

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

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| In the Matter of the Protest of |) | |
| |) | DOCKET NO. 15166 |
| [Redacted], |) | |
| |) | DECISION |
| Petitioner. |) | |
| |) | |
| |) | |

On September 30, 1999, the Construction Audit Group of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayer) asserting an Idaho use tax liability covering the January 1992 through December 1996 reporting periods. On November 30, 1999, the taxpayer filed a timely appeal and petition for redetermination. The taxpayer then submitted additional documentation to the Construction Audit Group for review. A Modified Notice of Deficiency Determination was then issued on April 17, 2001. The Modified Notice of Deficiency Determination asserts that the taxpayer owes Idaho use tax, penalty and interest in the total amount of \$20,165 for the January 1992 through December 1994 reporting periods. An informal conference was requested by the taxpayer and was held on July 10, 2001. The Tax Commission, having reviewed the file, hereby issues its decision upholding the April 17, 2001 Modified Notice of Deficiency Determination.

The sole issue raised in this protest is whether the Idaho use tax (Idaho Code § 63-3621) applies to a contractor improving real property on a federal [Redacted] base pursuant to a federal contract. For the reasons set out below, the Tax Commission finds that the Idaho use tax does apply under the circumstances presented in this appeal.

[Redacted] is headquartered in [Redacted], [Redacted]. In 1993 and 1994 the company performed two contracts at the [Redacted] [Redacted] near [Redacted], Idaho. These were federal construction contracts that required [Redacted] to perform or subcontract certain

renovation, repair and installation work. The first contract required [Redacted] to “provide all plant, labor, supplies, equipment, and supervision necessary to install new metal, soffits, and fascia systems to eighty-three (83) two story buildings . . . located on [Redacted] [Redacted].” The second contract required the taxpayer to “furnish all labor, plant, supplies, equipment, and supervision necessary to repair ninety-seven (97) one story single family housing units . . . located in the [Redacted].” Under Idaho law, use tax was owed on the materials and supplies used in these construction contracts. See Idaho Code § 63-3621 (imposing the Idaho use tax on the storage, use or other consumption of tangible personal property within this state) and § 63-3609(a) (providing that tangible personal property used in constructing, altering, repairing or improving real property is subject to the Idaho tax.). Unaware of this requirement, the taxpayer did not obtain an Idaho seller’s permit and did not file any Idaho sales/use tax returns relating to the work it did at the [Redacted] base.

In September 1999 the Tax Commission’s Construction Audit Group issued a Notice of Deficiency Determination to the taxpayer asserting that it owed Idaho use tax, late filing penalty, and interest on the property utilized in performing the contracts. Additional documents were provided which established the actual amount of the materials and supplies used in the two contracts. The deficiency was then modified accordingly. [Redacted] does not assert that the modified deficiency determination is mathematically inaccurate. Rather, the taxpayer contends that the Idaho tax does not apply to them because they were performing under a federal contract on federally owned land. The taxpayer cites to the “Federal Acquisition Regulations” to support its position. See 48 C.F.R. Chapter 1 (Federal Acquisition Regulations jointly issued by the Defense Acquisition Regulation Council and the Civilian Agency Acquisition Council).

The Federal Acquisition Regulations (FAR) are the “bible” of government contracting. They set the uniform policies and procedures for the acquisition of property or services by federal agencies. The Federal Acquisition Regulations are located at Title 48, Code of Federal Regulations (C.F.R.). Chapter 1 of the FAR sets out the general rules and regulations pertaining to acquisition contracts. Agency specific regulations are set out in Chapters 2 through 99. Each Chapter of the Federal Acquisition Regulations is further broken out into “Parts,” “Subparts,” “Sections,” and “Subsections.” See 48 C.F.R. 1.105-2 (2000) (describing the arraignment of the regulations).

Federal Acquisition Regulations, Chapter 1, Part 29 sets out the regulations dealing with federal, state and local taxes. 48 C.F.R. 29.000 – 29.402 (2000). The relevant portion of FAR, Chapter 1, Part 29 provides as follows:

PART 29—TAXES

29.000 Scope of part.

This part prescribes policies and procedures for (a) using tax clauses in contracts . . . (b) asserting immunity or exemption from taxes, and (c) obtaining tax refunds. It explains Federal, State, and local taxes on certain supplies and services acquired by executive agencies and the applicability of such taxes to the Federal Government. It is for the general information of Government personnel and does not present the full scope of the tax laws and regulations.

Subpart 29.1—General

29.101 Resolving tax problems.

(a) Contract tax problems are essentially legal in nature and vary widely. Specific tax questions must be resolved by reference to the applicable contract terms and to the pertinent tax laws and regulations. Therefore, when tax questions arise, contracting officers should request assistance from the agency-designated legal counsel.

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Subpart 29.3—State and Local Taxes

29.300 Scope of subpart.

This subpart prescribes the policies and procedures regarding the exemption or immunity of Federal Government purchases and property from State and local taxation.

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29.302 Application of State and local taxes to the Government.

(a) Generally, purchases and leases made by the Federal Government are immune from State and local taxation. Whether any specific purchase or lease is immune, however, is a legal question requiring advice and assistance of the agency-designated counsel.

(b) When it is economically feasible to do so, executive agencies shall take maximum advantage of all exemptions from State and local taxation that may be available. If appropriate, the contracting officer shall provide a Standard Form 1094, U.S. Tax Exemption Form (see part 53), or other evidence listed in 29.305(a) to establish that the purchase is being made by the Government.

