

## BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NOS. 15356 & 15357
[Redacted] )	)	
	)	DECISION
Petitioner(s).	)	
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	)	
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On November 22, 2000, the Sales Tax Audit Bureau of the Idaho State Tax Commission issued two Notices of Deficiency Determination. The first Notice was issued to [Redacted], and proposed additional use taxes, penalties, and interest for the period 12/1/95 through 12/31/96 in the total amount of \$169,531. The second Notice was issued to that company's successor, [Redacted], and proposed additional use taxes, penalties, and interest for the period 1/1/1997 through 6/30/97 in the total amount of \$36,713. The two companies are referred to collectively herein as the "taxpayer."

On January 18, 2001, a timely protest and petition for redetermination was filed by the taxpayer. An informal conference was requested by the taxpayer and held on June 25, 2001. Additional documentation was provided and additional field investigation was performed after the informal conference.

The Tax Commission has reviewed the file, is advised of its contents, and hereby issues its decision MODIFYING the Notice of Deficiency Determination.

### FACTS

#### Business overview

The taxpayer buys certain harvested plants and manufactures them into a bulk food commodity. It operates three factories in Idaho, at [Redacted]. The taxpayer's factories run 24 hours a day in late summer through winter. In late winter through summer, the equipment is shut down for maintenance, repair, and refurbishing.

The taxpayer holds a direct pay permit from the Tax Commission and so is authorized to buy tangible personal property without paying sales tax to the vendors. The taxpayer determines taxability when it withdraws tangible personal property from storage and accrues use tax upon items it determines to be taxable.

### **Audit methods**

The auditor downloaded the taxpayer's financial data and examined all purchases of \$10,000 and above in selected accounts. For items costing less than \$10,000, certain purchases were sampled over a 36-month period, from 7/1/94 to 6/30/97, with each factory sampled separately. The taxpayer agreed to use the error rates from these samples against activity from 12/1/95 to 6/30/97. The auditor sampled 10% of purchases of \$5,000 to \$9,999; sampled 5% of purchases of \$4,999 to \$1,000; and 1% below \$1,000. Error rates in the samples were multiplied by the dollar value of the sampled population in the 12/1/95 to 6/30/97 period to arrive at projected purchases subject to use tax. Asset additions of \$100 and above were examined in detail.

Credit was given for items originally reported by the taxpayer on its returns as subject to use tax. A negligence penalty of 5% was applied to the deficiency because the taxpayer has been previously audited at least twice.

### **Protested items**

Protested items are as follows.

- *Defoamers.* The harvested plants are unloaded into a recirculating "flume" or stream of water that cleans and floats them. After the plants are removed from the flume, the water is circulated through a mud pond to settle out dirt and solids (mainly plant fragments).

The surging water develops foam on its surface. The taxpayer adds chemical defoamers to the water to reduce the foam, which would otherwise destroy the pumps that pump the settled water from the mud pond back into the flume; the pumps cannot pump foam.

The taxpayer has two separate ledger accounts for defoamers. One is entitled, “operating material, . . . production, factory chemicals,” and the other is entitled, “waste water disposal materials.” The auditor picked up only the latter, reasoning that defoamers that qualify as used in production only include those in the first of the two accounts.

- *Disinfectant for water flume.* In the recirculating water flume, described above, the taxpayer adds chemical disinfectants to control bacteria in the water. This keeps the plants clean and also suppresses odors (pollution control). The chemicals do not become a part of the finished product. The taxpayer has provided a copy of DEQ rules on odor complaints.

The auditor disallowed the disinfectant because it is not directly used in manufacturing.

- *Expenditures for safety of employees*

- *Radios and telephone systems.* The taxpayer uses radios and telephone systems to communicate within the production area so that production flow and other processes can be adjusted. Federal Occupational Safety and Health Administration (OSHA) safety regulations require electronic communications systems over distances.

The auditor allowed exemption for equipment that was documented as being used in the production area.

- *Lab safety equipment cabinet.* The plant has a laboratory to take samples and test for quality during production. Safety equipment is required in labs under OSHA rules.

