

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 19969
[Redacted],)	
Taxpayer.)	DECISION
)	
)	
)	

On November 30, 2006, the staff of the Sales, Use and Miscellaneous Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination to [Redacted] (Taxpayer), proposing use tax, penalty, and interest for the period January 1, 2002, through December 31, 2004, in the total amount of \$24,239.

In a letter dated January 4, 2007, the taxpayer’s authorized representative filed a timely appeal and petition for redetermination. The petition stated disagreements with the auditor’s application of the law that the taxpayer wished to discuss at a hearing. The majority of the audit results were not contested. The Commission held a hearing via telephone at the representative’s request on April 19, 2007. Following the hearing with the Taxpayer and its representative, the Commission determined that the auditor’s findings should be upheld and hereby issues this decision.

Background and Audit Findings

[Redacted]The auditor held that the Taxpayer’s application [Redacted] at a manufacturing plant [Redacted]was an improvement to real estate, which places the burden on the Taxpayer (acting as a real property contractor) to pay a sales or use tax on the materials it incorporated into realty. In contrast, the Taxpayer classified the work as “repairs of manufacturing process materials” that is a “consumable part of the manufacturing process” (letter of protest, January 4, 2007.) It therefore views the transaction as a sale of tangible

personal property rather than an improvement to real property. Further, the Taxpayer stated that it had a Tax Commission Form ST-101 signed [Redacted], claiming a tax exemption on what the Taxpayer and [Redacted] view as a retail sale. Thus, the Taxpayer's view is significant because it changes the tax consequences.

Discussion of Applicable Sales and Use Tax Statutes

In Idaho, the sale of tangible personal property is taxable unless an exemption applies.

Sale. (1) The term "sale" means any transfer of title, exchange or barter, conditional or otherwise, of tangible personal property for a consideration (Idaho Code § 63-3612)

The sale of tangible personal property is not taxable if it qualifies for any exemption enacted by the legislature. As noted earlier, the Taxpayer believes it made a retail sale of tangible personal property. As such, it is required to collect sales tax from its customers unless an exemption applies (Idaho Code § 63-3619). One such exemption claimed by the Taxpayer is established in the following tax statute, cited in relevant part:

Production exemption. There are exempted from the taxes imposed by this chapter:

(a) The sale at retail, storage, use or other consumption in this state of:...

(2) Tangible personal property primarily and directly used or consumed in or during a manufacturing, processing, mining, farming, or fabricating operation, including, but not limited to, repair parts, lubricants, hydraulic oil, and coolants, which become a component part of such tangible personal property; provided that the use or consumption of such tangible personal property is necessary or essential to the performance of such operation. (Idaho Code § 63-3622D)

As noted earlier, however, it is the Commission's opinion that the Taxpayer engaged in an improvement or alteration of real property. Regardless of how consequential the materials are to production activities, the sale, purchase, or use of tangible personal property intended to become part of realty does not qualify for a production exemption:

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

(6) 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. (Idaho Code § 63-3622D)

Further, the burden of tax on the purchase or use of building materials to be incorporated into realty is borne by the real property contractor:

(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)

Analysis

The Commission believes that the Taxpayer has no dispute with the interpretation of the statutes cited previously. The major disagreement is with the Commission's characterization of the [Redacted] application as an improvement to real property. A related disagreement surrounds the use of the Form ST-101 to claim an exemption by the customer, which the Taxpayer believes clears it of any responsibility with respect to paying tax or collecting tax [Redacted]. To ignore the Form ST-101 is to put the Taxpayer in a difficult position, it says.

[Redacted].

[Redacted]The Taxpayer performed other [Redacted] work [Redacted]. [Redacted].

[Redacted].

The Commission does not dispute these claims but notes that the only issue is whether or not the [Redacted] contribute to the real estate, not whether they contribute to production or prevent environmental pollution.

Historically, the Commission has viewed [Redacted] areas to be improvements to realty and therefore holds the contractor responsible for taxes on the purchase of the building materials. Since the Taxpayer is acting as a real property contractor and is not selling tangible personal property, in the opinion of the Commission, [Redacted] use of an ST-101 to claim the production exemption for the retail sale of tangible personal property is ineffective. A customer cannot waive the contractor's obligations with respect to a tax the contractor owes. Further, according to the auditor's recollections, the Form ST-101 was not signed [Redacted] contemporaneously with the transaction at issue. That is, it was not given to the Taxpayer specifically for the transaction at issue.

