

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 25148
[Redacted],)	
)	
Petitioner.)	DECISION
_____)	

On May 4, 2012, 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, penalty, and interest for the period June 1, 2010, through July 31, 2010, in the total amount of \$14,322.

In a letter dated July 5, 2012, the taxpayer filed a timely appeal and petition for redetermination of the Notice. At the taxpayer's request, the Commission held an informal hearing on November 19, 2012. For the reasons that follow, the Commission upholds the audit findings.

Background

The taxpayer, had a [Redacted] contract, valued at approximately \$250,000, with the [Redacted] to [Redacted]. The Bureau's auditor imposed a tax on the estimated value of the [Redacted] provided by the government to the taxpayer, estimating [Redacted] to be worth \$.26 each. The taxpayer disputes that it owes a tax on the value of the [Redacted].

Applicable Tax Law and Administrative Rules

In Idaho, contractors improving real property are the consumer of materials used by them:

All persons engaged in constructing, altering, repairing or improving real estate, are consumers of the material used by them; all sales to or use by such persons of tangible personal property are taxable whether or not such persons intend resale of the improved property (Idaho Code § 63-3609(a)).

Idaho Code § 63-3615(b) defines “use” for the purpose of imposing a tax:

The term “use” includes the exercise of any right or power over tangible personal property incident to the ownership or the leasing of that property or the exercise of any right or power over tangible personal property by any person in the performance of a contract, or to fulfill contract or subcontract obligations, whether the title of such property be in the subcontractor, contractor, contractee, subcontractee, or any other person, or whether the titleholder of such property would be subject to the sales or use tax....(emphasis added).

If contractors don’t buy the materials they use to improve real property, they have no opportunity to pay the retailer an Idaho sales tax. Idaho is, as are all other states, pre-empted from imposing a tax on goods possessed or purchased by the federal government (IDAPA 35.01.02.094.06). Therefore, the [Redacted] in the case at issue were transferred to the taxpayer without a tax being paid by the [Redacted] government for its possession or purchase. Nevertheless, the taxpayer’s tax obligation is not extinguished:

10. Materials Provided by Project Owner....

b. If material needed for a contract is purchased or supplied by an owner who is exempt from sales and use taxes, then the use by the contractor is subject to use tax. This is true even if the property is owned by an exempt entity such as the federal government or a state government agency. For example, if a contractor has a public works contract to build a structure using materials owned and supplied by the government, whether federal, state, or local, he is the consumer of the materials and is subject to a use tax on their value. This tax falls directly upon the contractor and not the owner of the property. (IDAPA 35.01.02.012, excerpted in pertinent part).

Since neither the [Redacted] government nor the taxpayer paid a sales tax, the taxpayer owes a use tax. Payment of use tax extinguishes the sales tax obligation. The rate for sales and use tax are identical. (Idaho Code §§ 63-3612 and 63-3621).

The Commission is unaware of how the [Redacted] government came to possess the [Redacted]. The government could have bought them or accessed them from public or private land. If they were not purchased, the value for tax purposes would be on the acquisition of like

materials. The following excerpt from an administrative rule explains the methodology in an analogous situation, that of a road contractor who either purchases rock or receives rock from a party that is exempt from Idaho sales and use tax:

b. A contractor who applies crushed rock to the highway pursuant to a contract is a person engaged in improving real property. If the contractor applying the crushed rock purchases the rock, the purchase price will be subject to a sales or use tax. If the contractor applies rock owned by another party, the contractor will be responsible for a use tax on the value of the rock, unless the other party paid a sales tax upon its acquisition. This is true even if a government agency supplied the rock. If a recent retail acquisition of the crushed rock exists, the retail price shall be presumed to be the value of the material. If a recent retail sales price does not exist, then value shall be determined by the current acquisition cost of like material from the same or a similar source. For purposes of this section, a retail acquisition within one (1) year of the time of the performance of the contract shall be presumed to be a recent sales price.

c. A contractor whose contract calls for him to both crush and apply rock to a road is also subject to the must pay sales or use tax on the value of the rock whether the contract is performed for a governmental or private contractee. The value shall be determined by the royalty or similar charge for raw materials. If a royalty or similar charge does not exist, then the value will be determined as the royalty fee or value of like material from a similar source.... (IDAPA 35.01.02. 013.04).

