and SWUA intended: (1) SWUA and its employees would be responsible intially for operating and maintaining the distribution system; (2) the District anticipated having its own employees, although it did not state the responsibilities those employees would have; and (3) at some future point, operation of the distribution system, presumably including especially control of operational as opposed to administrative employees, would transfer primarily to the District.

18. Approximately two weeks after the Operation Agreement was signed, the same parties entered another agreement in which SWUA sold the electric distribution system to the District and agreed to sell power to the District. R. 376, 378-79, 381, 384 (Agreement to Purchase Distribution System and the Sale of Power ("Purchase Agreement")). The Purchase Agreement stated, *inter alia*, the parties agree the District "shall operate and maintain the system and serve the electric customers in the Strawberry Project service area." R. 379 (Purchase Agreement). The Purchase Agreement seems to support the language in the Operation Agreement indicating the District itself would at some point operate the distribution system. However, the Purchase Agreement contained no reference to the Operation Agreement and thus did not expressly purport to modify it. Indeed, Gary Aitken, a witness for the District, stated that he believed the Operation Agreement had not ever been modified by written agreement, and that he believed the Operation Agreement remains in effect today. T. 70, 81, 82. However, the Purchase Agreement marked a defined point at which the District began to work toward complete operation of the distribution facilities.

19. Were this case to have arisen shortly after the adoption of the Operation and Purchase Agreements of 1986 and if those agreements were the only evidence, members of the line crew would clearly have been the employees of SWUA. The question now is whether, in the twenty-six years after adoption of these agreements, the District absorbed control of operations as the Operation Agreement contemplates would happen to the extent it acquired the line crew or at least shared it. Since a written agreement may be modified other than in writing by, among other things, the performance of the parties showing an intent to modify it. *See, e.g., Johnson v. Morton Thiokol, Inc.*, 818 P.2d 997, 1003 (Utah 1991) (Stewart, J. concurring), District control need not necessarily be spelled out in writing. Thus, there may be a question of whether the parties modified the Operation Agreements by subsequent conduct so an employer-employee relationship arose between the line crew and the District. This question, however, is not critical to the analysis because the contractual language states the parties' intent of the relationship being a developing one in which eventually the District would control and "own" line operations impliedly including the linemen who spent most of their time working on the District's lines rather than performing SWUA work. The Agreement is thus a factor indicating the parties intended the employees working on the electrical distribution system, such as the line crew, would eventually migrate to the District.

20. However, the parties' contract is not determinative of the statutory outcome. It is only one factor for consideration in determining which entity, or whether both, had the employees. The parties cannot dictate contractually whether their workers fall within the legislative statute nor contract away tax liability. They can only create an agency relationship and let the Legislature's intent as expressed through its statute as construed against the taxpayer determine where the workers fall.

21. The line crew did its work on the electric distribution system (or new extensions to it) purchased by the District in 1986. F. ¶¶ 11-13. The audit period here in question–1999 to 2002–began thirteen years after the Operation Agreement of 1986. This long relationship between the District and its distribution system and the emplyess who serviced it also weighs in favor of finding that the line crew members were employees of the District. In addition, the District provided recommendations, and likely influenced, decisions concerning the wages and health insurance of the employees. *See* F. ¶ 30.

22. As the Commission has noted, however, SWUA, not the District, issued the line crew pay checks ; made direct contributions to the crew's pensions; paid the crew's insurance and other benefits; paid workers' compensation for the line crew; and issued W-2s to the crew in SWUA's name. Commission's Brief at 6. The District does not file quarterly federal tax forms (Form 941) on behalf of the line crew. *See* T. 45-46. The District and SWUA are separate accounting entities directed by separate boards with SWUA performing administrative/accounting functions for employees. T. 1, 9, 56. SWUA audits and board minutes indicate SWUA's continued role in setting salary and benefits in hiring decisions. These factors go toward establishing SWUA as the employer of the line crew.

