

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 16651
[Redacted],	)	
	)	DECISION
Taxpayers.	)	
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On May 10, 2002, the Sales, Use and Miscellaneous Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination to [Redacted](taxpayers). The Notice proposed additional sales and use tax, penalty and interest in the total amount of \$6,523 for the period September 1, 1994 through August 31, 2001. The taxpayers' authorized representative filed a timely appeal and petition for redetermination on June 20, 2002. Prior to holding a hearing, the Commission made some adjustments to the work papers that reduced the tax.

The taxpayers and their representative requested an informal conference by telephone. It was held on October 22, 2002, and was followed by correspondence from the Commission. On November 22, 2002, the Commission received an email from the taxpayers' representative stating that one of the taxpayers was preparing for surgery and would need additional time to review the audit findings. On February 28, 2003, the Commission wrote a letter to the taxpayers and their representative asking for a response to the prior correspondence and inquiring if the taxpayers needed additional time due to a continuing medical hardship. Within a week of the end of the 180-day period within which the Commission was required to render a decision following the hearing, the taxpayers requested and were granted an extension through a waiver signed by Mrs. [Redacted] on April 15, 2003. On August 18, 2003, the Commission received correspondence from the taxpayers' representative dated July 2, 2003. On March 8, 2004, the Commission responded with revised schedules and further adjustment to the amount asserted. On March 26, 2004, the

representative responded by email, followed by a mailed response from the taxpayers on April 9, 2004. The Commission recognizes that disagreements remain on major issues. The Commission has reviewed the file, is advised of its contents, and hereby issues its decision modifying and affirming an adjusted amount due.

### **DISCUSSION OF FACTS**

The taxpayers operate a farm and lease the cropland to a local farmer. The taxpayers actively raise some cattle for sale as beef, as well as for their own consumption. They actively and personally raise, train, and sell show horses, and they have a web site devoted to this. The taxpayers are not registered with the Commission as an Idaho retailer, and they do not have a use tax reporting number. The Bureau performed a seven-year audit and found nontaxed horse, beef and business asset sales and nontaxed purchases of items that do not qualify for a sales tax exemption.

### **ANALYSIS AND CONCLUSIONS**

In response to the audit findings, the taxpayers wrote a letter containing several arguments in favor of dismissing the majority of the amounts held taxable. The Commission was asked at the informal conference to respond to these arguments in writing, which it did two days later. Since those arguments are the basis of the taxpayers' appeal, they are summarized here with the Commission's response.

*Definition of Farm or Ranch.* The taxpayers believe that they qualify as a farm or ranch and are entitled to a blanket exemption from paying taxes on all purchases and from collecting taxes on any sales. The Commission agrees that the taxpayers qualify as a farm or ranch.

**63-3603. Farming.** The terms "farm" and "farming" refer to and mean the business of operating for gain or profit a ranch or farm and include stock, dairy, poultry, fish, fur, fruit and truck farms, ranches, ranges and orchards, and custom farming.

Farming and ranching operations do have some exemptions granted by the legislature, as shown below, but there is no blanket exemption from paying a tax on all purchases.

**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, mined, produced or fabricated for sale.

(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...

(5) Plants to be used as part of a farming operation....

(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...

(d) As used in this section, the term "directly used or consumed in or during" a farming operation means the performance of a function reasonably necessary to the operation of the total farming business, including, the planting, growing, harvesting and initial storage of crops and other agricultural products and movement of crops and produce from the place of harvest to the place of initial storage...

(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, processing, mining, farming or fabricating 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, processing, mining, farming or fabricating operations such as office equipment and supplies, and equipment and supplies used in selling or distributing activities.

The foregoing is commonly referred to as the “production exemption,” and it illustrates that the legislature intended to confer farming and ranching exemptions based on the particular use of certain items.

If farming and ranching operations had a blanket exemption from paying sales tax on purchases, as the taxpayers contend, that classification of buyers would be granted an exemption by the legislature. A complete list of exempt entities is found in *Idaho Code §63-3622O*, but the farming/ranching industry is not named therein.

The audit revealed multiple sales of beef, horses and business assets. With respect to the collection of sales tax on goods sold, the taxpayers state in their response to the audit findings that, “Most small farmers and ranchers in this state do not have a sales tax identification number, and do not remit sales or use tax, because the industry is exempt as a whole.”

A “sale” is defined in the Idaho Code, and is quoted here in pertinent part.

**63-3612. Sale.** (1) The term "sale" means any transfer of title, exchange or barter, conditional or otherwise, of tangible personal property for a consideration and shall include any similar transfer of possession found by the state tax commission to be in lieu of, or equivalent to, a transfer of title, exchange or barter.

The audit findings conclude that the taxpayers are by statutory definition sellers who made retail sales.

**63-3614. Seller.** The term "seller" means every person making sales at retail or retail sales to a buyer or consumer, whether as agent, broker or principal.

