

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 23102
[Redacted],)	
)	
Petitioner.)	DECISION
_____)	

On April 12, 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 sales tax, use tax, penalty, and interest for the period October 1, 2001, through September 30, 2008, in the total amount of \$41,340.

On June 10, 2010, the taxpayer filed a timely appeal and petition for redetermination of the Notice. On November 21, 2011, at the taxpayer’s request, the Commission held an informal hearing by telephone. Having considered the audit findings, the tax law, and the information obtained at the hearing, the Commission upholds the audit findings for the reasons that follow.

Background

The taxpayer is both a retailer of tangible personal property and a real property contractor. As a retailer, the taxpayer was required to have a seller’s permit which would enable it to collect sales tax on retail sales to its customers and remit the tax to the Commission (Idaho Code § 63-3620(a)). The taxpayer did not have a seller’s permit during the period, and the Bureau conducted a seven year audit (Idaho Code § 63-3633(c)). As a real property contractor, the taxpayer was required to pay a tax on its purchase or use of materials it incorporated into realty (Idaho Code § 63-3609(a)), but it failed to do so for many of its purchases.

Liability Issues and Applicable Tax Law

One area of disagreement arises from the following sequence of events. Real property contractors and subcontractors bring cabinets, doors, vanities, and similar tangible personal property to the taxpayer for finishing work which may include sanding, base coating, and further painting or staining as circumstances dictate. The contractors take delivery of the finished goods from the taxpayer and later install them as additions to homes or businesses under construction or renovation. The taxpayer will later travel to the residences or businesses where the tangible personal property has been installed to perform further painting, staining, and alterations necessary to fully integrate the property into the real estate.

The following is Idaho's sales and use tax law as it applies to the taxpayer's business. Among the definitions of sales subject to tax found in the tax code, the following is relevant with respect to the taxpayer's receipt of goods from customers for further processing:

- (2) "Sale" shall also include the following transactions when a consideration is transferred, exchanged or bartered:
 - (a) Producing, fabricating, processing, printing, or imprinting of tangible personal property for consumers who furnish, either directly or indirectly, the tangible personal property used in the producing, fabricating, processing, printing, or imprinting (Idaho Code § 63-3612).

Based on the previous code section, the auditor concluded that the taxpayer's charges for the labor and materials it expended and provided to further finish or process the cabinets and other tangible personal property items owned by its customers and brought to its work area were subject to sales tax. Offsetting this liability, however, is a refund for tax the taxpayer paid on the purchase of these materials because purchase of goods intended for resale are excluded from the definition of sales subject to tax (Idaho Code § 63-3609).

Improvements to real property are not defined as taxable sales in the full version of the previously cited statute, Idaho Code § 63-3612. Therefore, the labor and materials used to finish the cabinets, vanities, and doors at their installed location is not a retail sale. However, all persons engaged in constructing, altering, repairing, or improving real estate, are consumers of the material used by them, and all sales to or used by such persons is taxable (Idaho Code § 63-3609(a)).

Since the taxpayer did not pay a sales tax to its vendors or accrue a use tax for the material later used to improve real property, it owes a use tax to the state. Payment of use tax extinguishes the sales tax obligation (Idaho Code §§ 63-3612 and 63-3621).

The invoices provided by the taxpayer to its contractor customers included an undifferentiated labor charge that included labor applied at its workplace as well as labor applied at those locations where the cabinets had been recently installed. The auditor estimated that 20 percent of the total labor expended was at the taxpayer's location, and therefore held this amount subject to tax. The remaining 80 percent expended at the installation sites was for real property improvements and, consistent with the law as explained above, was not taxable.

Taxpayer's Protest

In the taxpayer's letter of protest, it states that, "The primary topic of misunderstanding is the definition and application of manufacturing labor in the construction and improvement of real property.we are unable to get a precise understanding of this issue, and therefore we are protesting this determination." No other issues were contested in the protest letter.

