

**BEFORE THE COURT OF TAX APPEALS
STATE OF KANSAS**

IN THE MATTER OF THE APPEAL
OF KOSS CONSTRUCTION CO.,
INC./KOSS MATERIALS CO., L.L.C.
FROM AN ORDER OF THE
DIVISION OF TAXATION ON
ASSESSMENT OF SALES TAX

Docket No. 2006-3798-DT

ORDER ON MOTIONS FOR SUMMARY JUDGMENT

Now the above-captioned matter comes on for consideration and decision by the Court of Tax Appeals of the State of Kansas. The Court heard oral arguments July 2, 2008 on competing motions for summary judgment. Koss Construction Co., Inc. ("Koss Construction") and Koss Materials Co., L.L.C. ("Koss Materials"), referred to collectively as "Taxpayers," appeared by and through their attorney of record, Mark A. Burghart. The Kansas Department of Revenue (the "Department") appeared by and through its attorney of record, John Michael Hale.

The Court has jurisdiction of the subject matter and the parties, as an appeal was properly and timely filed pursuant to K.S.A. 74-2438.

I.

Summary Judgment Standards

Summary judgment is appropriate where the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law. K.S.A. 60-256(c). The purpose of summary judgment is to eliminate delay in legal disposition where there is no real issue of material fact. *Timi v. Prescott State Bank*, 220 Kan. 377, 386, 553 P.2d 315 (1976).

In summary judgment proceedings the movant has the burden of demonstrating that there are no genuine questions of material fact and that he is entitled to judgment as a matter of law, which is a strict burden. *See Saliba v. Union Pacific R.R.*, 264 Kan. 128, 131, 955 P.2d 1189, 1192 (1998). The party opposing summary judgment must, in turn, respond with specific evidence to demonstrate that a genuine issue of material fact remains for trial. *Id.*

II. Uncontroverted Facts

On March 28, 2008, the parties filed a joint statement of stipulated facts (“Joint Stipulations”). The parties agreed to the Joint Stipulations only for purposes of the instant appeal, reserving the right to dispute the relevancy of each fact stipulated.

The Department sets out in its lead brief 17 statements of fact which it asserts are uncontroverted. Taxpayers set out in their lead brief 32 statements of fact which they assert are uncontroverted. Of the 49 statements of fact asserted by the parties together, 38 are based on the Joint Stipulations and 11 are based on affidavit testimony. The Department attempts to controvert none of Taxpayers’ factual statements. Taxpayers attempt to controvert four of the Department’s factual statements (§§ 5, 8, 10 and 14.)

Upon review of the papers submitted by the parties, the Court finds as follows. Each fact conceded is uncontroverted for purposes of these motions for summary judgment. In regard to those facts not conceded, the Department’s factual statement 5, which is not accompanied by a citation to the record, is uncontroverted, except as modified or supplemented by the Joint Stipulations. The Department’s factual statement 8, as well as Taxpayers’ response, speak to the interpretation of written agreements without reference to facts outside the four corners of those documents. Thus, factual statement 8, and Taxpayers’ response, are arguments, not factual statements, and will be considered as such. The Department’s factual statement 10 is uncontroverted because it is not directly rebutted by Taxpayers. The Department’s factual statement 14 contains a typographical error, as conceded by the Department.

Based on the foregoing, the Court concludes that the material facts are uncontroverted. They are as follows.

Koss Construction is a highway contractor incorporated in Iowa and headquartered in Topeka, Kansas. Koss Materials is a Kansas limited liability company wholly owned by Koss Construction. Koss Materials owns certain batch plants that include equipment used in the production of cement and asphalt products. When Koss Materials was formed in 2000, Koss Construction transferred certain assets to Koss Materials.

