

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 24642
[Redacted],	)	
	)	
Petitioner.	)	DECISION
	)	
	)	
_____	)	

On June 24, 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 February 1, 2004, through January 31, 2011, in the total amount of \$179,893. On August 25, 2011, the taxpayer filed a timely appeal and petition for redetermination of the Notice, and the Commission held an informal hearing on June 13, 2012, at the taxpayer’s request.

The Commission, having read the audit file and reviewed information provided by the taxpayer, hereby upholds the audit findings for the reasons that follow.

Background

The taxpayer is a for-profit partnership co-owned in equal shares by [Redacted]. [Redacted].

The partners, who refer to the taxpayer as a joint venture, are not-for-profit [Redacted] exempt by Idaho code from paying sales tax or use tax on purchases of tangible personal property. The auditor concluded that the taxpayer, while related to its exempt partners, is not entitled to the tax exemption. One of the tax exempt partners, [Redacted], made tax exempt purchases of tangible personal property throughout the audit period on behalf of the taxpayer, and the auditor asserted a use tax liability against the taxpayer on the price of these purchases.

Since the taxpayer did not have a Commission-issued permit as a registered seller, or a permit that allows it to file use tax returns on a periodic basis, the audit period was seven years, as allowed by statute (Idaho Code § 63-3633(c)). For reasons discussed in this decision, the taxpayer disputes the auditor's conclusion that as a for-profit entity related to its partners, it is not entitled to the exemption accorded the partners.

#### Idaho Tax Code Relevant to the Audit Findings

In Idaho, the sale, purchase, and use of tangible personal property is subject to a six percent sales tax unless an exemption applies. If sales tax cannot be or is not paid to the vendors, the buyer owes a use tax directly to the state. The sales and use tax rates are identical. Payment of use tax extinguishes the sales tax obligation (Idaho Code §§ 63-3612, 63-3619, and 63-3621).

The Idaho legislature grants sales and use tax exemptions for specific goods; for specific uses of goods; and, to specific entities and entity classes. The following exemption statute excerpt is relevant to this decision:

Exempt private and public organizations. (1) There are exempted from the taxes imposed by this chapter:

(a) Sales to or purchases by hospitals, health related entities,... (Idaho Code § 63-3622O(1)(a)).

Paragraph (2) of the previously cited statute defines both "hospital" and "health related entities," for purposes of the exemption:

(b) "Hospital" shall include nonprofit institutions licensed by the state for the care of ill persons. It shall not extend to nursing homes or similar institutions.

(c) "Health related entities" shall mean the Idaho Cystic Fibrosis Foundation, Idaho Epilepsy League, Idaho Lung Association, March of Dimes, American Cancer Society, Mental Health Association, The Arc, The Children's Home Society of Idaho, American Heart Association, Idaho Ronald McDonald House, United Cerebral Palsy, Arthritis Foundation, Muscular Dystrophy Foundation, National Multiple Sclerosis Society, Rocky Mountain Kidney Association, American Diabetes Association, Easter Seals, Idaho Community Action Agencies, Idaho Primary Care Association and community health centers who are

members of the Idaho Primary Care Association, the Idaho Diabetes Youth Programs, Special Olympics Idaho, the Idaho Women's and Children's Alliance, and the Family Services Alliance of Southeast Idaho, together with said entities' local or regional chapters or divisions (Idaho Code § 63-3622O(2)(b) and (c)).

An Idaho administrative rule elaborates on the exemption for hospitals and health-related entities:

Hospitals. In addition to the health related entities listed in Section 63-3622O, Idaho Code, hospitals which are nonprofit institutions licensed for the care of ill persons are exempt. To qualify for the exemption the hospital must be a facility defined in Section 39-1301(a), Idaho Code, and licensed as provided in Chapter 13, Title 39, Idaho Code, or an equivalent law in another state. Hospitals operated for profit do not qualify for this exemption, nor do nursing homes, clinics, doctors' offices, or similar facilities unless the organization qualifies for an exemption under Section 63-3622O, Idaho Code (IDAPA 35.01.02.085.04).