The auditor disallowed exemption of a cabinet that holds safety equipment on the ground that it is office furniture.

- *Welding goggles.* Welders wear safety goggles when repairing machinery. Goggles are required by OSHA for welders.

The auditor disallowed the goggles on the ground that they are used primarily to repair equipment during the off-season when production is shut down.

- *Expenditures for cleanliness of plant*

- *Paint.* The federal Food and Drug Administration (FDA) requires painted surfaces in food plants to be maintained free of flaking paint in order for food products to be clean.

The auditor disallowed exemption of the paint on the ground that the production exemption applies to equipment for the safety of the workers, not for the safety of the food.

- *Lighting.* The taxpayer installed special lighting that is “explosion proof,” so as not to introduce glass into the production area as prohibited by FDA rules. The cost of the special fixtures and bulbs is more than the cost of normal lighting.

The taxpayer is also claiming the cost of normal lighting because it is necessary for production and is required by OSHA.

The auditor disallowed exemption of the cost of the special lighting on the ground mentioned above and disallowed exemption of the cost of regular lighting because it is not directly used in manufacturing.

- *Pest control.* The taxpayer took preventive steps for rodent control to keep rodent hair and other contaminants out of the food. The FDA requires active pest control measures.

The auditor disallowed exemption of the pest control items for the reason mentioned above.

- *Other Items*

- *Wall panels and steel framing.* At [Redacted], the taxpayer installed cement tilt-up wall panels with steel supports, both of which had been removed from another structure. The taxpayer

claims that the walls and supports would be removed if the machinery inside the building were removed. The taxpayer claims that the wall panels and framing are personal property and are protective devices for machinery used in the production process.

The auditor reports that the wall panels are precast concrete walls that make up the entire outside of the building. Structural steel and rebar comprise parts of the building frame. These are real property improvements for which no exemption is allowed.

- *Machine supports.* The taxpayer incurred costs to anchor machines to the floor or to support the machines. The taxpayer claims these supports do not enhance the value of the building and would have to be removed if either the machines were replaced or the building were converted for non-factory use; hence the supports are component parts of the machines and are not real property.

The auditor's reasoning is that concrete pads poured to support heavy equipment are flooring and hence real property improvements.

- *Metal floor grating.* Metal floor grating is used to gain access to machinery for service. The claim is that this is tangible personal property and production equipment.

The auditor reports that there is a lot of metal floor grating in the factories. He has tried only to disallow floor grating while allowing equipment access items such as catwalks.

- *Space heaters.* At the [Redacted], the taxpayer bought four large space heaters. The taxpayer claims that it installed these because certain areas of the plants have inadequate regular heating on very cold days. The heaters are to keep the intermediate liquid product flowing in cold weather and not for comfort heating.

The auditor disallowed these because they also have a comfort function and are indirectly involved in manufacturing.

- *Air conditioners.* Also at [Redacted], the taxpayer installed a window mount air conditioner in a small compartment area containing an electronic control system. The claim is that the cooling is necessary for the control system to operate.

The auditor disallowed these because they also have a comfort function and are indirectly involved in manufacturing.

- *Computers.* The protest seems to state that computers are used in two ways. First, they monitor and control the process flow within the plant. And second, they are used to design such things as piping systems and machine installations, and to calculate heat balances. Whether these are the same computers for both uses is unidentified.

The auditor has allowed the exemption for project numbers 611 & 713, “upgrade control room.” He has attempted to disallow the engineers’ computers, software, etc. that he understands are separate from the control room. He reasons that the engineers design equipment and processes and do not monitor factory operations. The taxpayer’s chart of accounts lists factory engineering as an administrative account.

- *Pallets.* The taxpayer stacks bags of finished product on pallets, and sometimes shrink-wraps the product to the pallet and sometimes does not do so; in the latter event, shrink wrap covers the product but not the pallet. The taxpayer believes that pallets are containers for the product in both instances.

The auditor relies on the Tax Commission rule, quoted below, that requires shrink- wrapping of the product to the pallet in order for the pallet to qualify as exempt packaging.

