

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 24067
[Redacted],	)	
	)	
Petitioner.	)	DECISION
	)	
_____	)	

On April 13, 2011, the Sales Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (Notice) to [Redacted] (taxpayer). The Notice proposed additional sales and use tax, penalty, and interest in the total amount of \$11,519 for taxable periods January 2008 through December 31, 2010. The taxpayer filed a timely appeal and petition for redetermination on June 1, 2011, and requested an informal conference, which was held on January 24, 2012.

The Commission, having reviewed the audit file and considered the information obtained at the informal hearing, modifies the Notice for the reasons detailed below.

The taxpayer is an Idaho retailer selling various office furniture and equipment. The only transactions at issue in this protest are sales of [Redacted] (hereafter systems) and reconfigurations of existing systems. These transactions follow a similar pattern.

First, the taxpayer designs a custom system to fit a customer’s needs within a given office space. For a reconfiguration, the taxpayer designs a new arrangement for a portion of an existing system. The taxpayer provides the customer with a set of blueprints detailing the proposed design and allows them time to “shop around” with other system sellers. The customer then chooses whether to purchase the system from the taxpayer or a competitor. If the customer purchases the system from a competitor, the taxpayer charges the customer for the design work and that is the end of their dealings. If the customer chooses to purchase the system from the

taxpayer, the taxpayer will still charge the customer for the design time, though at a later date usually when the remainder of the transaction is invoiced.

The taxpayer orders and prepares all necessary parts and materials for the onsite “installation” (the taxpayer’s term) of the system. For a reconfiguration, the taxpayer works with the parts and materials already owned by the customer as much as possible. Where additional parts and materials are still required, the taxpayer acquires and prepares them no differently than a new system. The taxpayer assembles or rearranges the system onsite according to the design specifications set forth in the blueprints. Finally, the taxpayer prepares one or more invoices with separate charges for the parts, materials, and labor that went into the project.

For both new systems and reconfigurations, the taxpayer properly charged sales tax on sales of the parts and materials and, therefore, no dispute exists between the taxpayer and Bureau related to this portion of the transactions. The taxpayer and Bureau also agree that design labor is not subject to tax in instances where the customer chooses to purchase the system from a competitor.

However, the taxpayer and Bureau do not agree on the taxability of design or assembly labor charged alongside the sale of a new or reconfigured system. The taxpayer did not charge sales tax on either type of labor and the Bureau held them subject to sales tax in the audit findings. The entirety of the protest is related to these labor charges.

The Bureau primarily argued that the taxpayer sells fully fabricated systems, not individual parts and materials, and, therefore, any charges associated with the sale of the fabricated system are part of the sales price subject to sales tax unless specifically excluded by statute (Idaho Code § 63-3613):

(a) The term "sales price" means the total amount for which tangible personal property, including services agreed to be rendered as a part of the sale, is

sold,...without any deduction on account of any of the following:...

2. The cost of materials used, labor or service cost, losses, or any other expense...

(b) The term "sales price" does not include any of the following:...

4. The amount charged for labor or services rendered in installing or applying the property sold, provided that said amount is stated separately and such separate statement is not used as a means of avoiding imposition of this tax upon the actual sales price of the tangible personal property...

The definition of sales price includes both “services agreed to be rendered as part of the sale” and “labor or service cost[s],” one or both of which, in the Bureau’s opinion, would apply to the labor charges in question. That is the extent of the Bureau’s argument as it relates to the design labor.

The Bureau’s argument for including the assembly labor in the sales price requires additional explanation. The Bureau acknowledged that installation labor is excluded from the sales price by statute; however, the Bureau did not believe that the labor to fabricate the cubicles should be treated as installation labor. The Bureau relied on IDAPA 35.01.02.044.02 to determine more specifically what labor and services should be included in the taxable sales price:

02. Services Agreed to be Rendered as a Part of the Sale. The sales and use tax is computed on the sales price of a transaction. The term “sales price” is defined by Section 63-3613, Idaho Code, to include “services to be rendered as a part of the sale.” The following items are among those that are part of the sales price and, therefore, may not be deducted before computation of the sales price. This is not intended to be an exclusive list of such items:

a. Any charges for any services to bring the subject of a sale to its finished state ready for delivery and in the condition specified by the buyer, including charges for assembly, fabrication, alteration, lubrication, engraving, monogramming, cleaning, or any other servicing, customizing or dealer preparation.

Based on the above, the Bureau asserted that the systems were not in a finished state or in the condition specified by the buyer until the taxpayer fabricated the systems at the buyer’s location. Therefore, the Bureau argues that the labor to complete the systems was actually fabrication and assembly labor, not installation labor as asserted by the taxpayer. The Bureau also looked to

IDAPA 35.01.02.029 to further support its position that the installation labor should be treated as taxable fabrication labor:

01. In General. Tax applies to charges for producing, fabricating, processing, printing, imprinting, or the engraving of tangible personal property for a consideration, whether or not consumers furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, imprinting, or engraving.