Idaho code defines "hospital," as noted in the previously referenced rule:

Definitions. For purposes of this chapter the following definitions will apply:

(a) "Hospital" means a facility which:

- (1) Is primarily engaged in providing, by or under the supervision of physicians,
  - (a) concentrated medical and nursing care on a twenty-four (24) hour basis to inpatients experiencing acute illness; and
  - (b) diagnostic and therapeutic services for medical diagnosis and treatment, psychiatric diagnosis and treatment, and care of injured, disabled, or sick persons; and
  - (c) rehabilitation services for injured, disabled, or sick persons; and
  - (d) obstetrical care.
- (2) Provides for care of two (2) or more individuals for twenty-four (24) or more consecutive hours.
- (3) Is staffed to provide professional nursing care on a twenty-four (24) hour basis (Idaho Code § 39-1301).

The administrative rule cited previously underscores the narrow application of the code:

In General. The Sales Tax Act does not provide any general exemption for, charitable or nonprofit organizations, corporations, associations or other entities. Specific statutory provisions provide exemptions for some charitable organizations. **Unless an exemption is clearly granted to a specific organization** or to specific sales or purchases by a specific organization or a class of organization, **no exemption applies** (IDAPA 35.01.02. 085.01, emphasis added).

#### The Taxpayer's Protest

The taxpayer views itself as a department of its not-for-profit partners, specifically the [Redacted], suggesting that in substance it is an integrated part rather than an entity unto its own. It should qualify for the exemption granted to the not-for-profit partners. In the taxpayer's words, the Commission "fail[s] to recognize the broad sales and use tax exemptions afforded nonprofit [Redacted]."

The taxpayer contends that neither not-for-profit partner individually could afford the capital contributions necessary to undertake the taxpayer's responsibilities. A collaborative effort was and is required, and services are provided seamlessly through the joint venture. The provided services are an extension of the partners' mission, and patients are unaware of the separate legal status of the taxpayer. Patients believe they are being served by the [Redacted]. Medicare, a health insurance program of the federal government that serves primarily those over 65 years of age, recognizes the joint venture as a provider-based department of the [Redacted].

The taxpayer conveyed myriad reasons to substantiate the need for its legal status as separate from its partners. Most reasons have to do with the initial capitalization of the joint venture, as well as the labyrinth of government requirements embracing Medicaid and Medicare reimbursement.

The protest further addresses the charitable works of the taxpayer, noting that the excess of revenue over expenses is distributed to the not-for-profit partners and does not enrich individuals. The taxpayer treats a vulnerable, impoverished population that would not be cared for in its absence, or would impose an additional burden on financially strapped government services. It further suggests that charitable donors would be less likely to support the venture if it could not rely on the exemption afforded the not-for-profit partners.

In the taxpayer's opinion, the audit findings place undue weight on the legal form of the joint venture, neglecting the underlying substance, which consists of not-for-profit [Redacted] fulfilling their missions. The taxpayer stresses the considerable integration between itself and its partners, particularly the [Redacted]. Employment, medical records, governance, fixed asset ownership, service billing, and purchasing are all under the auspices of the [Redacted]. While the taxpayer concludes that the current dispute has no precedent in Commission-issued decisions, the Commission has nevertheless addressed the "form over substance" argument in Decision No. 12815, issued for a protested income tax case in January 4, 1999.

The taxpayer further addresses the "form over substance" argument, observing that it has its roots in federal tax cases. According to the taxpayer, "[t]he doctrine allows courts to re-characterize transactions and overlook formalities when the true substance of a transaction varies perceptibly from the outward form." It cites Helvering v. F & R Lazarus & Co. with this quote (precise attribution was omitted):

In the field of taxation, administrators of the laws and the courts are concerned with substance and realities, and formal written documents are not rigidly binding.

According to the taxpayer's reading of a Texas Comptroller Letter, 9907143L, dated July 6, 1999, tax authorities determined that a joint venture could buy assets tax exempt because

an exempt entity owned an interest in the venture and the asset use was consistent with the exempt charity's purpose.

The taxpayer cites a Utah private letter ruling (10-003, September 8, 2010) that extends that state's sales and use tax exemption to a subsidiary of a charitable organization established under Internal Revenue Code § 501(c)(2), suggesting that this is the conclusion Idaho should reach in the current case.

### Analysis and Conclusion

The taxpayer is not among the enumerated sales and use tax exempt entities or classification of exempt entities in Idaho Code § 63-36220. The taxpayer recognizes this and claims instead that it qualifies as an extension of its non-profit [Redacted] partners who have an exemption, found in Idaho Code § 63-36220(2)(b). Since the Sales Tax Act does not define [Redacted] for the purpose of the exemption, an administrative rule, IDAPA 35.01.02.085.04, defines "[Redacted]" by reference to another Idaho statute, Idaho Code § 39-1301.