Although the protest letter refers to a declaration at bid time [Redacted] in which the latter mentions the production exemption, we see no such reference in either the bid proposal dated February 14, 2003, or in [Redacted] acceptance, dated March 11, 2003. There is a letter [Redacted] to the Taxpayer discussing the necessity of the [Redacted] to the production process, but this letter was prepared [Redacted] on September 8, 2006, for the Taxpayer in the event that it could serve as audit evidence.

In *Potlatch Corporation v. Idaho State Tax Commission*, 813 P.2d 340 (1991), the Idaho Supreme Court affirmed the Commission's interpretation of the statutes in a case with some similarity to the instant case, by upholding the Commission's finding against Potlatch Corporation that tax was due on its purchase of materials intended for use as [Redacted]. In the instant case, the Commission believes that anything integrated with the foundations (in this case, tank pads) that is not equipment is subject to a sales or use tax on purchase. Regardless of [Redacted] joints over time and the materials' considerable relevance to the production process, the Commission believes the activity to be a real property improvement.

The Commission has adopted the common law three-factor test to determine when personal property has become a permanent part of realty. Rule 067 (IDAPA 35.01.02.067) of the Sales and Use Tax Administrative Rules states that the three factors are: annexation to the realty, either actual or constructive; adoption or appropriation to the use or purpose to which that part of the realty is connected is suitable [appropriately adapted to the purpose of the realty to which the article is connected]; and intention to make the article a permanent addition to the realty.

In photos of the work site, [Redacted] appear to be annexed to the real estate on which they sit. Their continued presence suggests that they are adapted to the purpose of the real estate to which they are connected. That is, they contribute to the production activity. Finally, there is no evidence that they are to be abandoned while the real estate is devoted to production purposes. In fact, the Taxpayer and [Redacted] agree that periodic maintenance and repair is necessary.

Nevertheless, the Commission acknowledges, as one of Idaho's courts did almost 100 years ago, that there is difficulty in determining what constitutes realty:

The question as to when an article loses its character as personal property, and takes on the character of a fixture so as to become a part of the realty, is one which has given rise to a multitude of decisions. The authorities are more or less conflicting. It seems that the question is of such an artificial character that no criteria or tests can be laid down which would be found to be of universal application. *Boise-Payette Lumber Co. v. H. A. McCornick*, 32 Idaho 462, 465 (1919)

The Commission believes that its interpretation is reasonable and its decision is equitable when compared to its treatment of similarly situated taxpayers.

According to the auditor's notes, one of the Taxpayer's primary interests in the protest is to determine how to handle similar work it expects to do in the next few years. While the Commission cannot judge a fact situation outside of this protest, it is worth noting that the Idaho

legislature made two amendments to the pollution control statute (Idaho Code § 63-3622X) which may have a bearing on some of the Taxpayer's future work.

The amended Idaho Code § 63-3622X that is effective July 1, 2007, exempts some materials incorporated into realty by a manufacturer when it serves pollution control purposes. [Redacted].

The Commission finds the deficiency prepared by the Bureau to be an accurate representation of the taxpayer's use tax liability for the period January 1, 2002, through December 31, 2004.

The Bureau added interest and penalty to the deficiency. The Commission reviewed these additions and found them to be appropriate per Idaho Code §§ 63-3045 and 63-3046. Further, the Commission notes that the taxpayer made a payment toward the deficiency.

WHEREFORE, the Notice of Deficiency Determination dated November 30, 2006, is APPROVED, AFFIRMED, and MADE FINAL.

As the Taxpayer has overpaid the amount due, a refund will be issued as shown below:

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$19,380	\$969	\$4,346	\$24,695
		Payment	<u>(\$24,944)</u>
		Refund Due	(\$249)

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 included with this decision.

DATED this ____ day of _____, 2007.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2007, 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]
[Redacted]

Receipt No.