During the tax years in question, the two affiliate companies had common officers and directors, although they conducted separate annual shareholder and board of directors meetings. Koss Construction maintains an inventory of millings, which are sold at retail to third parties. Koss Materials sells some of its products

directly to third parties. Koss Materials has no employees and does no installation of the products it manufactures or produces. Koss Materials' only activities involve the production of concrete and asphalt products at its batch plants. Koss Materials and Koss Construction have entered into an administrative services and overhead agreement, which states, *inter alia*, that the agreement does not constitute or involve a joint venture, partnership or profit-sharing arrangement.

The transactions at issue are governed by various contracts, all with similar language, executed by and between KDOT and Taxpayers. Taxpayers signed jointly as "Contractor." The contracts obligate Taxpayers to provide and furnish all labor and material required to perform and complete the highway construction projects. Nowhere in the contracts are there terms that apply to one Taxpayer but not the other. Nowhere in the contracts are there terms that address the provision of materials and the provision of labor as separate promises or obligations.

For the tax years in question, there are no invoices evidencing the sale of any products from Koss Materials directly to Koss Construction. There also are no invoices evidencing the sale of any products from Koss Materials to KDOT. At no time did KDOT take delivery or possession of the subject materials. Nor did KDOT provide, deliver or furnish the materials at its expense for incorporation into the highway projects. The Taxpayers never acted as agent for or on behalf of KDOT in connection with the purchase or sale of any of the construction materials. KDOT never provided an exemption certificate to either Taxpayer for the materials.

The Department conducted a retailers' sales tax audit of Koss Construction and Koss Materials for the period January 1, 2001 through December 31, 2003. The Department issued a Notice of Assessment on January 25, 2005, in which Koss Construction and Koss Materials were assessed \$2,739,451. This assessment consisted of tax in the amount of \$2,161,422; penalty in the amount of \$216,138; and interest in the amount of \$361,891.

A statement in the audit narrative identifies Koss Materials as a contractor not eligible for sales tax exemptions for ingredient and component parts and property consumed in production. On March 24, 2005, the Notice of Assessment was timely appealed to the Kansas Secretary of Revenue through a request for informal conference pursuant to K.S.A. 79-3610.

The hearing officer for the Department failed to act on the request for informal conference within 270 days. No written agreement to extend the time for issuing a written final determination was entered into by the parties.

On May 19, 2006, Koss Construction and Koss Materials filed a Notice of Appeal with the Board of Tax Appeals (predecessor to the Court of Tax Appeals).

III. Analysis

According to Taxpayers, the sole issue is whether the products purchased by Koss Materials from third-party suppliers are exempt from sales tax. Taxpayers claim the products are exempt because they were used by Koss Materials to make construction materials that were then sold directly to the State of Kansas for use by Koss Construction in state highway projects.

The Department characterizes the transactions differently. According to the Department, the construction materials were never sold directly to the State of Kansas. The Department argues that Koss Materials (acting as manufacturer) instead transferred the construction materials to Koss Construction (acting as contractor). The Department asserts that this transfer between related entities is subject to Kansas sales or compensating use tax.

The Court finds it useful to proceed under the following analytical framework. First, we must determine whether the compensating use tax is applicable to the transactions at issue. Next, we must determine whether Taxpayers, affiliate companies, should be treated as a single entity or as separate entities for purposes of this appeal. Finally, we must determine whether any of the relevant transactions are taxable and, if so, whether any exemption statutes apply.

It is well-settled that in determining whether a transaction is subject to taxation, statutes should be construed strictly in favor of the taxpayer. *See Director of Taxation v. Kansas Krude Oil Reclaiming Co.*, 236 Kan. 450, 455, 691 P.2d 1303 (1984); *see also In re Tax Appeal of Derby Refining Co.*, 17 Kan.App.2d 377, 380, 838 P.2d 354 (1992). The Act should not be enlarged to include matters not specifically embraced by it. *Kansas Krude*, 236 Kan. at 454. Conversely, when the question is whether a taxpayer should be exempt from a tax, the exemption statute is to be construed strictly in favor of taxation and against the party claiming exemption. *Id.*