Taxpayer's Protest

The taxpayer makes five arguments against the imposition of tax:

The company provides services. It does not sell a product. The [Redacted] were provided by the government; therefore the taxpayer does not owe tax.

1. The [Redacted] were incidental to the services, therefore IDAPA 35.01.02.011 applies.
2. Sales to and purchases by the federal government are exempt.
3. The logging exemption applies.
4. The contract does not transform something into something else. IDAPA 35.01.02.102 does not apply.

Analysis and Conclusion

Each argument noted above is addressed separately.

1. The company provides services. It does not sell a product. The [Redacted] were provided by the government; therefore the taxpayer does not owe tax.

The Commission is not asserting that the taxpayer sold a product and should have collected a tax on the sale. Though the [Redacted] were provided by the government, Idaho Code § 63-3609(a), cited previously, imposes a tax obligation on the contractor if the buyer did not pay an Idaho tax on purchase, or thereafter.

2. The [Redacted] were incidental to the services, therefore IDAPA 35.01.02.011 applies.

The taxpayer is referring to Sales and Use Tax Administrative Rule 011.02.a:

To determine whether a transfer of tangible personal property is a taxable retail sale or is merely incidental to a service transaction, the proper test is to determine whether the transaction involves a consequential or inconsequential professional or personal service. If the service rendered is inconsequential, then the entire transaction is taxable. **If a consequential service is rendered, then it must be determined whether the transfer of the tangible personal property is an inconsequential part of the transaction. If so, then none of the consideration paid is taxable** (IDAPA 35.01.02.011.02.a, emphasis added).

The basis for the preceding administrative rule is Idaho Code § 63-3613(a), which states that the sales price subject to tax is “the total amount for which tangible personal property, including services agreed to be rendered as a part of the sale, is sold.” This statute is inapplicable in the current case because it refers to the retail sale of tangible personal property with accompanying services. The issue at hand is the improvement to real property, which is not a retail sale as defined in Idaho Code § 63-3612.

3. Sales to and purchases by the [Redacted] government are exempt.

This statement is true, but it is inapplicable to the current case. As noted, an improvement to real property is not a retail sale subject to tax. The Commission is not asserting that the taxpayer made a retail sale of tangible personal property to the federal government.

4. The [Redacted] exemption applies.

The tax code includes an exemption for certain equipment and supplies used in [Redacted] operations. However, the [Redacted] exemption primarily applies to harvesting trees rather than planting them. Here, logging is defined for purposes of the tax code:

Logging. The term “logging” means the harvesting of forest trees by cutting, skidding, loading, thinning or decking, regardless of whether the forest trees are owned by the person performing the harvesting when such harvesting is for resale of the product harvested (Idaho Code § 63-3605A).

The logging exemption is defined in this code section:

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

(1) The sale at retail, storage, use or other consumption in this state of tangible personal property which is primarily and directly used or consumed in logging including, but not limited to, log loaders, log jammers, log skidders and fuel used in logging trucks, provided that the use or consumption of such tangible personal property is necessary or essential to logging.

(2) The exemption allowed by subsection (1) of this section does not include machinery, equipment, materials and supplies used in a manner that is incidental to logging such as maintenance and janitorial equipment and supplies, and hand tools with a unit purchase price not in excess of one hundred dollars (\$100); nor does it include tangible personal property used in any activities other than the actual logging, such as office equipment and supplies, equipment and supplies used in selling or distributing activities or, except for fuel used in logging trucks, in transportation activities; nor shall this exemption include motor vehicles or aircraft, without regard to the use to which such motor vehicles or aircraft are put; nor shall this exemption apply to vehicles or equipment described in section 63 3622HH, Idaho Code. (Idaho Code § 63-3622JJ).

The preceding statute makes no reference to the [Redacted] within the context of providing a [Redacted] exemption. However, raising an agricultural crop for sale qualifies for the production exemption, and the [Redacted] could be purchased tax exempt by a farming entity

cultivating a product for sale. Specifically, Idaho Code § 63-3622D exempts raw materials, as well as equipment and supplies, used to create tangible personal property that will be sold at retail. Under this production exemption statute, the use of plants in an agricultural operation is exempt from tax. Further, custom farmer performing agricultural work under contract to the owner could make use of the [Redacted] without incurring a tax (Idaho Code § 63-3622D(a)(2) and (5); (c)).

