

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 23618
[Redacted],	)	
	)	
Petitioner.	)	DECISION
	)	
	)	
_____	)	

On October 28, 2010, 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 (Notice) to [Redacted] (taxpayer) proposing use tax and interest for the audit period July 1, 2007, through May 31, 2010, in the total amount of \$10,021.

In correspondence dated December 8, 2010, the taxpayer filed a timely appeal and petition for redetermination. At the taxpayer’s request, the Commission held an informal hearing on February 17, 2011. For the reasons that follow, the Commission upholds the audit findings.

**BACKGROUND AND APPLICABLE TAX LAW**

The taxpayer is a real property contractor who measures for, manufactures, and installs [Redacted]. On most transactions, the taxpayer collected sales tax from his customers on the contract price, which included the cost of goods sold, mark-up, and labor.

Idaho Code §§ 63-3609 and 63-3612 define “sale” for the purpose of the Idaho Sales Tax Act. Improvements to real property are not defined as retail sales, and real property contractors should not collect sales tax from their customers on these transactions. Rather, all persons engaged in constructing, altering, repairing, or improving real estate are consumers of the material used by them, and they are required to pay a sales tax to their vendor, or a use tax to the state, on all purchases of tangible personal property they incorporate into realty (Idaho

Code §§ 63-3609(a) and 63-3621(a)). Contractors can pass this cost of doing business on to their customers, but it is not a retail sales tax.

The taxpayer either contracted with a homeowner or worked as a subcontractor to another party. In either case, the taxpayer measured for the requirements, fabricated and installed [Redacted], and charged tax on the total price. The tax code does not distinguish between contractors and subcontractors with respect to real property improvements, however, both are considered to be consumers of the material they use in fulfillment of contracts and owe a tax on their purchases (IDAPA 35.01.02.010.04).

#### AUDIT FINDINGS AND PROTEST

Since the taxpayer treated real property contracts as if they were retail sales, the taxpayer did not pay tax on the purchase of construction materials. The auditor imposed use tax on these transactions because no exemption applied. The taxpayer contends that by collecting sales tax from his customers on the contract price, more tax was remitted to the state than the use tax obligation would have been on the purchase price of the materials. The taxpayer determined that the sales tax remitted during the audit period exceeds \$21,000 and that since the auditor asserted approximately \$9,300 in tax, he is due a refund.

The taxpayer concedes that he installs [Redacted] but disagrees that the business is improving real property. The taxpayer claims that for 21 years he has been a “manufacturer” operating under “the production exemption guidelines.” By this he means that he buys materials tax exempt as a manufacturer of tangible personal property (Idaho Code § 63-3622D) and sells the finished and installed product as a retail sale, collecting sales tax.

## ANALYSIS AND CONCLUSION

The Commission agrees with the auditor that installed [Redacted] are real property improvements, as defined in the administrative rules:

02. Three Factor Test. A three (3) factor test may be applied to determine whether a particular article has become a fixture to real property. The three (3) tests to be applied are:

- a. Annexation to the realty, either actual or constructive.
- b. Adoption or application to the use or purpose to which that part of the realty to which it is connected is suitable.
- c. Intention to make the article a permanent addition to the realty (IDAPA 35.01.02.067.02).

In the past, auditors accepted sales tax erroneously collected by real property contractors from customers in lieu of use tax owed by the contractors. There are two significant reasons for discontinuing this practice. First, as noted previously, the tax code imposes the tax on the contractors, not on the customers. Customers can seek and obtain a refund of erroneously paid tax (Idaho Code § 63-3626 and IDAPA 35.01.02.117). Second, the amount of tax is greater when a contractor imposes a tax on the contract price in lieu of paying tax on the lower purchase price.

Previously, auditors advised contractors who were erroneously charging tax that they should change their purchasing and billing practices to conform to the tax code. As this advice asserted no liability against the contractors, compliance did not improve, and the Commission made a change.

Thus, in the case at issue, the auditor followed current Commission policy. For transactions that occurred prior to October 2008, the auditor allowed the taxpayer's offset of inappropriately collected sales tax against the taxpayer's sales and use tax liability on the purchase of the tangible personal property. For transactions dated from October of 2008, to the end of the audit period, the auditor disallowed the offset and asserted a use tax on the cost of

materials used. Contractors were informed in advance of this policy in the Commission's publication Tax Update ("Sales Tax Advice for Contractors," Vol. 20, #1, June 2008).

The taxpayer believes that the Commission has instituted an arbitrary and unfair change to the tax code, but the relevant statute has been unchanged since the enactment of the Sales Tax Act, as evidenced by this excerpt from a 1965 legislative report:

Section 9 (a) is intended to insure that there will be a tax imposed on the sale of building materials and other items that will be used to erect buildings or otherwise improve real property. The process of construction is regarded as a service, and sale of materials to the contractor is taxed without regard to resale intentions. This insures that a tax will be collected. Since the sale of the, building or other real property will not be taxed, sale of the materials which are used to erect or improve it must be taxed if a tax is to be imposed on consumption of this property (House Revenue and Taxation Committee Report in Support of House Bill 222, 1965).

The reference to Section 9(a), above, became Idaho Code § 63-3609(a), cited previously.

The Commission disagrees that the taxpayer is owed a refund for remitting tax in excess of the amount owed. As noted earlier, tax collected in error can be refunded to the customer. It is not the property of the taxpayer.

The taxpayer has not provided the Commission with information to establish that the amount asserted in the Notice is incorrect. As a result, the Commission will uphold the Notice for the period July 1, 2007, through May 31, 2010.

Interest was added to the tax liability per Idaho Code §§ 63-3045(6). Interest is accrued through August 31, 2011, and continues to accrue until the tax liability is paid.

THEREFORE, the Notice of Deficiency Determination dated June 30, 2009, is hereby APPROVED, and as APPROVED, is AFFIRMED and MADE FINAL in accordance with the provisions of this decision.

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>
\$9,346	\$924	\$10,270

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.  
  
\_\_\_\_\_