The first question is whether Taxpayers are subject to compensating use tax in connection with the construction materials. The Kansas compensating use tax imposes a tax on tangible personal property used, stored or consumed in Kansas when no tax on the property was previously paid. *See K.S.A. 79-3703*. This tax was enacted to ensure that out-of-state purchases of tangible personal property brought into, and used within, the state are subject to the same rate of tax as in-state purchases. *In re K-Mart Corp.*, 238 Kan. 393, 394-395, 710 P.2d 1304 (1985). The compensating use tax applies to out-of-state transactions, while the sales tax applies to in-state transactions. *See In re Appeal of J.G. Masonry, Inc.*, 235 Kan. 497,509-510, 680 P.2d 291 (1984). There is no statutory basis for invoking the

compensating use tax to proceed directly against a consumer where the transaction at issue occurred wholly within the state. *See id.*

In this case, there is no evidence that any of the relevant transactions occurred outside the State of Kansas. The compensating use tax therefore does not apply.

The next question is whether Taxpayers should be treated as a single entity or as separate entities for purposes of this appeal. As a general rule, separate business forms are treated as separate legal entities, particularly when all formalities incident to separate corporate existence are observed. The Department has addressed through its regulations taxability issues between related entities, stating that companies are treated as separate entities for tax purposes so long as they are separate entities either in fact or by law. *See K.A.R. 92-19-72(c).*

In this case, Taxpayers are parent and subsidiary companies which share common officers and directors. During the relevant period, the companies conducted separate annual shareholder and board of directors meetings, and they appear to have observed all requirements for maintaining separate legal statuses. Despite the Department's allegation that Koss Materials and Koss Constructions were "joined at the hip," we find no valid basis for treating them as a single entity.

Having determined that the compensating use tax is inapplicable and that Taxpayers should be treated as separate legal entities for purposes of this appeal, the final determination is how the Kansas retailers' sales tax act should apply under the uncontroverted facts of this case. The Kansas retailers' sales tax act, codified at K.S.A. 79-3601 *et seq.*, imposes a tax on gross receipts arising from sales of tangible personal property and certain services within the state. The tax is imposed on the privilege of engaging in the business of selling tangible personal property at retail or furnishing services made taxable under the Act. *See K.S.A. 79-3603.* While retailers have collection and remittance obligations, the ultimate burden of the tax falls to the property or service consumer. *See Southwestern Bell Tel. Co. v. State Commission of Revenue and Taxation*, 168 Kan. 227, 233, 212 P.2d 363 (1949). ("There is one basic principle about our sales tax act. It is that the ultimate consumer should pay the tax and no article should have to carry more than one sales tax.")

In order for a transaction to be subject to Kansas sales tax, the transaction must first be a "sale." The term is defined broadly under K.S.A. 79-3602:

"Sale" or "sales" means the exchange of tangible personal property, as well as the sale thereof for money, and every transaction, conditional or otherwise, for a consideration,

constituting a sale, including the sale or furnishing of electrical energy, gas, water, services or entertainment taxable under the terms of this act and including, except as provided in the following provision, the sale of the use of tangible personal property by way of a lease, license to use or the rental thereof regardless of the method by which the title, possession or right to use the tangible personal property is transferred. The term "sale" or "sales" shall not mean the sale of the use of any tangible personal property used as a dwelling by way of a lease or rental thereof for a term of more than 28 consecutive days.

According to Taxpayers, two sales occurred in this case – the first between third-party suppliers and Koss Materials involving ingredients and components for highway construction, and the second between Koss Materials and the State involving construction materials derived from the products supplied in the first sale. Taxpayers claim the first sale is exempt under K.S.A. 79-3606(m) and (n) because it involved ingredients and materials consumed in production of tangible personal property. Taxpayers claim the second sale is exempt under K.S.A. 79-3606(b) because the sale was made directly to the State.