29.303 Application of State and local taxes to Government contractors and subcontractors.

(a) Prime contractors and subcontractors shall not normally be designated as agents of the Government for the purpose of claiming immunity from State or local sales or use taxes. Before any activity [sic] contends that a contractor is an agent of the Government, the matter shall be referred to the agency head for review. The referral shall include all pertinent data on which the contention is based, together with a thorough analysis of all relevant legal precedents.

(b) When purchases are not made by the Government itself, but by a prime contractor or by a subcontractor under a prime contract, the right to an exemption of the transaction from a sales or use tax may not rest on the Government's immunity from direct taxation by States and localities. It may rest instead on provisions of the particular State or local law involved, or, in some cases, the transaction may not in fact be expressly exempt from tax. The Government's interest shall be protected by using the procedures in 29.101.

(c) Frequently, property . . . owned by the Government is in the possession of a contractor or subcontractor. Situations may arise in which

States or localities assert the right to tax Government property directly or to tax the contractor's or subcontractor's possession of, interest in, or use of that property. In such cases, the contracting officer shall seek review and advice from the agency-designated counsel on the appropriate course of action.

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Subpart 29.4—Contract Clauses

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29.401-3 Competitive contracts.

The contracting officer shall insert the clause at [Part] 52.229-3, . . . in solicitations and contracts if the contract is to be performed wholly or partly within the United States, its possessions, or Puerto Rico, when a fixed-price contract is contemplated and the contract is expected to exceed the simplified acquisition threshold

48 C.F.R., Part 29 (2000) (emphasis added). 48 C.F.R. 52.229-3 goes on to provide the precise language required in the “Federal, State and Local Taxes” clause of a competitive bid contract. Among the provisions required under this clause is that “[t]he contract price includes all applicable Federal, State, and local taxes and duties.” 48 C.F.R. 52.229-3(b) (2000).

It appears that the taxpayer interprets the Federal Acquisition Regulations as providing immunity from state sales and use taxation where a private contractor purchases tangible personal property for use in a federal construction contract. Unfortunately for the taxpayer, this is an incorrect reading of the Regulations. In fact, it is well-settled law that a state may impose its nondiscriminatory tax laws upon non-governmental entities that perform services for the federal government on government owned property. While a state is prohibited under the Supremacy Clause of the U.S. Constitution from taxing the federal government directly, or from imposing a tax that has a discriminatory effect on the federal government or its agents, that prohibition does not extend to nondiscriminatory taxes that are imposed on non-governmental

entities. As summarized in United States v. New Mexico, 455 U.S. 720, 102 S.Ct. 1373 (1982), “tax immunity is appropriate in only one circumstance: when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities, at least insofar as the activity being taxed is concerned.” Id. at 735, 102 S.Ct. at 1383. Thus, a non-discriminatory use tax imposed on a private contractor performing construction services under a federal contract on a federal military reserve is not prohibited. See, e.g. United States v. California, 507 U.S. 746, 113 S.Ct. 1784 (1993) (California use tax imposed on a private contractor performing oil drilling operations on a federal Naval Petroleum Reserve was upheld.); Washington v. United States, 460 U.S. 536, 103 S.Ct. 1344 (1983) (Washington sales tax imposed on private construction contractors dealing with the federal government upheld.).

It should also be noted that the Federal Acquisition Regulations relied on by the taxpayer are not intended to create substantive law regarding the relationship between the federal government and the several states. Rather, the purpose of the Regulations is to provide the various federal administrative agencies with “uniform policies and procedures” for acquiring property and services. 48 C.F.R. 1.101 (2000). Part 29 of the Federal Acquisition Regulations provides these agencies with a very general description of the federal, state and local tax ramifications associated with acquisition contracts. These Regulations are procedural in nature and are not designed to affect the legal rights and obligations of the federal government, the States, or private contractors performing services pursuant to a federal contract. Under current Constitutional law as interpreted by the United States Supreme Court, private contractors performing construction services under a federal contract on federal land are not immune from

state sales and use tax laws. Nothing in the Federal Acquisition Regulations changes this tax treatment or creates a broader immunity from state taxation.

The taxpayer's claim of immunity from Idaho's sales and use tax laws is not supported by any relevant authority and is hereby rejected. Under Idaho's law, use tax is owed on the materials and supplies used in the two construction projects performed by [Redacted] on the [Redacted]. There is nothing unconstitutional about requiring private contractors to comply with Idaho's use tax laws under the circumstances presented in this protest, and the Federal Acquisition Regulations do not create an otherwise unavailable exemption from the Idaho tax. Therefore, [Redacted] owes Idaho use tax on the supplies and materials it purchased and used in the two [Redacted] construction projects.

WHEREFORE, the Modified Notice of Deficiency Determination dated April 17, 2001, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following taxes, penalty and interest:

| <u>Period</u> | <u>USE TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------------|----------------|----------------|-----------------|-----------------|
| 1/1/92 – 12/31/94 | \$11,157 | \$2,814 | \$6,567 | <u>\$20,538</u> |

Interest is calculated through September 30, 2001, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

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

An explanation of the taxpayer's right 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]Receipt No. [Redacted]
[REDACTED][REDACTED]
[Redacted] [Redacted] [Redacted]

ADMINISTRATIVE ASSISTANT 1