

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
[Redacted],) DOCKET NO. 20968
)
) DECISION
Petitioner.)
_____)

On September 14, 2007, the Sales and Use Tax Audit Bureau of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination to [Redacted], [Redacted] (taxpayer) asserting additional sales and use tax, penalty, and interest totaling \$351,776 for the period of August 1, 2002, through July 31, 2005. The taxpayer protested the Notice of Deficiency Determination on November 14, 2007. The taxpayer requested an informal hearing, which was held on July 8, 2008.

The Commission has reviewed the file, is advised of its contents, and hereby issues its decision. The liability is reduced, in part, based on a review of documentation that the taxpayer provided since September 2007. The remaining liability is affirmed, as described in this decision.

BACKGROUND

The taxpayer is a retailer of [Redacted]. It has a separate, but wholly-owned, related entity that performs [Redacted], and it makes retail sales [Redacted]. This related business was the subject of another audit. Transactions between the two entities and those on behalf of one another gave rise to some of the liability for both audits. The auditor took care to assert liability against only one of the related entities if both entities were a party to a particular transaction. Thus, there is no duplication of taxable transactions in either of the audit findings or the decisions.

The issues of this case involve the sale, purchase, and use of tangible personal property. In Idaho, sales and purchases of tangible personal property are subject to sales tax unless an exemption exists under law (Idaho Code § 63-3601 *et. seq.*). Idaho Code § 63-3621 imposes a tax on the storage, use, or other consumption of tangible personal property in Idaho. The use tax is a complementary tax to the sales tax. The use tax rate is the same as the sales tax and is imposed on the value of the property. When property is stored, used, or consumed in Idaho, the user owes use tax unless he has paid sales tax on the purchase of the property or an exemption applies.

During the year following the hearing held with the Commission, the taxpayer provided additional documentation for the auditor's review. On October 15, 2008, the taxpayer signed a waiver of Idaho Code § 63-3045B's time limitation for issuing an Idaho State Tax Commission decision. The taxpayer recently indicated that its internal search and review of records was complete, giving rise to this decision. The Commission mailed final, revised workpapers to the taxpayer.

AUDIT FINDINGS

There are several areas that the taxpayer contests. For some, arriving at an audit conclusion was hampered by incomplete records, and the auditor did his best to understand the issues while having less than complete evidence.

Every retailer doing business in this state and every purchaser storing, using, or otherwise consuming in this state tangible personal property shall keep complete and adequate records as may be necessary for the State Tax Commission to determine the amount of sales and use tax for which that person is liable under Title 63, Chapter 36, Idaho Code (IDAPA 35.01.02.111.01).

These records must include the normal books of account ordinarily maintained by the average prudent businessman engaged in such business, together with all bills, receipts, invoices, cash register

tapes, or other documents of original entry supporting the entries in the books of account, together with all schedules or working papers used in connection with the preparation of tax returns (IDAPA 35.01.02.111.01.b).

The auditor identified some non-taxed sales but could not locate valid exemption certificates filled out by the buyers for those sales, as required by Idaho Code § 63-3621(e). Undocumented sales are presumed taxable.

Sellers, including this taxpayer, are required to obtain a Form ST-101 (or a form with substantially the same information) to validate customers' non-taxed purchases. In addition to other reasons, a purchaser can use this form to claim a valid tax exemption if the purchaser intends to resell the purchased goods or claim that [Redacted] parts bought from the seller that qualify for the production exemption described in Idaho Code § 63-3622D (Idaho Code §63-3622 and IDAPA 35.01.02.128.05.a.).

The auditor found several transactions where the taxpayer accepted exemption claims from buyers who could not make a valid claim for such exemptions. For example, the taxpayer accepted an exemption claim for the purchase of a [Redacted]. [Redacted]

For the tax-exempt sale of certain vehicles by the taxpayer, the Form ST-10MV is required from the buyer to claim an [Redacted] exemption. In order to claim this exemption, the buyer must attest that the [Redacted] will be immediately registered under the International Registration Program (IRP) and will be part of a [Redacted] which will operate at least 10 percent of its miles outside of Idaho (Idaho Code § 63-3622R(c)). These forms were missing for several transactions examined by the auditor. [Redacted].

A lease is considered to be a sale by the lessor to the lessee, and the sale is taxable unless an exemption applies (Idaho Code § 63-3612(2)(h)). The auditor found untaxed lease transactions where the taxpayer was the lessor and a related entity was the lessee.

