

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 21196
[Redacted],)	
)	DECISION
Petitioner.)	
)	
)	
_____)	

On December 31, 2007, the staff of the Sales Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination to [Redacted] (taxpayer) proposing sales and use tax, penalty, and interest for the period of March 1, 2001, through December 31, 2007, in the total amount of \$646,285.

On January 7, 2008, the taxpayer filed a timely appeal and petition for redetermination. The Commission held an informal hearing with the taxpayer on September 23, 2008. The taxpayer agreed to waive the 180-day period provision of Idaho Code § 63-3045B on February 17, 2009.

The taxpayer is in the business of selling [Redacted]. During the audit the taxpayer considered itself a contractor improving real property and paid sales or use tax on its material purchase. The taxpayer did not obtain an Idaho seller's permit during the audit period; nor did the taxpayer collect sales tax from its customers on sales of [Redacted]. The auditor found that the taxpayer primarily made retail sales of [Redacted] without installation. The taxpayer, therefore, should have been collecting sales tax on the retail sales price of the [Redacted] from its customers.

Idaho Code § 63-3612 defines sale as any transfer of tangible personal property for a consideration. The definition also includes the transfer of the title or possession of tangible personal property which has been produced or fabricated to the special order of the customer.

For this reason, charges for labor to produce custom made goods are included in the price subject to tax.

On the other hand, contractors who are improving real property do not sell tangible personal property. Idaho Code § 63-3609, which defines “retail sale,” states that such contractors are the consumers of the materials they install into realty. Therefore, building contractors pay sales or use tax on their materials purchases but do not collect tax from their customers.

In this case, the taxpayer’s sales invoices and quotes primarily are for the supply of [Redacted] only. They do not mention installation, and there is no separate charge for installation. The auditor did not impose tax on those transactions in which the taxpayer both supplied and installed [Redacted]. Nevertheless, the audit findings show that the taxpayer operated primarily as a retailer during the audit period.

The taxpayer argues that it actually is a contractor improving real property because it is contractually liable for [Redacted] in place. The taxpayer has cited several cases supporting its position. Rather than review each of these cases, the Commission notes that few of them are tax cases. In most of them there is no dispute about whether the contractor was improving real property. The Commission finds the cited authorities to be inapplicable.

The taxpayer does cite two cases from Washington that are illustrative of the issue in this case. The Morrison Knudsen Company was the taxpayer in both cases. In one case, *Morrison Knudsen Co., Inc. v. Washington*, 64 Wash.2d 86, 390 P.2d 712 64 Wash.2d 86, 390 P.2d 712, (1964), the taxpayer manufactured and installed components for a bridge. The Washington Supreme Court ruled that the taxpayer was the consumer of the bridge materials and that they were subject to use tax.

In the other case, Morrison Knudsen Co., Inc. v. Washington, 6 Wash. App. 306, 493 P.2d 802, (1974), the taxpayer once again manufactured bridge components. Because of a contract dispute, however, the taxpayer did not install the components. The installation was awarded to a different contractor. The Washington Court of Appeals ruled that the taxpayer made a retail sale of the bridge materials and that the taxpayer should have collected sales tax.

There is another case with substantially similar facts to this one. [Redacted]. The taxpayer supervised the installation and was obligated to correct defects. Quoting the district court decision, the Supreme Court of Minnesota stated:

Generally, suppliers are those who sell building materials. Contractors and subcontractors erect and construct the material into a building on the site. Modern improvements in construction techniques may in the future make it more difficult to recognize this distinction but, in this case, it seems clear that appellant is a supplier and not a subcontractor.’

