

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 16710
[REDACTED].,)	
)	DECISION
Petitioner.)	
_____)	

On May 22, 2002, the Construction Audit Group of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination to [Redacted] (taxpayer). The Notice proposed additional use taxes, penalty and interest in the total amount of \$50,655 for specific purchases made in 2001. The taxpayer’s authorized representative filed a timely appeal and petition for redetermination on July 23, 2002. An informal conference was requested and held on September 26, 2002. The Commission has reviewed the file, is advised of its contents, and hereby issues its decision affirming the deficiency determination.

DISCUSSION OF FACTS

The taxpayer is an Oregon-based real property contractor with two locations, one in Ontario, Oregon and one in Boise, Idaho. The taxpayer is not registered with Idaho as a retailer and does not have a use tax reporting number. An audit of the company was performed for two public works contracts and revealed the untaxed purchase of tanks and peripheral hardware from a Montana-based corporation (supplier). The supplier is a registered Idaho retailer.

The purchases of tanks and peripheral hardware by the taxpayer were for use in two Idaho municipalities, referred to as Municipality 1 and Municipality 2 in this Decision.

Municipality 1 contracted with the taxpayer to supply and erect a municipal water tank 70’ by 34’, holding about one million gallons.

Municipality 2 contracted with the taxpayer to make additions and repairs to a potato wastewater treatment facility that it owns, as noted below:

- An 81' by 19' bio-oxidation tank was supplied and erected on site.
- A 31' by 23' conditioning tank with domed top was supplied and erected, replacing an existing one that was leaking.
- Repairs were made to two sections of a 25' by 24' sludge tank

Bid proposals indicate that the supplier intended to contract with the taxpayer to both provide and erect/install the tanks, repair parts and peripheral hardware at both localities. Subsequently, however, the taxpayer decided to buy the materials and either installed them or hired a sub-contractor for that purpose. Responding to the intentions of the taxpayer, the supplier subtracted the installation labor and other charges from the original bids.

The water storage bid from the supplier was originally \$380,288. Below that price is the phrase, "Less all erection labor, subsistence, equipment rental, insurance. 15 days supervision is included. DEDUCT \$52,000.00" Below that is a handwritten total of \$328,288. The wastewater processing tanks bid from the supplier was originally \$521,000. Below that price is the phrase, "Less all erection labor, subsistence, equipment rental, insurance, waste disposal, for Demo and erection of all tanks. 30 days supervision is included. DEDUCT \$100,000.00 Total \$421,000". The taxpayer did not dispute the sales prices in the written protest or at the informal hearing.

In a sales and use tax audit of the taxpayer for transactions related to the two public works projects the auditor determined based on the bids that the taxpayer bought the tanks and related materials without paying sales tax to the supplier and did not remit use tax to the State of Idaho. Following the issuance of a Notice of Deficiency Determination and a timely protest by the taxpayer's representative, the Commission held a hearing.

With respect to Municipality 1, the taxpayer provided two related arguments as to why it should not be liable for tax on the purchase of the material required to build and install the water tank. First, the taxpayer argues that the purchase order it prepared stipulates that the supplier is responsible for all taxes, and therefore the supplier in fact has the tax but has not remitted it to Idaho.

Second, the taxpayer argues from a related perspective asserting that the supplier is a retailer under Idaho Code §63-3610, and that a retail sale occurred as defined by Idaho Code §63-3609. Finally, the taxpayer asserts that it is the duty of the seller to collect the tax owed and that no recourse to the buyer is allowed under Idaho Code §63-3619.

With respect to Municipality 2, the taxpayer indicated that the tanks and hardware were part of an Upflow Anaerobic Sludge Blanket Reactors (UASB) Odor Control Facility and would qualify as pollution control equipment exempt from tax upon sale, use or purchase as allowed in Idaho Code §63-3622X.

ANALYSIS AND CONCLUSIONS

The taxpayer states that the supplier is a retailer, that retail sales have taken place, and that the retailer “shall” collect the tax from the consumer. The Commission agrees that the supplier is a retailer and has a permit to collect and remit sales tax for the state:

Retailer. The term "retailer" includes:

(a) Every seller who makes any retail sale or sales of tangible personal property and every person engaged in the business of making retail sales at auction of tangible personal property owned by the person or others. (*Idaho Code §63-3610*)

Further, the Commission agrees that retail sales have taken place:

Retail sale -- Sale at retail. The terms "retail sale" or "sale at retail" means a sale for any purpose other than resale in the regular course of business or lease or rental of property in the regular course of business where such rental or lease is taxable under section 63-3612(h), Idaho Code. (*Idaho Code §63-3609*)

Additionally, the Commission agrees that the retailer (supplier) has a statutory requirement to collect the tax.