23. On the other hand, Aitkin testified to and the minutes support finding the District shared with SWUA the role of setting salaries and benefits, hiring and supervising work. Further, Aiken in his capacity as District general manager controlled the means and methods of completing the work, could terminate line crew members and controlled them in general with the line crew performing a majority of its work for the district. The crew's direct supervisor, Mikesell, performed about 90% of his work for the District, and would be one of the "employees" performing the installation by supervising the work directly. The District paid wages and benefits for the line crew as a pass-through to SWUA and SWUA charged the District no profit as a contractor typically would for its own employees. The district also paid SWUA for the time the shared accounting employees spent on District functions, e.g. R. 210. The pass-through sums paid coincided with employee salary and benefits. The reason for leaving the salary and benefits accounting functions in SWUA under the agreement and continuing the arrangement to this day is because the parties wanted to create a "synergistic" relationship as stated by Aitkin.[9] Both parties could benefit by leaving accounting and typical human relations functions in one

[9]"Synergy" and its adjectives "synergistic" and "synergistically" are, the Court understands, new names for teamwork wherein the whole result becomes greater than the sum of the parts (the parties) and wherein a consultant made a lot of money by changing what teamwork is called.

entity with the other to reimburse it for the time.

24. In the years following the creation of the District, an employer-employee relationship formed between the District and the line crew. While not dispositive, the touchstone in the analysis is the right to control the manner and means of the work performed. *See Reid*, 490 U.S. at 751-52. The District was created to be a public electric utility. Under the Operation Agreement of 1986 and since that time, the District and SWUA both played roles concerning the operation of the distribution system and, at least since 2000, have both been involved in details of employee wages and benefits.. As part of its responsibility over the electric distribution system, the District appointed Aitken to be responsible for the day-to-day operations of the District. Aitken is also responsible for the day-to-day operations of SWUA. T. 63-64. As general manager for both entities, Aitken reported to the boards of each entity. T. 62-64.In unrebutted testimony, Aitken testified the District gave that title and those responsibilities to him. Aitken was thus under the control and direction of both the District and SWUA boards As such, Aitken acted on behalf of each entity when he directed the work of the line crew. In short, the District shared with SWUA the right to control the manner and means of the line crew's work, and the entities exercised that control through Aitken. Aitken testified that he is Mikesell's supervisor; that Aitken directed Mikesell in performing the work in question; and that Aitken had the responsibility to ensure that the work performed by the line crew was done in a satisfactory manner. T. 69. Further, the specific methods and means by which the line crew did its work was controlled on-site by Mikesell, who was in turn supervised by Aitken. F. ¶¶ 17, 27. Aitken further controlled the employees through his authority to discipline and terminate members of the line crew. T. 69-70.

24. In viewing the other factors, there is no requirement employees work exclusively for an employer to be considered employees or have their salaries paid from the employer's accounting office. In fact, in these times of outsourcing personnel functions, the Court can take notice it is not uncommon for an entity other than the employer to issue employees a pay check in that entity's name and provide benefits, receiving in return payment for these amounts from the employer plus a service fee, just as happened here with the District paying SWUA the wage and benefit amounts plus paying for the accounting employee's time. Further, the Legislature would not have mandated employees be full time public servants for their installation work to be exempt. It did not say it was doing so-- but more importantly the Legislature would not have wanted to exclude from the potential benefits of the exemption small towns and service districts who only needed or could afford part time employees (or employees who may be shared by various public entities) to do the work. In another context, the Commission and employees would likely look to the District as liable in a situation as this if the issue were failure to withhold employee income tax.

25. The factors predominate in favor of the District being entitled to the exemption provided in § 59-12-104(2). The Commission's Ruling (which acknowledged employees were shared) is reversed. The Court wishes to commend counsel for both parties for their display of professionalism and excellent advocacy in this case. Plaintiff's counsel may prepare an appropriate judgment and submit it under the Rules of Civil Procedure.

Dated this 30th day of August 2007.

Samuel D. McVey
District Court Judge