In a subsequent case, the same court ruled that a seller of component packages for prefabricated homes was also a retailer:

Sterling contends that its activities at the construction site bring it within the definition of contractor or subcontractor and that, therefore, its purchase of raw materials is the taxable retail sale, not its sale of prefabricated component packages to builders. The tax court ruled, however, that Sterling was a supplier of building materials, and we consider [Duluth Steel Fabricators, Inc. v. Commissioner of Taxation, 306 Minn. 567, 237 N.W.2d 625 \(1975\)](#), indistinguishable in all significant respects. Although Duluth Steel is a fabricator of structural steel, Duluth Steel, like Sterling, fabricates components off-site for on-site incorporation into a building. Both supervise the unloading and placement of the components, designate the method of connection and the sequence of erection, and correct defective or ill-fitting components. Neither Duluth Steel nor Sterling, however, performed or was responsible for the performance of the actual work of construction which resulted in a completed improvement to real estate. See, e.g., [County of Hennepin v. State, 263 N.W.2d 639 \(Minn.1978\)](#). As we recognized in *Duluth Steel*, “Generally, suppliers are those who sell building materials. Contractors and subcontractors erect and

construct the material into a building on the site.” [306 Minn. at 568-69, 237 N.W.2d at 627](#) (quoting the tax court). We hold, therefore, that Sterling, like Duluth Steel, is a supplier of materials and that the sale of a prefabricated custom home component package is a “retail sale” subject to sales tax. *Sterling Custom Homes v. Commissioner of Revenue*, 391 N.W.2d 523, (1986).

The taxpayer also listed several differences between the taxpayer’s operations and what it deems to be classic retailers. The taxpayer listed fourteen such differences. None of them are sufficient to distinguish the taxpayer from other material suppliers. The following is an analysis of each of the fourteen items:

1. *The contracts require the taxpayer to have [Redacted] “in place” whereas a retailer would not.* The Commission is unsure of what the taxpayer means by “in place.” For the most part, the taxpayer would place bids using its own form to quote a price. The words “in place” do not appear in the quotes or in the taxpayer’s sales invoices. Most of the quotes call for the taxpayer to supply materials but not install them.

2. *The taxpayer has two contracting licenses.* Since the taxpayer does do some installation, it is necessary for it to be licensed as a contractor. This is no different than any other business involved in both contracting and retailing. Many retailers who sell floor covering have contractor’s licenses, as do many large hardware stores.

3. *The taxpayer must have workers’ compensation insurance, while other retailers have no such requirement.* The taxpayer has not provided any authority for this statement. Idaho Code § 72-203 states that the worker’s compensation laws apply to all types of employment except those exempted by Idaho Code § 72-212. Idaho Code § 72-212 does not provide an exemption for retailers.

4. *[Redacted] is subject to liquidated damages on erection and installation.* Although the taxpayer’s contracts may call for liquidated damages, the taxpayer is still primarily a retailer.

5. *The taxpayer is only paid progress payments until all [Redacted] is in place.*

Although this practice is most common in the construction industry, it is no different from a retailer who agrees to accept installment payments after making a sale.

6. *The taxpayer must be bonded in an amount of approximately five million dollars.*

Other retailers who sell large, custom made items are subject to bonding requirements.

7. *The taxpayer must prepare and follow designs and [Redacted] drawings.* Once again, this is true of retailers who fabricate large items to the specification of the buyer.

8. *The taxpayer remains contractually obligated to coordinate the [Redacted] regardless of who actually performs the installation labor.* In the great majority of cases, the taxpayer does not perform the installation. The taxpayer may offer supervision and advice but, as in the case of [Redacted].

9. *The taxpayer must have specialized and dedicated equipment necessary to meet its contractual obligations.* Many retailers need specialized and dedicated equipment. Automobile repair shops are an example, as are businesses that sell custom made furniture.

10. *The taxpayer must identify and solve all construction related problems involving the [Redacted].* Once again, this was true in the case of [Redacted]. As in that case, the taxpayer is still primarily a retailer.

11. *The taxpayer has no inventory of finished goods or raw material; the taxpayer must carry liability insurance in excess of one million dollars; the taxpayer must have a minimum of one million dollars in auto insurance to be on the construction site; the taxpayer's personnel must participate in all job coordination meetings.* None of these things change the nature of the taxpayer's business.

The taxpayer then goes on to argue that the Commission's Sales Tax Brochure No. 40 supports its position because it only focuses on the end result, that is, whether the materials become real property improvements. The taxpayer does not provide any quotes from the brochure. The brochure does address the difference between contractors and retailers, however. The sales tax brochures are written in a question and answer format. Sales Tax Brochure No. 40 contains the following questions and answers:

What's the difference between a contractor, a retailer, and a contractor/retailer?