The taxpayer doesn't meet the definition of a [Redacted] because it isn't licensed as such and doesn't provide inpatient care. The Commission need not consider the other defining statutory characteristics of "[Redacted]." Further, in the Commissions' opinion, the for-profit taxpayer is not unambiguously included in the sales tax exemption statute, nor is it remotely inferred.

The taxpayer holds that its mission, objectives, and health services delivery are an extension of the work of its not-for-profit partners. For reasons described earlier, the taxpayer was established as a for-profit joint venture, a form that in the opinion of the taxpayer, is immaterial to the underlying substance, and that it is nevertheless an integrated department of the [Redacted].

While the taxpayer refers to itself as a department of the [Redacted], the auditor finds that all other such departments encountered in the field work are not separately incorporated, nor do they file separate income tax returns.

This decision is not concerned with determining if unincorporated business segments of not-for-profit [Redacted], whether they are located on or away from [Redacted] property, qualify for the exemption provided in Idaho Code § 63-36220(2)(b). Those facts are not before the Commission. Rather, the decision centers on the unambiguous and uncontested fact that the taxpayer is an incorporated for-profit entity, and concludes that the sales and use tax exemption the taxpayer seeks is not reasonably available in the statute.

Nor can the Commission be influenced by the much deserved laudatory descriptions of the good works the taxpayer provides to Idaho citizenry, those capable and those incapable of covering their health care costs.

The Idaho Supreme Court stated:

If there is any ambiguity in the law concerning tax deductions, the law is to be construed strongly against the taxpayer. [Potlatch Corp. v. Idaho State Tax Comm'n, 128 Idaho 387, 913 P.2d 1157 (1996)] *.Id.* This Court has no authority to rewrite the tax code. [Bogner v. State Dep't of Revenue and Taxation, 107 Idaho 854, 693 P.2d 1056 (1984)]. Any exemption from taxation must be created or conferred in clear and plain language and cannot be made out by inference or implication. [Herndon v. West, 87 Idaho 335, 393 P.2d 35 (1964)]. This Court does not have the authority to create deductions, exemptions, or tax credits. If the provisions of the tax code are socially or economically unsound, the power to correct it is legislative, not judicial. (Idaho State Tax Commission v. Stang, 135 Idaho 800, 25 P.3d 113 (2001)).

It is a rule of statutory construction that tax exemptions exist only by legislative grace and are to be strictly construed against the party claiming the exemption. [Kwik Vend Inc. v. Koontz, 94 Idaho 166, 483 P.2d 928 (1971)]; [Leonard Construction Company v. Idaho State Tax Commission, 96 Idaho 893, 539 P.2d 246 (1975)].

The Tax Commission, therefore, is required to view exemptions narrowly, and while not insensitive to the economic efficiencies achieved and charitable goals accomplished by the taxpayer, it concludes that the remedy for what the taxpayer perceives as an injustice is in the hands of the legislature.

While the statute doesn't directly provide an exemption for joint ventures of otherwise qualifying entities, the taxpayer suggests that it is implied, or that the legislature would have specifically included and allowed it if it had occurred to that body that such ventures were likely. Yet, the specific provisions of Idaho Code § 63-3622O at issue have been in place since 1967 with no substantive change. Had the legislature chose to act, it had ample opportunity.

Regarding joint ventures, there is one reference in the relevant exemption statute:

The exemption granted by subsection (1)(f) of this section [the exemption for Idaho, its agencies and its political subdivisions] does not include any association or other organization whose members are political subdivisions or state agencies unless the organization is expressly created under the joint powers provision of sections 67 2328 through 67 2333, Idaho Code (Idaho Code § 63-3622(3)).

Thus, joint ventures of government entities, which are themselves exempt, are permitted an exemption only under specific conditions. The legislature's narrow attention to joint ventures in the context of government entities strongly suggests that joint ventures or other associations of not-for-profit tax exempt entities are not entitled to an exemption, or would be specifically referenced in the statute if they did qualify.

The decision now addresses the private letter rulings from Utah and Texas brought to its attention in the taxpayer's protest. In the request letter and Utah's response (10-003, September 8, 2010), the relevant facts are as follows. A charitable organization under IRC § 501(c)(2) holds title to real property for its parent, an IRC 501(c)(3) organization. According the letter request, citing the Internal Revenue Code, an organization can organize as

501(c)(2) tax exempt in order to hold title to real property as long as it turns over its profits to an organization established under the general provisions of 501(c).

