

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 23398
[Redacted],,)	
)	
Petitioner.)	DECISION
_____)	

On July 20, 2010, the staff of the Tax Discovery Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (Notice) to [Redacted] (taxpayer) proposing use tax, penalty, and interest for a transaction that occurred in taxable year 2009 in the total amount of \$34,904.

In correspondence dated August 18, 2010, the taxpayer filed a timely appeal and petition for redetermination. The taxpayer provided additional information in a letter dated April 21, 2011. On May 5, 2011, at the taxpayer's request, the Commission held a hearing. Following the hearing, the taxpayer corresponded with the Commission on May 20, 2011. The Commission, having reviewed the audit file, information obtained at the hearing, and correspondence submitted previously and thereafter, hereby upholds the audit findings for the following reasons.

Background

[Redacted]. is an Idaho-based [Redacted] dealer. At issue is the taxpayer's 2009 untaxed purchase of an [Redacted]. In a reply to the Bureau regarding the acquisition of the aircraft, the taxpayer answered that it purchased the aircraft from a [Redacted] entity, and that it was not purchased for resale.

The Bureau reviewed the "Aircraft Purchase/Sales Agreement" dated [Redacted]. The agreement specifies that [Redacted] received an [Redacted], valued at \$450,000 and \$420,000 in

cash. The [Redacted] entity, [Redacted], received an [Redacted], aircraft valued at \$870,000. These facts are undisputed.

The Bureau imposed a use tax on the \$450,000 value of the taxpayer's acquired [Redacted], determining that the taxpayer's use of the aircraft did not qualify for any exemption.

Applicable Tax Law

In Idaho, a tax is imposed on the sale of tangible personal property unless an exemption applies (Idaho Code § 63-3612(1)). Idaho retailers collect sales tax from the buyer and remit it to the state (Idaho Code § 63-3619). When a taxable sale is made by a vendor who is not obligated by law to collect Idaho sales tax, no tax is collected. Use tax, the complementary tax to sales tax, is due in these circumstances, and it is the responsibility of the Idaho resident to remit the tax to the state (Idaho Code § 63-3621). The sales and use tax rates are identical, six percent of the purchase price (Idaho Code §§ 63-3619 and 63-3621).

There are exemptions to the imposition of tax on sales and purchases. Those relevant to the dispute at issue are discussed in this decision.

Goods bought for resale are not taxable, because these transactions are not included in the definition of "retail sale":

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 ...(Idaho Code § 63-3609).

This exclusion is commonly referred to as a reseller's exemption.

When a sale or purchase is taxable, the sales price subject to tax is defined to include certain charges and omit others. Relevant to this decision is the trade-in allowance. Goods tendered by a buyer in exchange for other goods will lower the price subject to tax for the acquired goods if the tendered goods become part of the resale inventory of the seller. The value

of the goods taken in trade are deducted from the price subject to tax (Idaho Code § 63-3613(b)2).

A trade-down occurs when the value of traded goods exceeds the price of the goods bought in the exchange. In this case, the price subject to tax is zero, as long as the higher-valued goods become part of the resale inventory of the receiver. As noted previously, the taxpayer exchanged an aircraft valued at more than the aircraft the taxpayer received. The difference was satisfied by cash received.

Taxpayer Protest and Analysis

The taxpayer raised several defenses to the Notice. Each defense raised is followed by the Commission's analysis and opinion.

Issue: In the August 18, 2010, protest letter, the taxpayer states that the auditor deemed the aircraft exchange to be between individuals. However, the taxpayer continues, "a portion of the transaction was a valid trade-in," and the taxpayer "paid taxes on the \$420,000 received." However, the taxpayer "did not pay taxes on the \$450,000 – the value of the aircraft received- because this portion of the transaction qualifies for a trade-in allowance." The taxpayer stresses that as a registered aircraft dealer, it should be able to take advantage of a trade-in allowance.

The taxpayer defines its business as having two divisions, one devoted to aircraft sales and the other to providing agricultural spraying services. The aircraft it buys for agricultural aviation eventually become its resale inventory. According to the taxpayer, its use of aircraft to provide services should not preclude it from taking the tax advantages of a trade-in allowance.

Given this backdrop, the taxpayer defines the transaction at issue as follows:

...[Redacted]. In exchange, [Redacted] provided [Redacted] with an aircraft worth \$450,000 and \$420,000 in cash. Therefore [Redacted] effectively traded-down. The trade-in allowance that [Redacted] should be permitted to take is equal to the value of the aircraft it received in exchange for its aircraft, or

\$450,000. The portion of the transaction which is taxable is the \$420,000 cash or boot it received in the exchange and which [Redacted] properly paid sales tax on (August 18, 2010, protest letter, pg. 3)

The taxpayer concludes that, if it had used a third-party seller, it would not have been questioned by the Commission, and the trade-in allowance would have reduced the tax owed.

Opinion: The Commission respectfully contends that the taxpayer misunderstands the trade-in allowance, the reseller's exemption, and some of the facts surrounding the transaction at issue.

Resellers have no need for a trade-in allowance because they have a reseller's exemption. They owe no tax on what they purchase if they purchase with the intent to resell (Idaho Code § 63-3609). For non-retailers who have no other exemption available to them, the trade-in allowance on their purchase is contingent on whether the business accepting the goods in trade will make them part of a resale inventory. If that party is a reseller and intends to take goods in trade that it will resell, the trade-in allowance for tax purposes is appropriate (Idaho Code § 63-3613(b)2).

