

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 23693
[Redacted],)	
)	
Petitioners.)	DECISION
_____)	

On October 1, 2010, the Sales Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (Notice) to [Redacted] (taxpayers). The Notice proposed additional use tax, penalty, and interest in the total amount of \$42,825 for taxable period April 1, 2007, through September 30, 2007. The taxpayer filed a timely appeal and petition for redetermination on November 23, 2010, and requested an informal conference, which was held on March 31, 2011.

The Commission, having reviewed the audit file and considered the information obtained at the informal conference, upholds the audit findings as explained below.

Idaho Code § 63-3619 only imposes a sales tax on “retail sales.” Idaho Code § 63-3609 further defines retail sale as “a sale for any purpose other than resale in the regular course of business.” Consequently, when a retailer makes a purchase of tangible personal property that is intended for resale, it is not subject to sales tax.

In July 2007, the taxpayers completed construction on a [Redacted]. They did not pay sales tax on the purchase of any of the materials used to construct the [Redacted]. Though this was the costliest [Redacted] ever constructed by the taxpayers, they had previously constructed [Redacted] for sale in the normal course of business.

In April 2007, prior to the completion of construction, the [Redacted] was registered with Idaho State Parks and Recreation in the personal name of the husband. At the time of registration, the purpose of the [Redacted] was designated as “pleasure” rather than other options available including “rental/lease” or “dealer.”

[Redacted].

For income tax purposes, in taxable year 2007, the [Redacted] was listed as an asset of the business subject to depreciation expense. According to IRS Treasury Regulation § 1.167(a)-2, which governs income tax filings, assets that are part of a resale inventory cannot be depreciated, though depreciation is allowed for assets rented or leased to customers. The taxpayers later explained that the asset was depreciated as a rental asset.

In 2008, the business, which had formerly existed as a sole proprietorship, was incorporated as [Redacted], an S corporation separate from the individual taxpayers. Upon incorporation, certain equipment was transferred from the taxpayers to the new corporation. The [Redacted] became a personal asset of the taxpayers after the creation of the new corporation and remained a personal asset through the time of the audit.

In June 2010, the Bureau initiated a limited audit of [Redacted] exclusively focused on the construction of [Redacted]. The Bureau concluded that the taxpayers had constructed [Redacted] as a personal asset and transferred it to a resale inventory at a later date. All materials used to construct [Redacted] were held subject to use tax. The Bureau based their conclusion on the following: 1) [Redacted] in the personal name of the taxpayers with a stated purpose of “pleasure,” 2) the newspaper article in which the taxpayers claimed [Redacted] as a personal asset, 3) the inclusion [Redacted] as a depreciable business asset in taxable year 2007,

and 4) the exclusion of [Redacted] from the business assets upon incorporation in taxable year 2008 at which time it became a personal asset of the taxpayers.

The taxpayers protested the Bureau's audit findings asserting that [Redacted] was part of the business's resale inventory as soon as construction was completed. When [Redacted] was not purchased immediately, the taxpayers claim that [Redacted] was rented to customers, though it remained for sale. The rental status of [Redacted] was the reason given for including [Redacted] as a depreciable business asset on the 2007 income tax return. The taxpayers said the newspaper article was a publicity piece and did not represent their true intentions [Redacted]. They explained that it seemed "tacky" to say it was for sale in the context of what they viewed as a "human interest story." At the advice of the taxpayers' lawyer, [Redacted] was not transferred to the new corporation in taxable year 2008. They said it had "something to do with protecting the asset in the event of a lawsuit." They pointed out that other business assets were not transferred to the new corporation including the [Redacted] construction and repair occurred.

The taxpayers argue that they purchased materials to construct [Redacted] that was intended for resale. If their assertion is correct, the taxation of the materials was handled properly. The Bureau argues that [Redacted] was not intended for resale at the time of construction and, therefore, the materials were subject to use tax.

The taxpayers have no evidence that [Redacted] was actively marketed for sale at the completion of construction in July 2007. At the hearing, the taxpayers admitted they had not advertised the sale of [Redacted] in any way until fall 2009 when it was listed with a realtor in a package with [Redacted] real property. Marketing was expected to occur by "word-of-mouth." However, the April 2007 registration indicated that it would be used for "pleasure," which explicitly implies personal use, when the option was given to register [Redacted] in a category

that would more clearly suit a business asset. In addition, the local newspaper article from July 2007, in which the taxpayers were personally interviewed about [Redacted], mentioned nothing about the sale and explicitly stated that [Redacted] was built for the personal use of the taxpayers. Though the taxpayers dismiss the article as misrepresenting their intentions with the [Redacted], there is no counterevidence from this period of time that demonstrates the [Redacted] was for sale. Finally, when the taxpayers had the opportunity to transfer [Redacted] as a business asset to the newly formed corporation in 2008, [Redacted] remained a personal asset of the taxpayers. It seems an unusual business practice to hold an item of retail inventory outside the company making the sale. Despite the taxpayers' assertion [Redacted] was held for resale starting in July 2007, the Commission concludes that the evidence available does not support their claim and, in fact, supports the Bureau's claim that [Redacted] was intended for the personal use of the taxpayers.

The taxpayers also assert that [Redacted] was held as an asset available for customer rental. Under Idaho Code § 63-3612(2)(h), a rental is considered a sale for sales tax purposes. Similar to inventory that will be resold, rental inventory can be purchased without paying sales tax. IDAPA 35.01.02.024.02 clarifies that only "a rental of equipment without operator", also known as a bare equipment rental, "is a taxable sale." When equipment is rented with an operator, it is known as a fully operated rental, and is not subject to tax (IDAPA 35.01.02.024.03.a). If the primary purpose of equipment is fully operated rentals, the purchase of the equipment is subject to sales or use tax (IDAPA 35.01.02.024.04.b). The vast majority of the minimal rental income from [Redacted] stemmed from fully operated rentals. The Commission concludes that the primary purpose of [Redacted] was never bare equipment rental.

Based on the above conclusions, the Commission upholds the audit findings.

Finally, the Commission approves of the Bureau's imposition of interest as appropriate per Idaho Code § 63-3045(6).

THEREFORE, the Notice of Deficiency Determination dated October 1, 2010, and directed to [Redacted], is AFFIRMED by this decision.

IT IS ORDERED that the taxpayers pay the following amount of tax, penalty, and interest:

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$35,850	\$0	\$8,312	\$44,162

Interest is calculated through October 31, 2011, and will continue to accrue until the entire liability has been paid.

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

An explanation of the taxpayers' 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.