- *Boxcar and trailer linings, hatch covers, and cable locks.* Most of the taxpayer’s product is sold in bulk form and shipped in rail cars, each of which contains about 188,000 pounds of product. Finished product is screened to customer specifications and passes over magnets to detect any tramp

(scrap?) metal. The taxpayer lines the boxcar or trailer with cardboard and seals and locks it to prevent contamination during shipment. The taxpayer claims the product is not ready for “shipment” until these steps are complete, so the linings, covers, and locks are installed during the production process.

The auditor picked up a lot of shipping supplies as taxable, while the taxpayer has only protested the items just described. The auditor’s rationale is that “[n]one of these items are attached to the product, and are therefore not packaging materials, but rather are shipping supplies.”

- *Penalty.* The protest does not mention the penalty, but the taxpayer’s representative protested it at the informal conference.

## **LAW AND ANALYSIS**

### **Use tax in general**

Use tax is imposed on the storage, use, or other consumption of tangible personal property in Idaho at the rate of 5% of the value of the property. A recent sales price is presumptive evidence of the value of the property.<sup>1</sup> Every person storing, using, or otherwise consuming tangible personal property in Idaho is liable for the use tax.<sup>2</sup>

### **Production exemption: Code and rules**

As in effect in the audit period, the production exemption statute provides in pertinent part:

**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:

(1) Tangible personal property which will enter into and become an ingredient or component part of tangible personal property manufactured, processed, ..., [or] produced ... for sale.

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<sup>1</sup> Idaho Code § 63-3621.

<sup>2</sup> Idaho Code § 63-3621(a).

(2) Tangible personal property primarily and directly used or consumed in or during a manufacturing, [or] processing ... 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.

(3) Chemicals, catalysts, and other materials which are used for the purpose of producing or inducing a chemical or physical change in the product or for removing impurities from the product or otherwise placing the product in a more marketable condition as part of an operation described in subsection (a)(2) of this section, and chemicals and equipment used in clean-in-place systems in the food processing and food manufacturing industries.

(4) Safety equipment and supplies required to meet a safety standard of a state or federal agency when such safety equipment and supplies are used as part of an operation described in subsection (a)(2) of this section. ....

(b) Other than as provided in subsection (c) of this section, the exemptions allowed in subsections (a)(1), (2), (3) and (4) of this section are available only to a business or separately operated segment of a business which is primarily devoted to producing tangible personal property which that business will sell and which is intended for ultimate sale at retail within or without this state. ....

(e) The exemptions allowed in this section do not include machinery, equipment, materials and supplies used in a manner that is incidental to the manufacturing, [or] processing, ... operations such as maintenance and janitorial equipment and supplies.

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

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

(2) Tangible personal property used in any activities other than the actual manufacturing, [or] processing, ... operations such as office equipment and supplies, and equipment and supplies used in selling or distributing activities.

(3) Property used in research or development.

(4) Property used in transportation activities.

(5) Machinery, equipment, tools or other property used to make repairs. This subsection does not include repair parts that become a component part of tangible property exempt from tax under this section or lubricants, hydraulic oil, or coolants used in the operation of tangible personal property exempt under this section.



(6) Machinery, equipment, tools or other property used to manufacture, fabricate, assemble or install tangible personal property which is:

(i) Not held for resale in the regular course of business; and

(ii) Owned by the manufacturer, [or] processor, ...;

provided, however, this subsection does not prevent exemption of machinery, equipment, tools or other property exempted from tax under subsection (a)(2) or (a)(3) of this section.

(7) Any improvement to real property or fixture thereto or any tangible personal property which becomes or is intended to become a component of any real property or any improvement or fixture thereto.

....