When a buyer makes a purchase with both cash and an article of value which will become part of the seller's resale inventory, the buyer owes tax on the purchase price less the value of the goods traded (i.e., the cash consideration). If the trade-in exceeds the value of the purchase, as it does in a trade-down, no tax is due. The taxpayer is mistaken that tax was due on the cash received in the trade-down (i.e., boot) rather than on the value of the goods received. Further, the taxpayer is mistaken that it paid this tax to the state.

The taxpayer contends that the Bureau imposed a tax liability by its attention to the form of the transaction rather than its substance. As noted earlier, the taxpayer believes that it used its dealer business division to intercede on behalf of its service division, thus legally avoiding a tax.

Alternatively, it said it could have used a third-party dealer to intercede on its behalf, still legally avoiding tax.

The Commission's understanding differs. In the transaction at issue, tax is due regardless of the role of business divisions or the substitution of a third-party dealer. Applying the Commission's understanding of the law to the facts presented, the outcome is as follows.

The service division sells its \$870,000 aircraft to its dealer division or to a third-party dealer.¹ The service division receives \$870,000 in return. The dealer division or the third-party owes no tax because it bought the \$870,000 aircraft for resale.

Next, the dealer division or the third-party sells the \$870,000 aircraft to another party for an aircraft worth \$450,000 and \$420,000 in cash. It owes no tax on the \$450,000 aircraft received because it intends to resell it. It then sells the \$450,000 aircraft to its service division. The dealer division is made whole in that it now has its \$870,000 back. The service division has an aircraft valued at \$450,000 and \$420,000 in cash, which is precisely how it fares in reality.

However, the service division owes tax to the dealer division on its purchase price because it can claim no exemption. The service division's primary purpose, as admitted during the hearing, is to use the aircraft in agricultural aviation. No exemption exists for this use (Idaho Code § 63-3622GG and IDAPA 35.01.02.037.05.a).

¹ From the known information, the Commission does not accept the taxpayer's premise that the divisions can make true economic transactions between themselves.

Issue: In its April 21, 2011, correspondence, the taxpayer states that the auditor's:

...determination turned entirely on the fact that the aircraft in question was listed as an asset [in the taxpayer's books] rather than as inventory on [the taxpayer's] financial statements and as such that [the taxpayer] could not take a trade-in allowance....However, this should be irrelevant....The Rules do not clearly state the merchandise subject to a trade-in allowance must be listed as inventory on financial statements. They simply state that the merchandise must become a part of "an inventory held for resale." Here, the aircraft was part of an inventory held for resale at the time of sale and thus [the taxpayer] should be permitted to take a trade-in allowance just as if it had used a third party aircraft dealer to consummate the transaction (correspondence to the Commission dated April 21, 2011, p. 2)

Opinion: Some of the taxpayer's misunderstanding of the reason behind the liability stems from the Explanation of Deficiency provided by the auditor to the taxpayer as an attachment to the Notice. It states:

Idaho Administrative Rule 44 states that when two (2) individuals exchange tangible personal property, both parties must pay tax on the fair market value of the tangible personal property received in the trade...Tax computation is based on the purchase price of the aircraft as \$450,000 (Notice of Deficiency Determination, Explanation of Deficiency, July 20, 2010).

This explanation is correct, but it does not provide the taxpayer with a full understanding of the reasons for the liability. The following was explained in detail to the taxpayer at the hearing.

The reference to individuals in IDAPA 35.01.02.044, cited by the Bureau and reproduced above, is used to distinguish non-retailers from retailers. The auditor focused on the taxpayer's asset listing to show that while the taxpayer was a retailer, it was not making a purchase for resale and, therefore, had no exemption. Further, and more critical to the issue, the other party to the transaction was not making a purchase from the taxpayer with the intent of placing the \$870,000 aircraft in a resale inventory. Therefore, no trade-in (in this case, trade-down) allowance was applicable.

No information was presented to establish that [Redacted], the buyer of the \$870,000 aircraft, placed that aircraft in a resale inventory. A nominal search of the company on the Internet for a business profile indicates it is primarily an agricultural services business:

[Redacted] is a private company categorized under [Redacted]. Current estimates show this company has an annual revenue of less than \$500,000 and employs a staff of approximately 1 to 4 ([Redacted]).

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Issue: In its May 20, 2011, letter to the Commission, the taxpayer admits that it wrongly believed it paid tax on the transaction at issue in this decision. However, it has an alternative reason for not owing any tax.

The taxpayer correctly notes that [Redacted] originally sold the \$870,000 aircraft to the taxpayer through an exchange similar to the one at issue in this decision. In the prior transaction involving the \$870,000 aircraft, according to the taxpayer, the auditor allowed a trade-in to reduce the taxable amount. It now wishes to rely fully on that prior determination and believes it owes nothing. The taxpayer stresses two points from the prior transaction. The auditor denied the reseller's exemption but allowed a trade-in value deduction from the amount subject to tax.

Opinion: The auditor would most certainly deny a reseller's exemption, and it may have allowed a trade-in to reduce the amount subject to tax based on the level of research and conclusions it drew with respect to the second party ([Redacted]) to the transaction. However, this decision need not determine the validity of the taxpayer's claim nor be required to determine how closely the two transactions compare. It is sufficient to say that the Commission has no statutory bar to imposing tax based on the facts presented in this case.

The Bureau's imposition of interest and penalty are appropriate per Idaho Code §§ 63-3045(6) and 63-3046(c) and (g). Interest on the tax liability is accrued to October 31, 2011, and continues to accrue until paid.

THEREFORE, the Notice of Deficiency Determination dated July 20, 2010, is hereby APPROVED, in accordance with the provisions of this decision and, as so APPROVED, is AFFIRMED and MADE FINAL.

The Commission acknowledges receipt of the entire amount due:

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$27,000	\$6,750	\$2,427	\$ 36,177

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 _____ 2011.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2011, 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.
