

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Petition for)	
Redetermination of:)	
)	DOCKET NO. 14780
[Redacted],,)	
)	DECISION
Petitioner.)	
_____)	

On March 27, 2000, the Sales/Use Tax Audit Bureau of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to [Redacted]. (taxpayer). The Notice of Deficiency Determination proposed additional sales and use taxes, penalty and interest for the period January 1, 1992 through May 31, 1998, in the total amount of \$35,764.

On May 2, 2000, a timely protest and petition for redetermination was filed by the taxpayer. An informal conference was requested by the taxpayer and conducted by telephone on September 26, 2000. The Tax Commission has reviewed the file and is advised of its contents.

For the reasons set forth below, the Commission issues its decision MODIFYING the deficiency determination. The parties reached agreement on one of the issues raised by the taxpayer and the Commission reduces the deficiency determination concerning the agreed-upon issue. Additionally, the Commission abates the penalty set forth in the deficiency determination. However, the Tax Commission affirms the remainder of the deficiency determination regarding the contested issues. The Commission specifically finds pipets are hand tools excluded from the production exemption contained in Idaho Code § 63-3622D.

FACTS

The taxpayer operates in [Redacted], Idaho and, as the name suggests, manufactures [Redacted]. The taxpayer is a subsidiary of a Minnesota corporation based in [Redacted], Minnesota.

The Minnesota parent corporation operates [Redacted] production facilities in Minnesota and South Dakota, but also manages the administrative aspects of the taxpayer's business.

The taxpayer obtained a use tax permit in July of 1997. Staff conducted a field audit of the taxpayer in June of 1998, at the business offices of the parent corporation in [Redacted], Minnesota. Staff reviewed the company's charts of accounts, general ledgers, check registers, vendor invoices, and tax returns. This was the taxpayer's first experience with Idaho sales and use tax, as well as its first exposure to Idaho's audit process.

At the conclusion of the audit, staff determined a use tax deficiency concerning, among other things, two items appearing on the company's books: (1) property used to control the internal environment of the plant; and (2) pipets used for quality control testing during the manufacturing process. The pipets account for approximately \$50,000 of the taxable value. Staff issued an NODD in the amount of \$35,764 which includes use tax, penalty and interest.

The taxpayer protested part of the NODD. The taxpayer questioned the tax imposed on a portion of the environment control property and further believed the pipets should be completely exempted from tax. Additionally, the taxpayer questioned the imposition of penalty and interest. Approximately \$18,600 of the deficiency was not protested.

Based on information provided by the taxpayer, at and subsequent to the informal conference, the parties reached agreement on the first issue. The parties agreed that tangible personal property used as standard air conditioning equipment for "human comfort" constituted an improvement to real property and was subject to tax. Other property referred to as environment control property qualified for the production exemption provided in Idaho Code § 63-3622D because such property: (1) was directly used and necessary to the production of cheese; (2) was dedicated exclusively to and serviced specific production areas within the plant; (3) consisted of equipment

separable from the “creature comfort” air conditioning at the plant; and (4) was readily removable and would be taken by the taxpayer if the taxpayer changed its place of operation because it was specialized equipment necessary for cheese production. Based on these facts, the portion of the deficiency regarding the environment control property is reduced by 3/5 or 60%.

The unresolved issue in this case is whether or not “pipets” the taxpayer used in its manufacturing process was exempt from use tax under the production exemption. The taxpayer used the pipets to test the raw material ([Redacted]) for undesirable elements or contamination that could adversely affect the [Redacted] process. The pipets are sterilized and wrapped in an airtight package when purchased by the taxpayer. The taxpayer uses a pipet one time and then disposes the used pipet.

LAW AND ANALYSIS

Idaho Code § 63-3621 imposes a use tax on “every person storing, using, or otherwise consuming, in this state, tangible personal property.” The taxpayer does not dispute it used the pipets in this state. However, the taxpayer asserts the pipets were exempted from Idaho use tax under a statute commonly referred to as the production exemption.

The legislature exempted from Idaho sales and use taxes, tangible personal property directly used or consumed in the actual production of goods.