The applicable Tax Commission rule reads as follows:

**079. PRODUCTION EXEMPTION.** (7-1-93)

01. IN GENERAL. The Sales Tax Act provides an exemption from sales and use taxes for certain tangible personal property used in production activities. The production activities include: (7-1-93)

a. A manufacturing, processing, or fabrication operation devoted to producing tangible personal property for resale. (6-23-94)

02. QUALIFYING BUSINESSES. The production exemption applies only to a business or a separately operated segment of a business that primarily produces tangible personal property which is intended for ultimate sale at retail. (7-1-93)

03. EXEMPT PROPERTY. As applied to manufacturing, [or] processing, ... operations, the following items of tangible personal property are exempt, except as limited by other subsections of this rule: (7-1-93)

a. Raw materials that become an ingredient or component part of the product which is produced. (7-1-93)

b. Equipment and supplies used or consumed primarily and directly in the production process and which are necessary or essential to perform the operation. To qualify, the production use must be the primary use of the equipment and supplies. Also, the equipment and supplies must be used directly in the production process. (7-1-93)

c. Chemicals and catalysts consumed in the production process which are used directly in the process but which do not become an ingredient or component part of the property produced. (7-1-93)

- d. Repair parts, lubricants, hydraulic oil, and coolants, which become a component part of production equipment. (7-1-93)
- e. Fuel ... used in equipment while performing production exempt activities. (7-1-93)
- f. Chemicals and equipment used in clean-in-place systems in the food processing and food manufacturing industries. (7-1-93)
- g. Safety equipment and supplies required by a state or federal agency when used directly in a production area. (7-1-93)
- h. Equipment ... used primarily to install production equipment. (7-1-93)
- i. Equipment used primarily to fabricate production equipment. (7-1-93)

04. PRODUCTION PROCESS BEGINNING AND END. The production process begins when raw materials used in the process are first handled by the operator at the processing plant or site. The production process ends when the product is placed in storage, however temporary, ready for shipment or when it reaches the final form in which it will be sold at retail, whichever occurs last. (7-1-93)

05. TAXABLE PROPERTY. The production exemption does not include any of the following: (7-1-93)

- a. Motor vehicles .... (7-1-93)
- b. Repair parts for any equipment which does not qualify for the production exemption. (7-1-93)
- c. A hand tool with a unit price of one hundred dollars (\$100) or less .... (7-1-93)
- d. Office equipment and supplies. (7-1-93)
- e. Safety equipment and supplies used somewhere other than a production area, such as an office, or which are not required by a state or federal agency even if used in a production area. (7-1-93)
- f. Equipment and supplies used in selling and distribution activities. (7-1-93)
- g. Janitorial equipment and supplies, other than ... clean-in-place equipment and chemicals used in food processing or food manufacturing. (7-1-93)
- h. Maintenance and repair equipment and supplies which do not become component parts of production equipment, such as welders, welding gases, shop equipment, etc. (7-1-93)
- i. Transportation equipment and supplies. (7-1-93)

- j. Aircraft .... (7-1-93)
- k. Paint, plastic coatings, and similar products used to protect and maintain equipment, whether applied to production equipment or other equipment. (7-1-93)
- l. Research equipment and supplies .... (7-1-93)
- m. Other incidental items not directly used in production. (7-1-93)
- n. Fuel used in equipment while performing activities that do not qualify for the production exemption. (7-1-93)
- o. Recreation-related vehicles .... (7-1-93)
- q. Equipment used primarily to construct, improve, alter or repair real property. (7-1-93)

06. REAL PROPERTY. The production exemption applies only to tangible personal property. It does not apply to real property or to tangible personal property purchased with the intention of becoming improvements or fixtures to real property. . . . (7-1-93)

08. TRANSPORTATION ACTIVITIES. Equipment and supplies used in transportation activities do not qualify for the production exemption. (7-1-93)

- a. Transportation includes the movement of tangible personal property over private or public roads or highways, canals, rivers, rail lines, through pipelines or slurry lines, or on private or public aircraft. (7-1-93)
- b. Transportation includes movements of tangible personal property from one separate location which is a continuous manufacturing, processing, mining, fabricating or farming activity to another separate location which is a continuous exempt activity or process. (7-1-93)
- c. Transportation includes movement of raw materials, except farm produce, from a point of initial extraction or severance or importation to a point where processing, manufacturing, refining or fabrication begins. See Idaho Sales Tax Administrative Rule 83 regarding farming . . . . (6-23-94)

### **Analysis of claimed production exempt items**

- *Defoamers.* Under § 63-3622D(a)(2), the question is whether the defoamers are “primarily and directly used or consumed in or during a manufacturing [or] processing operation,” and if so, whether the use or consumption is “necessary or essential to the performance of such operation.”