Utah's sales tax law, specifically Utah Code § 59-12-104.1(8), provides a sales tax exemption for sales made to or by religious or charitable institutions in the conduct of their religious or charitable functions. Utah Administrative Code R865-19S-43 (Rule 43) requires qualifying religious or charitable institutions to be established under Internal Revenue Code § 501(c)(3). In the response letter, Utah officials determined that a 501(c)(2) would, in fact, qualify under the facts presented and that the rule impermissibly narrowed the authority of the statute.

Unlike Utah's tax code, Idaho does not extend sales and use tax exemptions to all not-for-profits, nor does it extend the exemptions to all not-for-profit organizations established under IRC § 501(c)(3). Rather, the legislature confers exemptions upon specific organizations and classes of organizations enumerated in Idaho Code § 63-36220. The relevant Utah tax code leaves ambiguity with respect to the definition of charitable institutions, and state officials concluded that an administrative rule could not permissibly narrow the exemption by restricting it to 501(c)(3) organizations. In the Commission's view, Idaho law contains no such ambiguity. In fact, had there been an acknowledged ambiguity, the rules of statutory construction would require the exemption to be construed against the taxpayer.

The Texas Comptroller's sales tax exemption ruling involves a case with facts similar to those at issue in this decision. In that ruling, the Comptroller notes it had previously

...allowed a for-profit joint venture to purchase tax free items for its use to the extent an exempt entity owns an interest in the joint venture. That position was based on the assumptions that, as required by Tax Code Section 151.310(a)(2), the use of the items purchased related to the purpose of the exempt entity/joint venturer and were not used for the personal benefit of a private stockholder or individual, and that the charity care provisions of Section 151.310(e) would be

met (Letter/Memo 9907143L, Texas Comptroller of Public Accounts, July 6, 1999).

While the Texas ruling is not binding on the Commission, its conclusion is worthy of discussion. Presented with identical facts and having only the Texas law and administrative rules to guide it, the Commission may not have arrived at the Comptroller's conclusion. Texas Tax Code Section 151.310 makes no exception for allowing for-profits to benefit from the exemption, nor does the relevant administrative rule, Title 34, Part 1, Chapter 3, Subchapter O, Rule § 3.322.

The Commission does not see the need to go beyond the unambiguous language of Idaho's relevant code and rule to broaden the exemptions therein, nor does it believe it is a permissible function of an enforcement agency to do so. Form over substance doctrines and legislative intent are unnecessary considerations in this analysis.

It is uncontested, as evidenced by purchase invoices, the [Redacted], made all of the tax-exempt purchases for the taxpayer. In its letter of protest, the taxpayer states that the [Redacted] provides billing services for the taxpayer's medical care services and accounts for all insurance reimbursements and patient receipts. In the words of the taxpayer, there are "due to/from" accounting transactions between [Redacted] and the taxpayer. Included in these accounting transactions are transfers related to supplies and equipment bought tax-exempt by the [Redacted] on behalf of the taxpayer. The taxpayer claims to hold title to the equipment.

The Commission concludes that [Redacted] made purchases for the purpose of reselling the supplies and other goods to the taxpayer, and it should have collected tax on those sales because the buyer (taxpayer) does not qualify for an exemption. Since there is no evidence that the seller collected tax, the burden of use tax falls to the buyer, as noted previously, per Idaho Code §§ 63-3612 and 63-3621. Further, the Commissioner notes that a seller's retention of title

to goods does not obviate a sale when consideration is exchanged, as sales can be conditional, most commonly when a rental or lease of tangible personal property occurs:

- Sale.** (1) The term "sale" means any transfer of title, exchange or barter, conditional or otherwise, of tangible personal property for a consideration and shall include any similar transfer of possession found by the state tax commission to be in lieu of, or equivalent to, a transfer of title, exchange or barter.  
(2) "Sale" shall also include the following transactions when a consideration is transferred, exchanged or bartered:...
- (h) The lease or rental of tangible personal property (Idaho Code § 63-3612).

Absent information to the contrary, the Commission finds the deficiency prepared by the Bureau to be an accurate representation of the taxpayer's use tax liability for the period February 1, 2004, through January 31, 2011.

The Bureau added interest to the use tax deficiency. The Commission found it appropriate per Idaho Code § 63-3045, and has updated interest accordingly. Interest is calculated through February 28, 2013, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

THEREFORE, the Notice dated June 24, 2011, 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 and interest:

<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$145,415	\$43,024	\$188,439

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

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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.