Imposition and rate of the sales tax. An excise tax is hereby imposed upon each sale at retail at the rate of five per cent (5%) of the sales price of all retail sales subject to taxation under this chapter and such amount shall be computed monthly on all sales at

retail within the preceding month.

(a) The tax shall apply to, be computed on, and collected for all credit, instalment, conditional or similar sales at the time of the sale or, in the case of rentals, at the time the rental is charged.

(b) The tax hereby imposed *shall be collected by the retailer from the consumer. (Idaho Code §63-3619, emphasis added).*

We disagree with the taxpayer's conclusion that the retailer (in this case, supplier) having failed to collect the tax absolves the taxpayer from the obligation to pay it. By statute, a tax deficiency can be assessed against those who store, use, or otherwise consume materials when due.

A use tax provision in the statute states, in part:

Imposition and rate of the use tax -- Exemptions. An excise tax is hereby imposed on the storage, use, or other consumption in this state of tangible personal property acquired on or after July 1, 1965, for storage, use, or other consumption in this state at the rate of five percent (5%) of the value of the property, and a recent sales price shall be presumptive evidence of the value of the property...

(a) Every person storing, using, or otherwise consuming, in this state, tangible personal property is liable for the tax. His *liability is not extinguished until the tax has been paid to this state except that a receipt from a retailer maintaining a place of business in this state or engaged in business in this state given to the purchaser is sufficient to relieve the purchaser from further liability for the tax to which the receipt refers. (Idaho Code §63-3621, emphasis added).*

Additionally, a statute places responsibility for tax directly on those who use materials with the intent to construct or improve real property:

(a) 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. *(Idaho Code §63-3609)*

Therefore, while the retailer must collect the tax and can be held liable for it, the Commission may impose it upon the user if the retailer has not collected it or if the user has not

remitted it voluntarily to the state.

As an aside, lest the taxpayer find the playing field unequal, we point out that if a retailer is held responsible in an audit for a tax that should have been collected, that retailer may then recover the tax plus accrued and assessed interest from the buyer, as the incidence of the tax is intended to fall on the latter.

07. Reimbursement Of Tax From The Purchaser To The Seller.

If the seller does not collect the sales tax at the time of the sale and it is later determined that sales tax should have been collected, the seller can then collect the sales tax from the purchaser if the delinquent tax has been paid by the seller. The legal incidence of the tax is intended to fall upon the buyer, Section 63-3619, Idaho Code.

a. Example: The Commission determines that certain nontaxed sales by a seller are subject to sales tax and that the seller did not collect the tax and did not have documentation supporting exemption from the sales tax. The Commission issued a Notice of Deficiency Determination to the seller imposing the tax and interest. *The assessment then paid by the seller entitles the seller to reimbursement from the buyer. (IDAPA 35, Title 01, Chapter 02, Rules Of The Idaho State Tax Commission, Sales Tax Administrative Rule 068, emphasis added).*

The Rule cited above has been upheld in an Idaho district court decision (*Peterson Motor Company vs. Benton M. Hofferberger, Jr.*, Case No. 3L-49344, Michael Dennard, Magistrate, 1987).

The taxpayer was unable to provide an invoice or receipt that shows a sales tax had been applied to the sale. Therefore, as it states in Idaho Code §63-3621 cited previously, the liability is not extinguished. The taxpayer argues here that both purchase orders and bids reference the tax and that the supplier has billed and remitted it or, alternatively, has the tax and has failed to remit it. The Commission reviewed both the purchase order and the bid associated with Municipality 1 and found that only the original bid for materials and installation refers to tax, saying that it is included in the bid price.

Without sufficient and reliable evidence to the contrary, the Commission does not accept

purchase orders and bids as *prima facie* evidence that the retailer has billed the proper tax.

(c) Every seller, every retailer, and every person storing, using, or otherwise consuming in this state tangible personal property purchased from a retailer shall keep such records, receipts, invoices and other pertinent papers as the state tax commission may require. (*Idaho Code §63-3624*)

The present case is persuasive in that it points out the unreliability of accepting documents other than receipts as evidence of tax paid. The absence of a retail sales invoice or receipt in this case is believed by the Commission to be the result of changes that were made to the contract between the taxpayer and the supplier.