The account from which the auditor has disallowed the defoamers is entitled, “Waste water disposal materials.” The disposal of waste water is not a primary and direct use in manufacturing. The defoamers are therefore subject to use tax.

- *Disinfectant for recirculating water system.* The taxpayer puts disinfectants in the recirculating water system described above. The disinfectant keeps the harvested plants clean while in the water and is thus essential to manufacturing. It also causes a physical change in the plants and removes impurities from them if they start out contaminated. The disinfectants thus qualify for exemption under § 63-3622D(a)(3).

- *Wall panels and steel framing.* With modern equipment, one can uproot a house from its foundations and truck it to a new location. Portability is not the sole test for real property, because with enough effort, most buildings can be moved, as the wall panels were here. The taxpayer has not stated any intent to remove the panels and framing in question.

The wall panels and steel framing are real property, excepted from the production exemption by paragraph (f)(7).

- *Machine supports.* The Idaho Supreme Court has expressly held that structural steel equipment foundations are real property and not eligible for the production exemption. *Potlatch Corp. v. Idaho St. Tax Com’n*, 120 Idaho 1, 4-6 (1991). The fact that the supports would have to be removed if the building were sold does not make them personal property.

- *Metal floor grating.* The taxpayer has the burden of factually establishing which portions of grating are directly used in production. The auditor has given the taxpayer the benefit of the doubt and allowed exemption of certain parts of the floor grating. The taxpayer has not submitted any detailed evidence on the disallowed portion. Accordingly, the auditor’s action is sustained.

- *Space heaters and air conditioners.* If it can be established that the space heaters “primarily” are used to keep [intermediate food product] flowing, and that the [intermediate food product] would not flow without them, then they would qualify under paragraph (a)(2) of § 63-3622D.

Under prior law, the Idaho Supreme Court cited an Ohio case that disallowed the production exemption for an air conditioner that rigidly controlled the quality of air in a color TV picture tube factory on the ground that the equipment was not directly used in the production of the tubes. *Richardson v. State Tax Comm’n*, 100 Idaho 705, 709 (1979). Here, if it can be established that the controls would not function without the cooling provided by the air conditioners, then the air conditioners would qualify as production exempt.

The taxpayer has not provided such proof for the space heaters or the air conditioners. The items are therefore disallowed as “incidental” under subsection (e) of § 63-3622D.

- *Computers.* Control computers for the manufacturing process would qualify for exemption under § 63-3622(a)(2). On the other hand, computers for design functions would be incidental under subsection (e). The taxpayer has the burden to clarify exactly which computers perform which functions. Having failed to do so, the exemption of the claimed computers is disallowed.

### **Safety expenditures for employees**

Before the addition of paragraph (a)(4) to § 63-3622D, the Idaho Supreme Court held that safety equipment, specifically a sprinkler system in a sawmill, although necessary and essential to the continued operation of the taxpayer’s business, was “not integrated with or directly related to” the sawmill operation and hence was “incidental to the manufacturing process.” *Richardson v. State Tax Comm’n*, 100 Idaho 705, 709 (1979).

Paragraph (a)(4) of § 63-3622D now exempts “[s]afety equipment and supplies required to meet a safety standard of a state or federal agency . . . .” As OSHA expands its reach into the workplace with detailed regulation, this exemption looks to play a larger role as time passes. Although the exception for incidental items remains in subsection (e), the more recent enactment of paragraph (a)(4) may be a limitation on that exception. Thus, required safety equipment and supplies “used as part of” a manufacturing operation is exempt, even if it might not be “primarily and directly used or consumed” in that operation or might be “incidental to” that operation under the *Richardson* case.

Rules 079.03.g and .05.e limit exempt safety equipment and supplies to those used in a production area based on the statutory language that the equipment and supplies must be “used as part of a [manufacturing] operation.”

- *Radios.* The auditor has exempted communications items that were documented as being used in the production area. In a visit to the [Redacted] plant, he observed supervisors wearing two-way radios on their clothes, but there was conflicting evidence on the range of the radios including a statement made that they could be used to page supervisors traveling away from the plant. The taxpayer having failed to document an in-plant use for the radios, the exemption for the radios is disallowed.