63-3622D. Production exemption. There are exempted from the taxes imposed by this chapter (a) The sale at retail, storage, use or other consumption in this state of . . . (2) Tangible personal property primarily and directly used or consumed in or during a manufacturing, processing, mining, farming, or fabricating operation, including, but not limited to, repair parts, lubricants, hydraulic oil, and coolants, which become a component part of such tangible personal property; provided that the use or consumption of such tangible personal property is necessary or essential to the performance of such operation.

Idaho Code § 63-3622D(a)(2). The pipets must satisfy a two-pronged test before they qualified for the exemption: (1) the pipets must have been primarily and directly used or consumed in or during

the manufacturing operation, and (2) the use or consumption of the pipets must have been necessary or essential to the taxpayer's manufacturing operation.

The taxpayer stated the pipets are necessary to its manufacturing operation. Absent quality control of the [Redacted], the taxpayer could not manufacture [Redacted]. Additionally because the pipets are used only once before they are disposed, the taxpayer believes the pipets are directly consumed in its manufacturing operation.

If one were to look only at subsection (a)(2) of Section 63-3622D, it appears the taxpayer's argument may be well taken. However, the statute contains additional conditions that must be met. The production exemption statute also provides that:

Without regard to the use of such property, this section does not exempt:

- (1) Hand tools with a unit price not in excess of one hundred dollars (\$100). A hand tool is an instrument used or worked by hand.

Idaho Code § 63-3622D(f)(1). The taxpayer stated the pipets had a unit price of less the \$100 and were instruments used or worked by hand.

Pursuant to the plain language of the statute, the taxpayer's use of the pipets was not exempt from use tax. The taxpayer asks the Commission to look beyond the plain language of the statute to infer an exemption. The taxpayer does not believe the legislature intended the term "hand tool" to include disposable property used only once. The taxpayer reasons such disposable property is consumed in the manufacturing process and therefore should be exempted from sales and use taxes.

Although the taxpayer makes a policy argument, the Commission cannot infer a tax exemption. Only the legislature has the power to weigh policy consideration and bestow tax exemptions. Idaho Constitution, Article 7, Section 5. Because tax exemptions are purely a matter of legislative grace, exemptions cannot be presumed. Statutes granting tax exemptions are to be strictly construed by the executive and judicial branches of government. Exemption statutes cannot

be interpreted or extended so as to create an exemption not specifically authorized by the legislature. *Church of Latter-Day Saints v. Ada County*, 123 Idaho 410, 849 P.2d 83 (1993) and *Canyon County v. Sunnyridge Manor, Inc.*, 106 Idaho 98 (1984).

The production exemption statute does not provide an exception for hand tools that are disposed after only one use. Accordingly, the Commission cannot infer an exemption as the taxpayer requested.

The taxpayer also asked the Commission to abate the negligence penalty imposed by the audit staff. Penalty may be abated if the Commission finds that the taxpayer acted in good faith when failing to report or pay tax on a particular item. Idaho Code §§ 63-3635 and 63-3047. The Commission notes the audit occurred within one year of the taxpayer obtaining a sales and use tax permit. The taxpayer stated this was its first experience with Idaho sales and use tax.

CONCLUSION

Idaho Code § 63-3622D specifically excludes hand tools from the production exemption. The merits of the taxpayer's arguments regarding disposability aside, the Commission cannot construe the statute in a manner that infers or presumes an exemption. However, the Commission finds the taxpayer reasonably believed the pipets and other tangible personal property were not subject to use tax.

WHEREFORE, the Notice of Deficiency Determination dated March 27, 2000, is hereby MODIFIED and as MODIFIED is APPROVED, AFFIRMED and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following taxes, penalties, and interest for the period January 1, 1992 through May 31, 1998:

<u>Tax</u>	<u>Penalty</u>	<u>Interest</u>	<u>Total</u>
\$ 21,303	- 0 -	\$ 8,048	\$ 29,351

Interest is computed through February 1, 2001, and will accrue at \$4.66 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 _____, 2001.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2001, 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]