As discussed previously, the supplier was originally asked to provide and install materials in fulfillment of a real property contract with the taxpayer. When the taxpayer decided to make a change to a “materials only” retail purchase, the supplier subtracted the installation labor from the bid. It should have, but did not, add a retail sales tax. While bids and proposals are often used as the final documents in a “supply and install” contract to improve real property where no retail sales tax is due, receipts or invoices with separately stated tax is the statutory requirement for documenting retail sales.

05. Tax To Be Separately Displayed. The amount of tax collected by the retailer must be displayed separately from the list price, marked price, the price advertised in the premises or other price on the sales slip or other proof of sale. The retailer may retain any amount collected under the bracket system which is in excess of the amount of tax for which he is liable to the state during the period as compensation for the work of collecting that tax. (*IDAPA 35, Title 01, Chapter 02, Rules Of The Idaho State Tax Commission, Sales Tax Administrative Rule 068*).

The Rule cited above derives its authority by statute:

(e) The tax commission may by rule provide that the amount collected by the retailer from the customer in reimbursement of the tax be displayed separately from the list price, the price advertised

on the premises, the marked price, or other price on the sales slip or other proof of sale. (*Idaho Code §63-3619*)

In the Commission's oral communication with the supplier, it was found that some use tax for the material provided to the taxpayer was accrued and remitted to Idaho under the supplier's sales and use tax permit number. Additional amounts of tax were said to be paid to vendors. These amounts are recoverable by the supplier because it did not use the materials in the improvement to real property in Idaho. Rather, it sold the material as part of a retail sale, and the buyer owes the tax.

If it were feasible, the Commission would examine the transactions comprehensively to determine if there were nontaxable elements that could be adjusted from the final amounts held. One such element is the sales and use tax paid by the supplier directly to the state or indirectly to the state through vendors. It is common practice for a contractor improving real property to pass these costs along to a customer. We surmise that they were included in the original bid but suggest that they may not have been backed out when the agreement between the parties was reduced to a retail sale of goods. Nevertheless, due to a dispute between the taxpayer and the supplier, this information is not forthcoming. In the end, it is the burden of the taxpayer to acquire and provide sufficient and reliable documentation related to amounts held taxable.

(c) Every seller, every retailer, and every person storing, using, or otherwise consuming in this state tangible personal property purchased from a retailer shall keep such records, receipts, invoices and other pertinent papers as the state tax commission may require. (*Idaho Code §63-3624*)

In a receipt or invoice where an aggregate figure is present and differentiation is not evident, the entire transaction amount is considered taxable and can be held so. Note that in the statute that defines “sales price” for purposes of the Sales Tax Act, there are several instances where a breakdown of costs on an invoice or receipt could lessen the tax liability.

- (b) The term "sales price" does not include any of the following:
1. Retailer discounts allowed and taken on sales, but only to the extent that such retailer discounts represent price adjustments as opposed to cash discounts offered only as an inducement for prompt payment.
 2. Any sums allowed on merchandise accepted in payment of other merchandise....
 4. The amount charged for labor or services rendered in installing or applying the property sold, *provided that said amount is stated separately* and such separate statement is not used as a means of avoiding imposition of this tax upon the actual sales price of the tangible personal property...
 5. The amount of any tax (not including, however, any manufacturers' or importers' excise tax) imposed by the United States upon or with respect to retail sales whether imposed upon the retailer or the consumer.
 6. The amount charged for finance charges, carrying charges, service charges, time-price differential, or interest on deferred payment sales, provided such charges are not used as a means of avoiding imposition of this tax upon the actual sales price of the tangible personal property.
 7. Delivery and handling charges for transportation of tangible personal property to the consumer, *provided that the transportation is stated separately* and the separate statement is not used as a means of avoiding imposition of the tax upon the actual sales price of the tangible personal property *Idaho Code §63-3613, emphasis added.*)

The preceding discussion of purchase orders, bids, and potential adjustments to amounts held taxable are applicable to the purchases for Municipality 2 as well. While the original bid from the supplier for a material and labor contract for the wastewater treatment facility tanks refers to Idaho sales/use taxes as included, the taxpayer did not raise this defense with respect to liability held by the Commission.

In addressing Municipality 2, the taxpayer believes the purchase of tanks and related hardware qualifies for the pollution control exemption.