The Court finds Taxpayers' contentions are not supported by the evidence. The contracts governing the subject transactions were between the State (through its agent KDOT) and Taxpayers (together as "Contractor"). Under the contracts, Taxpayers promised to provide and furnish all labor and materials required to complete highway construction projects. The contracts do not contain separate terms for the supply of materials by one company and the provision of labor by the other. The fact that both Taxpayers executed the contracts jointly, as parent and subsidiary, does not mean that the State entered into a distinct agreement with each Taxpayer for severable portions of the construction projects. Taxpayers' interpretation of the parties' relationship requires a strained reading of the state highway construction contracts.

Further, it should be noted that, for the time in question, there are no invoices evidencing the sale of any products from Koss Materials directly to Koss Construction. There also are no invoices evidencing the sale of any products from Koss Materials to KDOT. At no time did KDOT take delivery or possession of the subject materials. Nor did KDOT provide, deliver or furnish the materials at its expense for incorporation into the highway projects. The Taxpayers never acted as agent for or on behalf of KDOT in connection with the purchase or sale of any of the construction materials. KDOT never provided an exemption certificate to either Taxpayer for the materials. These facts are uncontroverted.

Based on the foregoing, we conclude that the contracts and subsequent course of performance of the parties establish that Taxpayers provided, and the State accepted, completed highway projects. There is no evidence tending to prove that Taxpayers agreed to sell, or actually sold, tangible personal property to the State. *C.f. Fusco-Amatruda Co. v. Tax Commissioner*, 168 Conn. 597, 601-602, 362 A.2d 847, 850-851 (1975) (Purchase of construction materials for exempt organization held not exempt from use tax where contract and circumstances failed to support conclusion that title to materials ever passed to exempt organization.)

The Court finds that the tangible personal property used in the highway construction projects is subject to sales tax. Koss Materials contracted jointly with its parent company to provide and furnish all labor and materials used to perform and complete highway construction projects for the State. The two affiliate companies executed the highway construction contracts together as "Contractor," making them jointly obligated for performance of the projects.

The facts demonstrate that the two affiliate companies were jointly awarded state highway construction project. And, although the companies performed separate functions, they jointly undertook performance of the projects. In view of their staffing and operational structure, the companies must have, out of necessity, cooperated closely with each other during the course of the projects. This arrangement allowed the affiliates to spread costs and risks and use common management and personnel resources. Based on all of the evidence presented, the Court finds that Koss Materials and Koss Construction together became contractors under the Kansas retailers' sales tax act.

Kansas imposes a tax on gross receipts received from sales "of tangible personal property to all contractors, subcontractors or repairmen for use by them in erecting structures, or building on, or otherwise improving, altering, or repairing real or personal property." K.S.A. 79-3603(1)(1). By regulation, the Department has instructed that contractors are considered final users or consumers of materials they use to convert into real property improvements. *See* K.A.R. 92-19-66.

The Department has promulgated regulations specifically addressing a contractor's sales tax obligations in connection with construction materials. Pursuant to K.A.R. 92-19-66(b),

[e]ach contractor, subcontractor or repairman shall be responsible for the payment of sales tax on all materials and supplies purchased for use by the contractor, subcontractor or repairman in erecting structures for others, or for building on, or otherwise improving, altering or repairing real or personal property of others.

Koss Materials, as joint contractor, is responsible for sales tax on its purchases of tangible personal property from third-party suppliers during the tax years in question. No exemption applies because Taxpayers have failed to show that there was a subsequent sale at retail, as required by K.S.A. 79-3606(m) and (n).

Based on the uncontroverted evidence as applied to the pertinent statutes and regulations, we conclude that there are no genuine questions of material fact and that the Department is entitled to judgment as a matter of law. The Department has met its burden and has established the validity of its assessment. Taxpayers have failed to rebut the assessment and have failed to clearly bring themselves within any exemption under the Kansas retailers' sales tax act.