**63-3610. 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.

(b) Every person engaged in the business of making sales for storage, use, or other consumption or in the business of making sales

at auction of tangible personal property owned by the person or others for storage, use, or other consumption.

(c) Every person making more than two (2) retail sales of tangible personal property during any twelve (12) month period, including sales made in the capacity of assignee for the benefit of creditors, or receiver or trustee in bankruptcy, or every person making fewer sales who holds himself out as engaging in the business of selling such tangible personal property at retail or who sells a motor vehicle.

There is a valid reason why some farmers in the state do not have a seller's permit. Farmers can be wholesalers of goods that they produce. That is, they sell goods exclusively to those who will buy them exempt from tax for the purpose of resale. Wholesalers are not required to have a seller's permit because they never make sales subject to tax (i.e., retail sales). The sale of goods for resale is not subject to tax. The taxpayers in the present case are retailers, not wholesalers, and are required to collect and remit taxes on retail sales unless the buyers can claim a legitimate exemption.

**63-3609. 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...[Emphasis Added]

The taxpayers believe that sales tax is due upon sale to the ultimate consumer. In their words, "The *ultimate consumer* for livestock has always been considered to be the person who consumes products from the dead animal."

The Commission believes that the taxpayers take the words "consumed" and "consumer" literally. Literal consumption, in the form of ingestion, is not the intent of the legislation. For example, contractors who improve real property, "are consumers of the material used by them." (Idaho Code §63-3609(a)). Thus, contractors must pay a tax on all building materials used by them, but literal consumption of the materials is not intended.

The taxpayers counter the foregoing argument by saying that a person who buys a horse from them may not be the last in the chain of buyers and is therefore not the "*ultimate consumer*." While

this may be true, a buyer of tangible personal property buying for one's own use (however short-lived, and where no exemption applies) is required to pay tax unless an exemption applies. There is no statutory requirement that they be the last in the chain of buyers and never resell the item once acquired. With respect to sales, horses are treated no differently than automobiles for the sake of this discussion. The sale of used cars has no blanket exemption from sales tax. Tax is imposed on sales transactions and not the property itself (Idaho Code §§63-3612, 63-3619 and 63-3621).

The auditor gave the taxpayers the opportunity to collect and provide sales tax exemption certificates to substantiate any sale that they believed was not subject to tax. They did not provide these certificates.

**63-3622. Exemptions -- Exemption and resale certificates -- Penalties.** (a) To prevent evasion of the sales and use tax, it shall be presumed that all sales are subject to the taxes imposed by the provisions of this chapter and the retailer shall have the burden of establishing the facts giving rise to such exemption unless the purchaser delivers to the retailer, or has on file with the retailer, an exemption or resale certificate.

The taxpayers contend that the State legislature intended for there to be a blanket exemption for the sale of horses, based on Idaho Code §63-3622MM.

**63-3622MM. Livestock sold at livestock markets.** (1) There are exempted from the taxes imposed by this chapter, the sale, purchase or use of livestock when sold at a livestock market.  
(2) As used in this section, the term "livestock market" shall mean:  
(a) A "public livestock market" as defined in section 25-1721, Idaho Code, and holding a charter issued by the Idaho department of agriculture pursuant to chapter 17, title 25, Idaho Code; and  
(b) Those organizations expressly exempted from the chartering requirement by section 25-1722, Idaho Code.  
(3) As used in this section, the term "livestock" shall mean cattle, calves, sheep, mules, horses, swine or goats.

Idaho Code §63-3622MM, Livestock Sold at Livestock Markets, was enacted by the State legislature on February 27, 2002, and was effective almost one year after the period under audit.

The enactment of a statute specifying those circumstances when horses, among other livestock, can be sold exempt suggests that there was never a blanket exemption from taxing all sales of horses under any circumstances. A blanket exemption would need no clarification. Further, since the new code section specifies certain conditions under which such sales are exempt, it presupposes that there are conditions under which taxes are to be collected. "...[I]t is not to be presumed that the legislature performed an idle act of enacting a superfluous statute." *Sweitzer v. Dean*, 118 Idaho 568, 798 P.2d 27 (1990).

In answer to the taxpayers' question, "Did the legislature ever intend to tax the sale of livestock?" the Commission would answer in the affirmative. Finally, Idaho Code §63-3622MM was not given effect retroactively; further evidence that it was not intended by the legislature as a clarification of its previous position on this subject. The Commission is an administrative agency, not a legislative one. It will not substitute an alternative interpretation when it finds no ambiguity in the statutes.

The objective of statutory interpretation is to derive the intent of the legislative body that adopted the act *Albee v. Judy*, 136 Idaho 226,230, 31 P.3d 248,252 (2001). If the language of the statute is unambiguous, "the clear expressed intent of the legislature must be given effect and there is no occasion for construction." *Udy v. Custer County*, 136 Idaho at 388, 34 P.3d at 1071 [citing: *Ada County Assessor v. Roman Catholic Diocese*, 123 Idaho 425,428, 849 P.2d 98,101 (1993)].