Pollution control equipment. There is hereby exempted from the taxes imposed by this chapter the sale, use or purchase of tangible personal property, which property is pollution control equipment required to meet air and water quality standards of a state or federal agency having authority to regulate and set air and water quality emission standards. (*Idaho Code §63-3622X*).

In applying this exemption to a factual case, there are two considerations. First, Idaho Code §63-3622X applies to items that retain the characteristics of tangible personal property and do not incorporate into or become real property. While we believe that this statute prohibits the extension of the exemption to real property improvements, we point out that statutes granting tax exemptions must be strictly construed against the taxpayer and in favor of the state. *Potlatch Corp. v. Idaho State Tax Com'n*, 128 Idaho 387 (1996); *Hecla Mining Co. v. Idaho State Tax Comm'n*, 108 Idaho 147, 697 P.2d 1161 (1985); *Appeal of Canyon County v. Sunny Ridge Manor, Inc.*, 106 Idaho 98, 675 P.2d 813 (1984); *Leonard Constr. Co. v. State Tax Comm'n*, 96 Idaho 893, 539 P.2d 246 (1975).

Hence, it is our opinion that the legislature did not intend for the exemption to apply to purchases of building materials or fixtures to real estate.

The exemption for purchases of pollution control equipment was originally proposed as House Bill 98 in 1977. This bill amended Idaho Code § 63-3622(d) (commonly called the "production exemption" and since recodified as Idaho Code § 63-3622D). The statement of purpose for the bill stated the following:

The purpose of this legislation is to extend the existing sales tax exemption on property purchased and used as a means of production to include pollution control equipment required to meet air and water quality standards. Because pollution control equipment is a necessary and essential part of the production process without which the process cannot be operated, its exemption from sales tax falls reasonably within the intent of the

existing law. The proposed legislation would clarify the existing law to specifically exempt pollution control equipment. (*H.B. 98, 1977 and ultimately enacted in H.B. 252 the same year.*)

It is clear from the statement of purpose that the legislature intended the exemption to be similar to the production exemption, which limited qualifying purchases to “tangible personal property.” The Idaho Supreme Court stated that purchases of the materials used to construct smokestacks, which were clearly real property improvements, did not qualify for the production exemption in *Bunker Hill v. State Tax Com’n*, 111 Idaho 457, 725 P.2d 162 (1986). This holding was reaffirmed by the Court in *Potlatch Corp. v. Idaho State Tax Commission*, 120 Idaho 1, 813 P. 2d 340 (1991). Thus, the Commission has reasoned in the past that neither the production exemption (which has been recodified as Idaho Code § 63-3622D) nor the pollution control exemption apply to purchases of materials that will be affixed to real property.

Therefore, the relevant question for the items purchased for Municipality 2 is not whether they perform a pollution control function. Rather, the tax consequences hinge upon whether the material retains the characteristics of tangible personal property. If it does, no further discussion is required. The sale of tangible personal property to an Idaho municipality is exempt as a matter of law (Idaho Code §63-3622O(1)(f)). Although the taxpayer did not raise this defense for Municipality 1’s transaction, the question is relevant: Do the materials retain the characteristics of tangible personal property or become improvements to realty? If the materials become improvements to realty, they are taxable to the contractor (in this case the taxpayer).

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. (*Idaho Code § 63-3609(b)*)

(4) The exemptions granted by subsection (1) of this section [*exemptions from tax for certain private and public organizations*] do

not include the use of tangible personal property by a contractor used to improve real property of an exempt entity when such use is within the definition provided by section 63-3615(b), Idaho Code, [*“the exercise of any right or power over tangible personal property by any person in the performance of a contract, or to fulfill contract or subcontract obligations, whether the title of such property be in the subcontractor, contractor, contractee, subcontractee, or any other person, or whether the titleholder of such property would be subject to the sales or use tax”*] whether the use tax liability is included in a contract total or stated separately in a contract. (*Idaho Code § 63-3622O, parenthetical information added*)

The Idaho Supreme Court adopted the common law “Three-Factor Test” in 1919, and continues to use it to determine if an item becomes a fixture to realty.

1. Actual annexation to the realty, or something appurtenant thereto.
2. Appropriation to the use or purpose of that part the realty with which it is connected.
3. Intention of the party making the annexation to make the article a permanent accession to the freehold—this intention being inferred from the nature of the article affixed, the relation and situation of the party making the annexation, the structure and mode of annexation, and the purpose or use for which the annexation has been made. *Boise-Payette Lumber Co. v. McCornick*, 32 Idaho 462, 186 P. 252 (1919).