IT IS THEREFORE ORDERED that, for the reasons stated above, the Department's motion for summary judgment is granted and the Taxpayers' motion for summary judgment is denied.

Any party to this action who is aggrieved by this decision may file a written petition for reconsideration with this Court as provided in K.S.A. 2008 Supp. 77-529. The written petition for reconsideration shall set forth specifically and in adequate detail the particular and specific respects in which it is alleged that the Court's order is unlawful, unreasonable, capricious, improper or unfair. Any petition for reconsideration shall be mailed to: Secretary, Court of Tax Appeals, Docking State Office Building, Suite 451, 915 SW Harrison St., Topeka, KS 66612-1505. A copy of the petition, together with any accompanying documents, shall be mailed to all parties at the same time the petition is mailed to the Court. Failure to notify the opposing party shall render any subsequent order voidable. The written petition must be received by the Court within fifteen (15) days of the certification date of this order (allowing an additional three days for mailing pursuant to statute). If at 5:00 pm on the last day of the specified period the Court has not received a written petition for reconsideration of this order, no further appeal will be available.

IT IS SO ORDERED.

THE KANSAS COURT OF TAX APPEALS

SEAL



ATTEST:


REBECCA W. CROTTY, JUDGE


FRED KUBIK, JUDGE

(Concurring Opinion)
TREVOR C. WOHLFORD, JUDGE PRO TEM


JOELENE R. ALLEN, SECRETARY

CONCURRING OPINION

I agree that a taxable exchange of tangible personal property occurred in this case and that summary judgment should be granted in favor of the Department and against Taxpayers. Based on the uncontroverted evidence, however, I would find that the taxable exchange was between Koss Materials and its parent company, Koss Construction.

As the majority has concluded, the companies did not sell – nor did they agree to sell – tangible personal property directly to the State of Kansas. Yet that finding alone does not resolve the question of where the taxable exchange occurred. Beyond the fact that the two affiliates were joint signatories to the highway contracts, there is little evidence that the companies actually engaged in a common enterprise or combined their property, technology, skills or capital to complete the highway projects through a unified venture. In fact, the evidence compels the opposite conclusion.

The majority found Koss Materials to be a contractor for two reasons: (1) the company contracted jointly with its parent, Koss Construction, to complete the highway projects and (2) the staffing and operational structure of the companies necessarily required close cooperation during the course of the projects. Granting the reasonableness of the majority's analysis, I would nonetheless find Koss Construction to be the sole contractor in this case.

The two affiliate companies operated as separate entities, both in fact and law. They also performed separate work during the course of the highway projects, operating under an agreement in which they acknowledged their relationship did not involve a joint venture, partnership or profit-sharing arrangement. The facts are uncontroverted in regard to the companies' respective roles in the state highway projects. Koss Materials manufactured concrete and asphalt at its batch plants and then provided the materials to the construction sites. The company did not install any of the materials it manufactured. The installation work was performed by Koss Construction. Thus I would find Koss Construction, not Koss Materials, to be the contractor.

In view of the fact that the two affiliates performed separate work, one as manufacturer and the other as contractor, the question becomes whether a taxable exchange occurred during the transition of work from one company to the other. Kansas imposes a tax on gross receipts from sales "of tangible personal property to all contractors, subcontractors or repairmen for use by them in erecting structures, or building on, or otherwise improving, altering, or repairing real or personal property." K.S.A. 79-3603(l)(1). A contractor is "responsible for the payment of sales

tax on all materials and supplies purchased for use by the contractor..." in "altering or repairing real or personal property of others." K.A.R. 92-19-66. It is the contractor that is considered the final user or consumer of construction materials for purposes of sales tax. *See id.*