A **contractor** installs or attaches materials to real property. A **retailer** sells goods, but doesn't attach them to the real property. A **contractor/retailer** does both. (Emphasis in original)...

Should a contractor charge sales tax on the materials he installs?

No. A contractor doesn't charge his customers sales tax. His bid should be high enough to cover any taxes he's had to pay on materials without itemizing sales tax on his bid. If he does charge sales tax, his customer can refuse to pay it.

Example: A cabinetmaker agrees to build cabinets and install them in a home. He bids the job for labor and materials.

The materials cost him \$1,000. If the tax rate is 6%, he must pay \$60 sales tax to his material supplier or, if the supplier doesn't collect Idaho sales tax, he must pay \$60 use tax to the state. When he bills his customer, he has a materials cost of \$1,060. He reimburses himself for his material costs (including the tax he paid), but he *doesn't* charge his customer sales tax.

The bill might read:

Job materials	\$1,060
Labor	\$3,000

How does sales tax apply to a retailer?

A retailer must get a seller's permit to collect and pay sales tax. A cabinetmaker who builds cabinets and delivers them to another contractor to install in a home is a retailer. As a retailer, the cabinetmaker must collect sales tax on the full retail sales price of the cabinets, including the labor to make them.

His bill might read:

Materials to build cabinets	\$1,000
Labor to build cabinets	\$2,500
Sales tax on \$3,500	\$ 210*

(*If the tax rate is 6%)

Brochure No. 40 is also consistent with the sales tax rules, which state that a sale of materials without installation is a retail sale. For instance, Rule 012.01.b. (IDAPA 35.01.12.01.b.) states:

b. Persons doing residential repairs, such as plumbers and electricians, as well as those who both sell and install carpet, also are contractors improving real property. Such contractors are defined as the consumers of the materials they install and are required to pay sales or use tax on their cost for the materials. *They do not charge sales tax to their customers unless they make a sale of materials only, with no installation.* (Emphasis added.)

Although the rule does not mention steel fabricators, it does emphasize that sales of materials without installation are retail sales. The same is true of Rule 014.06 (IDAPA 35.01.02.014.06):

06. Sales of Both Tangible Personal Property and Improvements to Real Property. If a contract includes both retail sales of personal property and improvements to real property, the contractor-retailer must collect sales tax on the retail portion of the contract. Also, if he does not pay sales tax to his vendor, he must pay use tax on the materials used to perform the real property portion of the contract. (7-1-93)

a. Example: A cabinet builder contracts to build and install kitchen cabinets and build a portable, freestanding china hutch. In the case of the cabinets, he is a contractor and must pay tax on his material costs. In the case of the china hutch, he is a retailer and must charge his customer sales tax on the full price of the hutch, including labor. (7-1-93)

b. Example: A cabinet builder is hired by Contractor X to fabricate and deliver cabinets to the job site. Contractor X will do the installation. *In this case, the cabinet builder is a retailer and must charge sales tax to Contractor X on the full sales price, including labor.* (Emphasis added.) (7-1-93)

It is not possible to discuss this case without mentioning the taxpayer's largest customer, [Redacted]. [Redacted] was also audited, and purchases from the taxpayer were an issue in that audit. The Commission issued a decision in 2008 holding [Redacted] liable for use tax on those purchases. See the Commission's decision for Docket No. 21065. [Redacted] did not dispute that its purchases of [Redacted] from the taxpayer were taxable but that the taxpayer in this case was liable because it did not collect the tax. The sales that were held taxable in the [Redacted] audit are not included in this case.

Finally, the Commission has adjusted the amount of the tax due in this case. The taxpayer in this case paid either sales or use tax on all of its purchases of materials. This tax was paid erroneously because the taxpayer should have bought the materials exempt from tax and then charged tax on its sales. The original deficiency did not give credit for the tax paid in error. The deficiency is also being adjusted to deduct sales of materials that were delivered to job sites outside of Idaho.

WHEREFORE, the Notice of Deficiency Determination dated December 31, 2007, is MODIFIED, and as MODIFIED, APPROVED, AFFIRMED, and MADE FINAL.

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

<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$135,033	\$34,763	\$169,796

Interest is calculated through May 29, 2009, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioner'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.
