

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 24483
[Redacted]	)	
Petitioner.	)	
	)	DECISION
	)	
	)	
_____	)	

On May 13, 2011, 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 period December 1, 2003, through September 30, 2010, in the total amount of \$26,022.

On July 13, 2011, the taxpayer filed a timely appeal and petition for redetermination of the Notice and, at the taxpayer’s request, the Commission held an informal hearing on January 19, 2012. For the reasons that follow, the Commission upholds the audit findings.

Background

The taxpayer provides a [Redacted] service by placing [Redacted]business premises into which employees [Redacted]. On an agreed-upon schedule, the taxpayer either removes [Redacted] to the street level where the taxpayer’s [Redacted]. The taxpayer empties the [Redacted]. A customer representative may be present to witness that the [Redacted]. If the [Redacted].

Not all [Redacted]. Depending upon the contractual agreement, the [Redacted]. The taxpayer provides [Redacted] businesses in Idaho, including [Redacted].

The taxpayer is related to an entity named [Redacted]. The taxpayer sells the [Redacted], which then [Redacted].

The auditor believes that the purchase and use of [Redacted] by the taxpayer for its [Redacted] service is taxable. The taxpayer protests this finding, believing that [Redacted]entitles it to what is commonly called the production exemption.

#### Relevant Tax Law

In Idaho, the sale, purchase, and use of tangible personal property is subject to tax unless an exemption applies. If sales tax cannot or is not paid to the vendor, the buyer owes a use tax to the state. Payment of use tax extinguishes the sales tax obligation (Idaho Code §§ 63-3612 and 63-3621). Since the taxpayer did not pay a sales tax to its vendors on the purchase [Redacted], or a use tax directly to the state thereafter, the auditor imposed a use tax liability under the premise that the production exemption did not apply.

The production exemption follows, in relevant part;

Production exemption. There are exempted from the taxes imposed by this chapter:

- (a) The sale at retail, storage, use or other consumption in this state of: ...
- (2) Tangible personal property primarily and directly used or consumed in or during a manufacturing, processing, mining, farming, or fabricating operation, including, but not limited to, repair parts, lubricants, hydraulic oil, and coolants, which become a component part of such tangible personal property; provided that the use or consumption of such tangible personal property is necessary or essential to the performance of such operation....
- (4) Safety equipment and supplies required to meet a safety standard of a state or federal agency when such safety equipment and supplies are used as part of an operation described in subsection (a)(2) of this section....
- (b) Other than as provided in subsection (c) of this section, the exemptions allowed in subsections (a)(1), (a)(2), (a)(3) and (a)(4) of this section are available only to a business or separately operated segment of a business which is primarily devoted to producing tangible personal property which that business will sell and which is intended for ultimate sale at retail within or without this state....
- (f) The exemptions allowed in this section do not include machinery, equipment, materials and supplies used in a manner that is incidental to the manufacturing, processing, mining, farming or fabricating operations such as maintenance and janitorial equipment and supplies...
- (g) Without regard to the use of such property, this section does not exempt:...
- (2) Tangible personal property used in any activities other than the actual manufacturing, processing, mining, farming or fabricating operations such as office equipment and supplies, and equipment and supplies used in selling or distributing activities...(Idaho Code § 63-3622D).

The following administrative rule, in relevant part, interprets the statute:

...

- 02. Qualifying Businesses. The production exemption applies only to a business or a separately operated segment of a business that primarily produces tangible personal property which is intended for ultimate sale at retail....
  - a. For the purposes of this rule, a separately operated segment of a business is a segment of a business for which separate records are maintained and which is operated by an employee or employees whose primary employment responsibility is to operate the business segment
  - b. The production exemption does not include ...service-related businesses not devoted to the production of tangible personal property for ultimate sale at retail....
  - g. Safety equipment and supplies required by a state or federal agency when used directly in a production area...

04. Production Process Beginning and End. The production process begins when raw materials used in the process are first handled by the operator at the processing plant or site. The production process ends when the product is placed in storage, however temporary, ready for shipment or when it reaches the final form in which it will be sold at retail, whichever occurs last....

05. Taxable Purchases. The production exemption does not include any of the following:...

e. Safety equipment and supplies used somewhere other than a production area, such as an office, or which are not required by a state or federal agency even if used in a production area....(IDAPA 35.01.02.079).

#### Taxpayer's Protest

In its letter of protest, the taxpayer describes the business as “[Redacted],” stressing that [Redacted], the subject of the use tax liability in this protest, are required by federal regulations in order for the business to legally handle [Redacted].

The protest letter also refers to a 1991 Commission declaratory ruling written for the taxpayer. That ruling determined [Redacted]. The taxpayer maintains presently that it is in the production business and that [Redacted] are part of the production process. Thus, the use of them should be exempt per Idaho Code § 63-3622D.