The administrative rule regarding [Redacted] does include exemptions for reforestation equipment and supplies when part of the operation of a [Redacted] (IDAPA 35.01.02.102.07.b. and c.). However, the Commission does not believe that the federal government is operating a [Redacted], nor has the taxpayer provided evidence to suggest or prove that it is. The U.S. Forest Service, the [Redacted] agency that contracted with the taxpayer, provides this statement regarding its purpose:

The U.S. Forest Service, under the leadership of Chief Tom Tidwell, is entrusted with 193 million acres of national forests and grasslands. We are dedicated to the improvement of water resources, development of climate change resiliency, creation of jobs that will sustain communities and restoration and enhancement of landscapes (<http://www.fs.fed.us/>).

Thus, in the Commission's opinion, while the U.S. Forest Service allows and pursues [Redacted] harvesting, there is no indication that the [Redacted] work done by the taxpayer is preparation for a stand of timber to be harvested. The [Redacted] is for forest management, and harvesting is inconsequential to the overall objectives.

5. The contract does not transform something into something else. IDAPA 35.01.02.102 does not apply.

As noted under the previous argument in paragraph 4, the reference in paragraph 5 is to the logging exemption. The Commission is unaware of how the assertion in paragraph 5 advances the taxpayer's defense of its position. The production exemption and the logging

exemption both allow for tax-exempt purchases of tangible personal property when the business intends to grow, process, fabricate, or manufacture the property into new property for sale at retail.

The Commission contends, in the absence of contrary evidence, that the purpose of [Redacted] for the U.S. Forest Service is to further that agency's public purpose, which decidedly is not to be for the sole purpose of growing trees with the intention that they will be harvested and sold.

In a defense proposed during the hearing, the taxpayer stated that within the context of a tree farm, trees are not real property because they are intended to be removed and sold as tangible personal property. The Commission notes that while trees are not defined in the Sales Tax Act, they are defined as real property under Idaho's property tax code:

(23) "Real property" means land and all rights and privileges thereto belonging or any way appertaining, all quarries and fossils in and under the land, and all other property which the law defines, or the courts may interpret, declare and hold to be real property under the letter, spirit, intent and meaning of the law, improvements and all standing timber thereon, including standing timber owned separately from the ownership of the land upon which the same may stand, except as modified in chapter 17, title 63, Idaho Code. Timber, forest, forest land, and forest products shall be defined as provided in chapter 17, title 63, Idaho Code (Idaho Code § 63-201. Definitions, (23)).

Ultimately, the Commission does not concur with the taxpayer that its [Redacted] contract took place on [Redacted]. Finally, Idaho sales tax law considers landscapers to be real property contractors (IDAPA 35.01.02.012.01.a). Under the commonly understood use of the word, a landscaper could alter real property by the addition or removal of trees.

The Taxpayer did not provide evidence adequate to establish that the amount asserted in the Notice of Deficiency Determination is incorrect. While it argued with the auditor's premise

that it was a contractor improving real property, it did not offer a substitute for the value of the seedlings assigned by the audit staff based on experience with this issue.

As a result, the Commission will uphold the Notice. A determination of the State Tax Commission is presumed to be correct (Albertson's, Inc. v. State, Dept. of Revenue, 106 Idaho 810, 814, 683 P.2d 846, 850 1984) and the burden is on the taxpayer to show that the deficiency is erroneous (Parsons v. Idaho State Tax Commission, 110 Idaho 572, 574-575 n.2 Ct. App. 1986.)

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 June 1, 2010, through July 31, 2010.

The Bureau added interest and penalty to the sales and use tax deficiency. The Commission reviewed those additions, found both to be appropriate per Idaho Code §§ 63-3045 and 63-3046, and has updated interest accordingly. Interest is calculated through August 15, 2013, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

THEREFORE, the Notice of Deficiency Determination dated May 4, 2012, 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>
\$12,688	\$634	\$1,484	\$14,806

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 _____ 2013.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2013, 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.