- *Lab safety equipment cabinet.* The taxpayer documented that OSHA rules require that safety equipment be maintained and accessible. The cabinet that holds safety equipment qualifies for the safety exemption.

- *Welding goggles.* The goggles fall within the safety exception. They are also used in production to the extent welders use the goggles to repair production equipment, and the Idaho Supreme Court has allowed the exemption for “repair or remanufacture of worn or broken production equipment” and “equipment used to repair production equipment.” *Idaho St. Tax Com’n v. Haener*

*Bros., Inc.*, 121 Idaho 741, 749 (1992). Although the goggles are not applied directly to production equipment and hence might be said to be used “in the repair of” equipment rather than “to repair” equipment, the broader language of the safety exemption makes them exempt.

### **Expenditures for plant cleanliness**

- *Paint.* The Tax Commission’s Rule expressly disallows paint. Rule 079.05.k contains no safety exception for paint. The Tax Commission is required to follow its own rules. *Cf. Appeal of Railbox*, 116 Idaho 909, 911 (1989)(“the Tax Commission cannot be permitted to ignore its own regulation in an attempt to search out special circumstances . . .”). The paint is therefore subject to use tax.

- *Lighting and pest control.* The lighting, both ordinary and specialized, and the pest control expenditures are not used directly in manufacturing. Exemptions from taxation are strictly construed against the taxpayer. *E.g., Housing Southwest v. Washington County*, 128 Idaho 335, 337-338 (1996). If the safety exemption were to be expanded to cover all expenditures that protect the quality of manufactured food, it would also have to cover expenditures that help to make any manufactured product conform to specifications, since defective products of all kinds commonly have safety implications.

The Tax Commission declines the invitation for the safety exemption to swallow the limitations on the manufacturing exemption. The safety exemption applies only to measures that protect the safety of workers in the plant.

### **Linings, etc., under production exemption**

With respect to boxcar and trailer linings, hatch covers, and cable locks, the Tax Commission’s rules are potentially in conflict. On the one hand, Rule 079.04, defining the production process, states that production ends when the product is placed in storage ready for shipment, or when it is in its final form for retail sale, whichever occurs later. Since the taxpayer is a

wholesaler, one could argue that this rule treats all of the taxpayer's handling of the product as part of production. Such an interpretation would irrationally favor the shipping activities of wholesalers over those of retailers.

On the other hand, the statute denies the production exemption for "property used in transportation activities." § 63-3622D(f)(4). Rule 079.08.a defines movement by rail as part of transportation. The disputed linings, covers, and locks are installed before movement but are "used" during transportation, i.e., that is when they are useful.

The Tax Commission denies the production exemption to the linings, hatch covers, and cable locks. Below, the possible application of the container exemption is considered.

#### **Containers: Code and rule**

The Code provides in pertinent part:

**63-3622E.** CONTAINERS. There is exempted from the taxes imposed by this chapter the sale or purchase of containers in the following categories:

- (a) Nonreturnable containers when sold without the contents to persons who place the contents in the container and sell the contents together with the container.
- (b) Containers when sold with the contents if the sales price of the contents is not required to be included in the measure of the taxes imposed by this act.
- (c) Returnable containers when sold with the contents in connection with a retail sale of the contents or when resold for filling.

The applicable Tax Commission rule provides:

#### **084. CONTAINERS - RETURNABLE - NONRETURNABLE. (7-1-93)**

01. CONTAINER. A container encloses or will enclose tangible personal property which is sold at wholesale or retail. A container may be comprised of one or more components. Items used as shipping supplies which do not enclose the product are not considered to be containers.