The taxpayers believe that they qualify for the "occasional sale exemption" and are not required to collect tax on the sale of business assets.

**63-3622K. Occasional sales.** (a) There are exempted from the taxes imposed by this chapter occasional sales of tangible personal property.

(b) As used in this section, the term "occasional sale" means:

(1) A sale of property not held or used by a person in the course of an activity for which he is required to hold a seller's permit, provided

such sale is not one (1) of a series of sales sufficient in number or of such a nature as to constitute the seller a "retailer" under section 63-3610(c), Idaho Code.

Since the taxpayers do qualify as sellers under Idaho Code §63-3610 as previously described in this decision, they cannot qualify as occasional sellers as well.

The taxpayers object to being taxed on the purchase of certain business assets and ordinary expenses. At the crux of the decision as to whether or not certain items qualify for the production exemption (in this case farming/ranching) is the phrase “primarily and directly used.”

(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

Here, the statute gives some guidance but does not list every conceivable item nor can it determine, in the absence of knowing the particular circumstances, which items are “primarily and directly used” and are therefore exempt from tax on purchase or use.

The Commission must use its interpretive judgment on a case-by-case basis when the legislation lacks specificity as to the particular facts at hand. However, the Commission is guided in its interpretive function as noted in the following. “Tax exemptions existing only by legislative grace are to be strictly construed against the party claiming the exemption.” *Kwik Vend Inc. v. Koontz*, 94 Idaho 166, 483 P.2d 928 (1971); *Upper Columbia Mission Society v. Kootenai County*, 93 Idaho 880, 477 P.2d 503 (1970)

The Commission views “primarily and directly” in the “production” of a horse to apply to all items that are directly used in raising the horse. That would include food and medicine, for example.

Items that don’t become part of the horse (or the horse itself) do not qualify for the exemption.

Saddles and tack are used, in the taxpayers' words, to train or manage the horses. This does not contribute directly and primarily to production but rather to training. Similarly, show clothes and the like are selling expenses, not directly and primarily related to production.

The taxpayers object to the seven-year audit period on the basis that it is a punitive measure taken against those businesses that act with an intent to defraud the State. Idaho Code §63-3633(c) allows for a seven-year audit when a taxpayer fails to file returns, and it is on this basis that the seven-year period was chosen for these taxpayers. The use of the seven-year audit is not imposed exclusively in those cases where there is an intent to defraud. Rather, as noted in the code cited below, there is no time limitation with respect to the audit period for those committing fraud.

**63-3633. Period of limitation upon assessment and collection.**

Except as otherwise provided in this section...

(b) In the case of a false or *fraudulent return* with the intent to evade tax, or a willful attempt in any manner to defeat or evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, *at any time*.

(c) In the case of taxes owed by a person who has *failed to file a return* as provided in section 63-3623, Idaho Code, the amount of taxes imposed in this chapter shall be assessed within seven (7) years of the time the return upon which the tax asserted to be due should have been filed.

(d) The periods of limitation upon assessment and collection provided in this section shall not apply:

(1) In cases where the facts disclose a false or fraudulent act with the intent to evade tax... [Emphasis added]

It was noted previously that the taxpayers signed a waiver of the 180-day requirement for the Commission to issue a decision following a hearing. In a letter dated April 9, 2004 the taxpayers argued that the Commission did not "follow statutory requirements" and believe the waiver to be invalid. There is insufficient information in the letter to determine on what basis the taxpayers draw this conclusion.

Idaho Code §63-3045B, to which the waiver refers, requires the Idaho State Tax Commission to render a decision within 180 days of the informal hearing unless the taxpayer requests, in writing, an extension of that time. There is no particular statutory requirement for such an extension other than subsection 63-3045B(4), which states: “A final decision may be held in abeyance, notwithstanding the requirements of subsection (3) of this section, with the prior approval in writing of the taxpayer.”

Mrs. [Redacted] requested such an extension and signed a waiver on April 15, 2003. The hearing was held October 22, 2002 and the statutory period expired on April 20, 2003, five days after the signing. The Commission received information pertaining to the audit following the receipt of the signed waiver and made adjustments to the amount asserted as a result. There was no request by the taxpayers that a decision be issued.

The Commission finds the addition of interest and penalty to the taxpayers’ liability appropriate per Idaho Code §§ 63-3045 and 63-3046. Interest on the Notice of Deficiency Determination has been updated to July 25, 2004.

WHEREFORE, the Notice of Deficiency Determination dated May 10, 2002, is hereby MODIFIED, and as so modified is APPROVED, AFFIRMED and MADE FINAL.

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

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$4,261	\$213	\$1,958	\$6,432

DEMAND for immediate payment is hereby made and given.

An explanation of the taxpayers' right 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]  
\_\_\_\_\_