For the “Three-Factor Test,” we address Municipality 1 and 2 applying common sense to the facts.

Are the tanks annexed to the realty? The common meaning of “annex” is “to add or join to; append or attach...”(*American Heritage Dictionary American Heritage Publishing Company, Inc.*, 1969 p.53). We know that the two largest tanks (the bio-oxidation tank and the water tank) are attached to concrete, under which the soil has been chosen and prepared for its ability to sustain the weight of the tanks and has been graded to comply with engineering standards. Municipality 1’s water tank sits within a sand-filled concrete footing. The base or floor of the tank is attached with angle irons to the footings. The tank itself is attached to a pump house and its water lines. This tank as well as the others are a working part of that to which they are attached.

Do the tanks appropriately adapt to the purpose of the realty to which they are connected?

The wastewater tanks of Municipality 2 are part of a substantial potato processing water treatment facility and they hold, and in some cases treat, the wastewater that flows through them. According to the Bidding Requirements and Contract Documents for the construction of the UASB Odor Control Facilities prepared by an architectural firm and provided by the taxpayer at the informal hearing, the entire facility measures approximately 285' from north to south. From east to west the distance varies from 20' to 100'. The water tank of Municipality 1 is more self-evident; it is an integral part of an above- and under-ground municipal water delivery system. If the tanks in question are removed from the real estate to which they are attached or somehow annexed, the real estate can no longer function as it had up to the time of the removal.

Are the tanks intended to be a permanent addition to the realty? The supplier intended their original contracts with the taxpayer to be improvements to real property, as evidenced by its accrual of use tax and the initial bids it prepared stating the inclusion of tax, but not mentioning the tax as a specific dollar amount on a separate line as commonly expected in a taxed, retail sale of goods. The supplier has been registered with the Commission for tax purposes since 1987.

For as long as the potato processing plant exists, there is a need for wastewater treatment to protect the environment. There is a considerable investment in the wastewater processing, based on the value of the tanks alone. They are by no means intended to be temporary, although the city could decide to cease its efforts to manage the waste of private enterprise. Municipal water systems have a sense of permanence. People think of them as community fixtures.

All of the tanks are intended to perform a continuing function with respect to what they are attached to, and it is not foreseeable that they would not be needed as long as the facility or system to which they are attached exists. The mode of annexation required that the tanks be built (and in

one case, repaired) on site from pre-assembled panels. To be moved, they would need to be dismantled and reassembled elsewhere.

On appeal by the Potlatch Corporation, the Idaho Supreme Court addressed in *Potlatch Corporation v. Idaho State Tax Commission*, a “tangible personal property vs. real property” question for the purpose of sales tax. The court rejected the corporation’s argument and upheld a district court decision that the following items were improvements to realty:

Propane Fuel Tank Storage. Tank used to receive, hold and disperse propane fuel used in the production process, more particularly described as follows:

(a) Approximately 5,000 gallon total capacity propane tanks holding propane fuels used at the Potlatch St. Maries Plant primarily for use by lift trucks directly engaged in the production process. Some of this fuel is also used by lift trucks not directly engaged in the production process.

(b) A propane pump used to dispense propane from the propane tank at the Potlatch Jaype Plant into the lift trucks which are used in the production process.

(c) A propane tank stand used to hold and support the propane tank at the Potlatch Jaype Plant.

(d) A 30,000 gallon propane tank at the Potlatch Post Falls Particle Board Plant. Propane is used to fire and to provide fuel to the main power boiler, which power boiler is an integral part of the production process.

In this case, the district court concluded that tangible personal property which was used by Potlatch in creating the propane fuel tank storage and structural steel equipment support had become affixed or incorporated in the real estate and affirmed the decision of the Commission to tax the use of this tangible personal property. Based on our analysis... we agree with this conclusion. (*Potlatch Corporation v. Idaho State Tax Commission*, 120 Idaho 1, 813 P.2d 340).

The Commission also finds the addition of interest and penalty to the taxpayer’s liability appropriate per Idaho Code §§ 63-3045 and 63-3046. Interest on the Notice of Deficiency Determination has been updated to the present.

WHEREFORE, the Notice of Deficiency Determination dated May 22, 2002, is hereby MODIFIED, and as so modified is APPROVED, AFFIRMED and MADE FINAL.

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

TAX	PENALTY	INTEREST	TOTAL
\$37,464	\$9,367	\$5,791	\$52,622

DEMAND for immediate payment 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 _____, 2003.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2003, 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]
