BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Petition for Redetermination of	)	
	)	DOCKET NO. 17610
[REDACTED]	)	
	)	DECISION
Petitioner.	)	
	)	

On June 27, 2003, the Sales Tax Audit Section of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayer). The Notice proposed additional sales and use taxes and related penalty and interest in the total amount of $41,292 for the periods January 1, 1993 through July 31, 2001. The taxpayer timely protested and requested a redetermination on August 28, 2003. An informal conference was requested and held on December 2, 2003. After the informal conference, the taxpayer provided additional information regarding its position. The Commission has reviewed the file, is advised of its contents, and hereby issues its decision based thereon.

At all relevant times, the taxpayer was engaged in the business of applying dust control liquids to unpaved roads. The major clients of the taxpayer are governmental entities. The audit staff determined the taxpayer is making alterations or improvements to real property, and therefore it should pay use tax on its use of the dust control liquids. In the informal conference, the taxpayer contended that it is selling the liquids to its customers and therefore should collect sales tax on the sales made to non-governmental customers. However, during the audit period, the taxpayer did not collect tax. It purchased its materials from out of state and did not pay sales or use tax on the purchases.

Idaho Code § 63-3609(a) provides:

> All persons engaged in constructing, altering, repairing or improving real estate, are consumers of the material used by them;

> all sales to or use by such persons of tangible personal property are taxable whether or not such persons intend resale of the improved property.

The question is whether road oils that are placed on gravel roads to control dust become part of the real estate. In Potlatch Corp. v. Idaho State Tax Commission, 120 Idaho 1, 813 P.2d 340, the Idaho Supreme Court held as taxable logging road equipment because those items were used to construct, alter, repair or improve real estate—the logging roads. Accordingly, those items were subject to tax pursuant to section 63-3609(a). Here, the dust control oils are applied to real estate—gravel roads—and actually become part of the real estate. Real property is defined in Idaho Code § 55-101:

> Real property or real estate consists of:
>
> 1. Lands, possessory rights to land, ditch and water rights, and mining claims, both lode and placer.
> 2. That which is affixed to land.
> 3. That which is appurtenant to land.

The road oils qualify as real estate. They become both affixed and appurtenant to the land. Accordingly, the Audit Staff's determination that the taxpayer owes use tax on its use of the road oils is correct.

Even assuming the road oils remain tangible personal property, the taxpayer's use of the materials is still subject to tax. The Idaho Sales Tax Act imposes sales tax on the sale of tangible personal property. On the other hand, the sale of most service transactions is not subject to tax. The sales tax does not apply to transactions where the rendering of a service is the object of the transaction, even though tangible personal property is exchanged incidentally. Ryder v. Idaho State Tax commission, 130 Idaho 245, 939 P.2d 564 (1997). Accordingly, if the taxpayer is providing a service, it cannot charge sales tax. If, on the other hand, the taxpayer is selling tangible personal property, it would collect sales tax on its sales. This difference is

material. If the taxpayer is providing a service, then it is the consumer of the materials it uses in performing the service. Thus, it would pay sales or use tax on the cost of the materials it uses to complete the service. In this case, the materials would be the road oils. If, on the other hand, the taxpayer is making retail sales of the road oils, it would buy the materials free from tax and collect tax on the retail sale. Thus, the question is whether the taxpayer is providing a service or making a retail sale. As the Court noted in Ryder, the proper test to determine whether a transaction is primarily a sale of tangible personal property subject to sales tax or a service transaction is to look to the object of the transaction. If the object of the transaction is the rendering of a service, then the service provider owes use tax on its materials. The test is set out in IDAPA 35.02.09.1:

> In determining whether a transfer of tangible personal property is a taxable retail sale or a transfer merely incidental to a service transaction, the proper test is to determine whether the transaction involves a consequential or inconsequential professional or personal service. If the service rendered is inconsequential, then the entire transaction is taxable. If a consequential service is rendered, then it must be ascertained whether the transfer of the tangible personal property was an inconsequential element of the transaction. If so, then none of the consideration paid is taxable. In determining whether a mixed transaction constitutes a consequential service transaction, a distinction must be made as to the object of the transaction—i.e., is the object sought by the buyer the service per se or the property produced by the service.

Here, the object of the transaction is dust control services. The evidence that is in the possession of the Commission indicates that customers of the taxpayer pay a fee to have the dust controlled. During the audit period, the customers were billed a fee for dust control services. In fact, of the invoices the auditor reviewed, there was no separate statement of the materials used on each job. Thus, each customer did not know the type of road oils used or the amount of road oils used. The customer is billed by the foot for dust control services and not by the quantity of

the materials used. This is sufficient evidence to indicate that the primary object of the transaction is a service.

Title to the road oils never transfers to the customers. The road oils are consumed by the taxpayer in the process of applying them to the roadways. The customer does not have the ability to direct how much road oils should be applied and never even really knows how much oils were applied.

There may be other facts; but this in and of itself is sufficient for the Commission to conclude that even if the road oils do not become a part of the real estate, the primary object to the transaction is a service, and therefore the taxpayer owes use tax on the purchase of the road oils.

THEREFORE, the Notice of Deficiency Determination dated June 27, 2003, is hereby APPROVED, AFFIRMED and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following taxes, penalties, and interest for the periods January 1, 1993 through July 31, 2001:

TAX	PENALTY	INTEREST	TOTAL
$24,488	$6,122	$10,967	$41,577

Interest is computed through February 27, 2004 and will accrue at $3.75 per day until paid in full.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's rights to appeal this decision is enclosed with this decision.

DATED this ____ day of _____, 2004.

IDAHO STATE TAX COMMISSION

_____
COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2004, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]
[Redacted]

Receipt No.

_____