*Example:* Cartons of canned goods are placed on a pallet. Shrink wrap is used to bind the cartons to the pallet. A shipping address label is affixed to the shrink wrap. The container includes the cans in which the goods are enclosed; the cartons in which the canned goods are placed; and the shrink wrap and pallet which enclose the cartons. The address label is not part of the container. (7-1-93)

02. CONTAINERS EXEMPT FROM TAX. The following containers are exempt from sales or use tax: (7-1-93)

a. Nonreturnable containers purchased by a retailer or wholesaler who places the contents in the container and sells the contents with the container at retail or wholesale .... (7-1-93)

b. Returnable containers when the container, along with the contents, is sold at retail if the fee for the container is separately stated ... but only when sold back to retailers or manufacturers for refilling. (7-1-93)

c. Returnable containers when sold back to retailers or manufacturers for refilling. (7-1-93)

d. Returnable or nonreturnable containers when sold with contents that are exempted from the tax .... (7-1-93)

03. TAXABLE CONTAINERS. Containers subject to sales and use tax include: (7-1-93)

a. Containers used by persons who are providing a service rather than selling a product (7-1-93)

b. Storage tanks, such as fuel and oil tanks. (7-1-93)

04. SUPPLIES. Shipping, selling, or distribution supplies are not considered to be containers and are subject to the tax when purchased by the shipper, seller, or distributor, such as: (7-1-93)

a. Shipping pallets and lumber stickers when not banded or shrink wrapped to the product to be sold, thereby NOT becoming a part of the container. (7-1-93)

b. Gift wrap and boxes when not regularly offered to all purchasers of merchandise or when a fee is charged for the service of gift wrapping (7-1-93)

c. Banding or binders used to secure goods to transportation equipment. (7-1-93)

d. Shipping or mailing paper, tape, string, and address labels. (7-1-93)

e. Price stickers ... that do not provide any product information .... (7-1-93)

f. Example: Plywood is wrapped with lumber wrap. The bundles are rested on

pallets for shipping. In this example the lumber wrap is the only container. As the bundles are not enclosed onto the pallet, the pallet is not a container and is instead a shipping supply subject to the tax. (7-1-93)

### **Analysis of claimed items under exemption for containers**

- *Pallets.* Pallets would qualify under subsection (a) of § 63-3022E if they are not returnable to the taxpayer's supplier and the taxpayer places the "contents in" the pallet. Pallets have no interior, so nothing can be placed "in" them; rather, one places goods "on" them. This reasoning supports Rule 084.01, which defines a pallet as a container only if the pallet plus shrink wrap "enclose" the product. Subsection (a) does not exempt the pallets.

Subsection (b) would exempt the pallets if they are sold with the contents and the contents are not taxable. Here, products stacked on top of the pallet are not "contents" of the pallet, since the pallet has no interior to "contain" anything. Subsection (c) does not apply because the taxpayer is not purchasing any contents at retail, and the taxpayer is not accepting a return of a pallet from a customer for refilling.

Since none of the statutory exemptions for containers applies, the pallets are taxable. The Rule on pallets as shipping supplies, 084.04.a and .f, is on point.

- *Boxcar and trailer linings, hatch covers, and cable locks.* The treatment of these items seems to depend on whether each item is a "container" in the ordinary meaning of the term. They are not containers; they are merely parts of containers. The container exemption does not apply to the boxcar and trailer linings, hatch covers, or cable locks.

### **Negligence penalty**

This taxpayer has not been audited since the period ending March, 1983. The Tax Commission exercises its discretion to abate the negligence penalty.

## CONCLUSION

WHEREFORE, the Notices of Deficiency Determination dated November 22, 2000, are hereby MODIFIED and, as so modified, are hereby APPROVED, AFFIRMED and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following taxes and interest (computed through May 23, 2002):

<u>PERIOD</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
12/01/95-12/31/96	\$116,626	\$0	\$54,490	\$171,116
01/01/97-06/30/97	\$ 23,946	\$0	\$ 9,497	<u>\$ 33,443</u>
			TOTAL DUE	<u>\$204,559</u>

Interest accrues at \$26.96 per day until the deficiency is 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 \_\_\_\_\_, 2002.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

## **CERTIFICATE OF SERVICE**

I hereby certify that I have on this \_\_\_\_\_ day of \_\_\_\_\_, 2002, served a copy of the within and foregoing DECISION by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No. 7000 0600 0028 9049 5457

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ADMINISTRATIVE ASSISTANT 1