It is important to note that a taxable exchange need not be an arms'-length transaction between unaffiliated entities. While transfers between departments within a single entity are never taxable, certain transfers between separate but related entities are taxable sales. *See* K.A.R. 92-19-72(a) and (b). This is true even if the transfer in question is between companies that have common principals, ownership, or operations; share the same business location; file consolidated income tax returns; or enjoy no profit or expense as a result of the transaction. K.A.R. 92-19-72(b). Sales tax is imposed on sales between related entities the same as it is on unrelated entities. *See id.*

The Department has authority to promulgate interpretive regulations to administer sales tax statutes. *See* K.S.A. 79-3618. The Department's administrative interpretation should be given consideration and weight. *In re Tax Appeal of McKee*, 19 Kan. App.2d 43, 861 P.2d 1386 (1993). Administrative regulations have the force and effect of law and are presumed valid. *See In re City of Wichita*, 277 Kan. 487, 495, 86 P.3d 513 (2004)

Koss Construction and Koss Materials contracted jointly (as parent and subsidiary) with the State of Kansas to provide and furnish all labor and materials required to complete the highway construction projects. In performing the contracts, Koss Materials acted as manufacturer and Koss Construction acted as contractor. There is no evidence that the State of Kansas ever purchased – or took possession or control of – the materials. In fact, there is no evidence of any intervening titleholder or possessor between the time Koss Materials relinquished control of the materials and the time Koss Construction assumed control of the materials.

Transfers between separate but related entities for use or consumption, and not for resale, are taxable. *See* K.A.R. 92-19-72. Based on the uncontroverted evidence, I would find such a transfer occurred between Koss Materials and Koss Construction in this case. It makes little difference that the two related entities failed to produce a paper trail of intercompany transactions involving the construction materials. The absence of intercompany transfer documents has minimal probative value in determining whether a taxable exchange occurred. No record of transfer or other documentary proof is required.

A sale is broadly defined under the Act to include a wide range of exchanges involving transfers of title, possession, or rights of usage, without regard to the method by which the exchange is made. *See* K.S.A. 79-3602. And though there is no

direct evidence that Koss Construction provided consideration for the construction materials, there also is no evidence that the materials, valued at approximately \$35 million, came into the possession of Koss Construction by means of a gratuitous exchange. Consideration can be inferred from the attendant circumstances. *C.f. Uarco, Inc. v. Eastland*, 584 F.Supp. 1259, 1262 (D.Kan. 1984) (Under Kansas law, there is a rebuttable presumption that contracts are supported by consideration) (citing *Ferraro v. Fink*, 191 Kan. 53, 379 P.2d 266 (1963))..

Like the majority, I would grant the Department's motion and would deny Taxpayers' motion. However, I would conclude that a transfer of tangible personal property constituting a taxable exchange occurred between Koss Materials and Koss Construction.


TREVOR C. WOHLFORD, JUDGE PRO TEM

CERTIFICATE OF SERVICE

I, Joelene R. Allen, Secretary of the Court of Tax Appeals of the State of Kansas, do hereby certify that a true and correct copy of this order in Docket No. 2006-3798-DT and any attachments thereto, was placed in the United States Mail, on this 6th day of May, 2009; addressed to:

Koss Construction Co., Inc./Koss Materials
Koss Construction Co, Inc.
5830 SW Drury Lane
Topeka, KS 66604

Mark Burghart
Alderson, Alderson, Weiler, Conklin, Burghart, & Crow, L.L.C.
2101 Southwest 21st Street
Topeka, KS 66604-3174

and copies were placed in capitol complex building mail, addressed to:

John Michael Hale
Attorney
Legal Services Bureau
Department of Revenue
DSOB, 915 SW Harrison, 2nd Floor
Topeka, KS 66612

James Bartle
General Counsel
Legal Services Bureau
Department of Revenue
DSOB, 915 SW Harrison, 2nd Floor
Topeka, KS 66612

IN TESTIMONY WHEREOF, I have hereunto subscribed my name at Topeka, Kansas.


Joelene R. Allen, Secretary