Analysis and Conclusion

The Commission agrees with the auditor's conclusions and contends that the taxpayer misunderstands the distinctions made in the tax code between processing and finishing tangible personal property versus improving real property.

The Commission further notes that repair labor applied to tangible personal property (e.g., returning goods to their original condition) is exempt. The auditor did not knowingly hold restoration labor taxable. The following excerpt from a sales and use tax administrative rule illustrates processing and fabrication labor from repair or reconditioning labor:

Repairing and Reconditioning Distinguished. Producing, fabricating, and processing includes any operation which results in the creation or production of tangible personal property or which is a step in a process or series of operations resulting in the creation or production of tangible personal property. The terms do not include operations which do not result in the creation or production of tangible personal property or which do not constitute a step in a process or series of operations resulting in the creation or production of tangible personal property, but which constitute merely the repair or reconditioning of tangible personal property to refit it for the use for which it was originally produced (IDAPA 35.01.02.029.02).

Additional Issues and Analysis

The taxpayer brought other issues to the informal hearing for consideration but did not provide further evidence, thus the Commission bases its decisions on what was stated at the hearing and the evidence in the file.

The taxpayer stated that the auditor held several purchases of sample materials subject to tax, protesting that the transactions were already taxed. However, the auditor indicates that only one item for \$52 was held liable and cannot locate the numerous transactions the taxpayer refers to. The samples in question were used as a marketing tool. There is no general exemption in the tax code for the use of samples in promoting a business or product, and the purchase of tangible personal property is taxable unless an exemption applies.

Materials held for resale can be used for demonstration purposes without incurring a tax (Idaho Code § 63-3621(f)), but for the transaction in question, the auditor asserts that the materials were no longer intended to be resold. Ultimately, the taxpayer does not argue about the validity of the auditor's argument, only that there is double taxation, but the auditor can find no evidence of this.

The taxpayer objects to the imposition of tax on its purchase and use of flooring material but, as noted previously, material used by a contractor to improve real property (in this case the installation of floors) is taxable to the taxpayer acting as the contractor.

The taxpayer contends that some of the invoices subject to tax by the auditor represented uncollectible debt. The tax code allows a credit for sales tax paid on amounts found to be worthless (Idaho Code § 63-3613(d)). While the taxpayer did not collect tax, the Commission agrees that the taxpayer should not be liable for the tax, but the taxpayer has failed to show specifically which invoices it contends were written off in the accounting records as worthless and if those amounts were in fact held taxable by the auditor.

The taxpayer protests the imposition of the penalty. The auditor imposed a 5 percent negligence penalty (Idaho Code § 63-3046) due to the taxpayer's failure to collect tax on retail sales and failure to pay tax on its use of material incorporated into real property. The Commission believes the penalty is justified.

Absent information to the contrary, the Commission finds the deficiency prepared by the Bureau to be a reasonably accurate representation of the taxpayer's sales and use tax liability for the period October 1, 2001, through September 30, 2008.

The Bureau added interest to the sales and use tax deficiency. The Commission found the deficiency appropriate per Idaho Code § 63-3045 and has updated interest accordingly.

The taxpayer made four partial payments for a total of \$20,000. Each partial payment was applied first to outstanding interest and then to tax, per IDAPA 35.02.01.140. To the extent that partial payments extinguished accrued interest, it lowered the tax and the subsequent interest accrual between future partial payments. The figures below reflect the results of the application of the partial payments. Interest is calculated through July 31, 2012, and will continue on the unpaid tax liability at the rate set forth in Idaho Code § 63-3045(6) until paid.

THEREFORE, the Notice of Deficiency Determination dated April 12, 2010, is hereby APPROVED, in accordance with the provisions of this decision, and is AFFIRMED and MADE FINAL.

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

	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
Liability	\$31,687	\$1,587	\$10,280	\$43,554
Allocation of Partial Payments	(11,102)	0	(8,898)	<u>(20,000)</u>
TOTAL DUE	20,585	1,587	1,382	<u>\$23,554</u>

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 _____ 2012.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2012, 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.