...02. 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.

The Bureau argued that the assembly of the systems is a step in a process that “result[s] in the creation or production of tangible personal property.” Prior to assembly, the parts and materials consist of various sized wall panels and attachment mechanisms with little use on their own. In the Bureau’s opinion, upon assembly, the taxpayer has created new tangible personal property—a fully customized system that divides an office space according to a customer’s specifications.

The taxpayer disagreed with the Bureau’s assertion of tax on both design and installation labor though for different reasons.

First, the taxpayer argued that the design labor is part of a separate transaction and, therefore, cannot be “a service agreed to be rendered as part of the sale” of the system. As evidence, the taxpayer pointed to the timeline laid out above. When the taxpayer agrees to design a system, there is no guarantee that the customer will purchase the system. The sale of the tangible personal property is only agreed upon after the design work is done. The taxpayer

also pointed out that the design labor is often invoiced separately from the rest of the transaction, further drawing a line between the design work and the sale of the system. Therefore, the taxpayer argues, the design service is separate from the sale of the system.

Second, the taxpayer argues that the onsite labor to assemble the cubicles is nothing more than installation labor which is specifically excluded from the sales price subject to tax. The taxpayer points out that the parts and materials are interchangeable and can function in a variety of configurations without modification of individual pieces. The taxpayer finds unreasonable the Bureau's assertion that this labor is fabrication because the taxpayer does not manufacture any of the parts or materials either on or offsite.

The Commission's analysis will separately discuss the design and installation labor in the context of new system sales and reconfigurations.

For new systems, the Commission agrees with the Bureau's primary claim that the customer's object in these transactions is the fully assembled system. The various labor and services required to attain that object are included by statute in the sales price subject to sales tax unless some exclusion applies (Idaho Code § 63-3613).

The taxpayer argues that the design labor is a separate transaction and, therefore, cannot be a "service agreed to be rendered as part of the sale." However, the Commission finds little factual support for this claim. Though the design labor often occurs before the customer commits to purchasing a new system from the taxpayer, the invoicing of and payment for that labor only occur after the customer has committed to purchase tangible personal property from the taxpayer. In addition, the taxpayer usually invoices the design labor around the same time as or simultaneously with the billing for the new system.

It is also important to note that a new system could not be sold without the design labor.

The taxpayer designs each system for a specific customer's needs and space. The design labor is an integral part of the sale of a system. The labor may have already occurred, but the final product cannot be completed without this preparatory work. In fact, once a customer chooses to purchase a new system from the taxpayer, the taxpayer seems to be the only user of the blueprints after that point. The law is unambiguous that service and labor costs underlying a sale of tangible personal property are part of the taxable sales price. Therefore, it seems unreasonable to exclude any labor or service so essential to the sale of the tangible personal property without some statutory exclusion.

The Commission also agrees with the Bureau that the labor required to assemble the cubicles is not installation labor. While the Commission concedes the taxpayer's point that installation labor is not defined in Idaho code or rules, we can look at the code and rules underlying the sales price. As the Bureau pointed out, assembly and fabrication labor necessary to bring a product into a finished state are, by rule, specifically included in the sales price subject to tax (IDAPA 35.01.02.044.02.a). While it is true that the taxpayer does not manufacture the parts and materials that comprise each system, the Commission agrees with the Bureau that the taxpayer performs vital steps in the creation of a new product which is defined as fabrication labor by rule (IDAPA 35.01.02.029.02). The fully fabricated system is the customer's object in the transaction and the finished system seems like a fundamentally different product than the individual pieces prior to assembly.

Finally, the Commission disagrees with the Bureau's assertion of tax on design and installation labor arising from the reconfiguration of existing systems. In these cases, the taxpayer sold a minimal amount of new parts and materials, primarily working with pieces from a small portion of the existing system. As the sale of tangible personal property is minimal, it

seems unreasonable to treat the design labor as a service agreed to be rendered as part of the sale.

In addition, the labor to reconfigure a small part of an existing system seems more akin to a repair of existing tangible personal property rather than fabrication of something new. Repair labor is excluded from the sales price subject to tax (IDAPA 35.01.02.062.02).

Therefore, the Commission hereby reduces the Notice for all design and repair labor associated with a reconfiguration of an existing system. If these reconfiguration jobs had involved substantial additions of new parts and materials to a system or complete reconfigurations of an entire system, the Commission's analysis may have gone a different direction.

THEREFORE, the Notice of Deficiency Determination for sales and use tax dated April 13, 2011, and directed to [Redacted] is AFFIRMED as MODIFIED by this decision.

IT IS ORDERED that the taxpayer pay the following amount of tax and interest:

<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL DUE</u>
\$8,751	\$1,446	\$10,197

Interest has been calculated through October 18, 2012.

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.  
  
\_\_\_\_\_