While sales (or leases) of capital assets between related entities can be conducted tax free when certain conditions are met, there is also a requirement that the initial transferor must have paid sales or use tax previously for the exemption to apply (Idaho Code § 63-3622K(b)(4)). Since the taxpayer was leasing [Redacted] from its resale inventory, that condition was not met. By definition, a retail inventory is comprised of items purchased tax free. Further, the related party buyer was a company that could not and did not claim any exemption from tax upon entering the lease period.

In other transactions related to leasing, the taxpayer apparently required its lessees to be responsible for repairs during the lease period. The taxpayer charged the lessees for repair parts and should have collected tax on those parts sales, but did not (IDAPA 35.01.02.106.06.e.).

The auditor examined sales recorded to a “trust account” in the taxpayer’s name. The auditor determined that these were sales of vehicles to employees and personal acquaintances. Some sales were untaxed, but the buyers made no declarations (via exemption certificates) claiming an exemption from the tax. There is no statutory provision for a retailer to treat sales to employees and acquaintances differently from any arm’s length transaction. The sales price is subject to tax unless an exemption applies.

The auditor investigated the taxpayer’s use of Form 502 which the latter recorded for some of the sales it made to employees and acquaintances. Form 502 is provided by the Idaho Department of Transportation, [Redacted], and it reports both the sale and application for certificate of title [Redacted]. [Redacted] fill out these forms for buyers and submit them to the Department. On some of the forms examined by the auditor, the taxpayer indicated that it had collected sales tax from the buyers. Further investigation showed tax was not collected and remitted for those sales despite the declaration.

The auditor examined the taxpayer's purchases for the appropriate tax or to determine that a tax exemption applied. He determined that some untaxed purchases, classified as follows, were taxable: office supplies, electrical supplies used by the taxpayer for real property improvements, and [Redacted] parts other than those purchased for resale. The latter were purchased for use by the taxpayer's related companies, and no exemption exists for such use.

The taxpayer periodically used [Redacted], and related activities. Whenever a retailer withdraws non-taxed items from a resale inventory for a purpose other than resale, a use tax is due. For those [Redacted] that the taxpayer titled and licensed in order to [Redacted], tax is due on the acquisition cost. For the use of resale inventory that does not require title and licensing, the auditor imposed a tax based on a reasonable rental value (IDAPA 35.01.02.105.06.b. and 108.05.a. and .05.b.).

The taxpayer owned a subsidiary real property contractor business (herein, Company B) which it sold in its entirety in [Redacted], [Redacted]. According to the auditor, prior to the sale, the taxpayer first added [Redacted] to Company B's asset holdings that were actually owned by itself and a related entity.

The sale of substantially all of the operating assets of a business to a buyer who continues operation of the business is exempt from sales tax (Idaho Code § 63-3622K(b)(5)). The statute does not allow for a business to indiscriminately sell additional assets under the exempt provision without first owning those assets. The additional assets were from the taxpayer's resale inventory. As such, they were originally, and legitimately, purchased exempt from tax and held for resale (Idaho Code § 63-3609). Their legal transfer of ownership to Company B would have required taxable sales transactions. As a [Redacted] contractor, Company B would have no exemption for this purchase of operating assets and equipment (Idaho Code § 63-3609(a)). By

arbitrarily making the additional goods part of Company B's assets and subsequently selling them as part of the bulk sale of the business, the taxpayer evaded taxable sales and used resale inventory for a purpose other than intended. In order to hold the value of these added assets subject to tax, the auditor listed them in a workpaper schedule as untaxed sales to Company B. He used fair market values or acquisition costs, as appropriate.

The auditor imposed a 50 percent fraud penalty for the taxpayer's abuse of the privilege of buying goods tax-exempt for resale and subsequently using those assets in a taxable manner or transferring them to a related entity without assessing itself a use tax or charging a sales tax (Idaho Code Section 63-3634 and 63-3046(b)). Further, the auditor believed that the fraud penalty was justified by the taxpayer's misrepresentations to the [Redacted] on sales made and tax it purportedly collected and remitted to the state.

WHEREFORE, the Notice of Deficiency Determination dated September 14, 2007, is hereby APPROVED as MODIFIED, and is AFFIRMED and MADE FINAL.

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

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$117,836	\$58,918	\$42,333	\$219,087

Interest on unpaid tax is part of this assessment per Idaho Code § 63-3045(6) and has been extended to June 30, 2009. Interest on unpaid tax continues to accrue until the tax 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.

DATED this _____ day of _____, 2009.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2009, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]

Receipt No.