The taxpayer believes that the [Redacted] qualify under an additional subsection of the production exemption, Idaho Code § 63-3622D(a)(4):

Safety equipment and supplies required to meet a safety standard of a state or federal agency when such safety equipment and supplies are used as part of an operation described in subsection (a)(2) [Tangible personal property primarily and directly used or consumed in or during a manufacturing, processing, mining, farming, or fabricating operation].

The taxpayer disputes when the production process begins, stating that it begins when its customers [Redacted]. The auditor, the taxpayer contends, believes the process begins when the [Redacted]. Determining when the production process begins is critical to justifying an exemption.

Finally, the taxpayer relies on a statute and administrative rule that refers to [Redacted] and under what conditions their sale, purchase, and use is exempt (Idaho Code § 63-3622E and IDAPA 35.01.02.084). The taxpayer asserts that while the use of [Redacted] provided by a business providing a service are taxable to the business, there is no prohibition from the exemption for a business' use of containers to both provide a service and sell a product.

#### Analysis and Conclusion

With the facts in its possession, the Commission need not dispute that the taxpayer engages in activities that create a product for resale, that being [Redacted], or that the [Redacted] play some role in the production process. However, as the preceding production exemption code details, not everything merely associated with a production process will qualify for the exemption. Nor will a business not primarily dedicated to manufacturing qualify for the exemption.

The Commission believes that the [Redacted] are not “primarily ... used or consumed in or during a manufacturing ... or fabricating operation....” (Idaho Code § 63-3622D(a)(2)). The Commission does not debate that, for a few moments at least, some of the [Redacted]. Although the word “primarily” is not defined in the statute, even by the most liberal definition of the word the taxpayer’s use of the [Redacted], far from the substantial amount of time during which the [Redacted].

It is not the object of a customer to have [Redacted].

The Commission believes that the taxpayer’s business doesn’t satisfy the code requirement that the exemption be “available only to a business or separately operated segment of a business which is primarily devoted to producing tangible personal property which that business will sell....” (Idaho Code § 63-3622D(b)).

The auditor indicates that there is no separate segmentation of the service from the manufacturing process. While there are a few different contractual agreements that are possible between the taxpayer and its customers, when a customer contracts for on-site (i.e., curbside) [Redacted], the employee who retrieves the [Redacted].

The taxpayer contends that the use of the [Redacted].

The taxpayer's categorization of its [Redacted] that qualify for the production exemption is unpersuasive. Idaho Code § 63-3622D(a)(4) refers to "[S]afety equipment and supplies required to meet a safety standard of a state or federal agency when such safety equipment and supplies are used as part of an operation described in subsection (a)(2)", which refers to a manufacturing process. The [Redacted].

The administrative rule interpreting the production exemption defines the beginning and end of the manufacturing process. Tangible personal property used outside of the production period will not qualify. The production process begins when [Redacted] (IDAPA 35.01.02.079.04). In the instant case, the process occurs when the taxpayer empties a cabinet of its inner bag or transports the [Redacted]. Since the [Redacted] serve the customers' security needs the majority of the time, they fail the overriding requirement that they be primarily used in production.

The taxpayer believes that the [Redacted] are exempt containers described in Idaho Code § 63-3622E. There are three exempt container categories:

- (a) Nonreturnable containers when sold without the contents to persons who place the contents in the container and sell the contents together with the container.
- (b) Containers when sold with the contents if the sales price of the contents is not required to be included in the measure of the taxes imposed by this act.
- (c) Returnable containers when sold with the contents in connection with a retail sale of the contents or when resold for filling (Idaho Code § 63-3622E).

The taxpayer does not sell the [Redacted] to its customers. It charges them for a service that makes use of them. The customer does not sell the [Redacted] to the taxpayer. It pays the taxpayer for [Redacted]. The taxpayer sells the [Redacted] material to the [Redacted]. At that point, [Redacted]. The Commission concludes that Idaho Code § 63-3622E has no favorable application to the taxpayer.

Absent information to the contrary, the Commission finds the deficiency prepared by the Bureau to be a reasonable representation of the taxpayer's use tax liability for the period December 1, 2003, through September 30, 2010.

The Bureau added interest to the use tax deficiency, appropriate per Idaho Code § 63-3045.

THEREFORE, the Notice of Deficiency Determination dated May 13, 2011, is hereby APPROVED in accordance with the provisions of this decision and is AFFIRMED and MADE FINAL.

The Commission acknowledges receipt of the full amount:

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>
\$21,609	\$4,413	\$26,022
	LESS PAYMENT	<u>(26,022)</u>
	BALANCE DUE	<u>\$ 0</u>

An explanation of the taxpayer's right to appeal this decision is enclosed.

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2012.

IDAHO STATE TAX COMMISSION

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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.

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