

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

In the Matter of the Protest of )  
[Redacted],. ) DOCKET NO. 25481  
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 )  
Petitioner. ) DECISION  
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\_\_\_\_\_ )

On December 14, 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) asserting sales tax, use tax, penalty, and interest for the periods November 1, 2008, through October 31, 2011, in the total amount of \$18,227.

On December 20, 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 April 30, 2013. Present at the informal hearing were Commissioner [Redacted], Deputy Attorney General [Redacted], and Tax Policy Specialist [Redacted].

The Commission is fully advised of the contents of the audit file, as well as information obtained at the hearing and thereafter and hereby issues its decision upholding the audit findings.

**Background and Audit Findings**

The taxpayer designs, manufactures, installs, services, and leases several types of [Redacted].

The Bureau conducted a routine comprehensive audit of the taxpayer’s business for the purpose of determining compliance with Idaho sales and use tax law. The taxpayer is in agreement with the audit findings with the exception of the imposition of Idaho use tax on the purchase of materials incorporated into the real property component of [Redacted] that the

Bureau identified as having both a real property component and a tangible personal property component. [Redacted] descriptions, limited to those at issue, are listed below.

[Redacted].

The taxpayer has consistently treated the sale of [Redacted] as retail sales of tangible personal property and has collected sales tax from its customers on the entire sales price in those transactions. However, real property transactions are not retail sales nor are they subject to sales tax. Instead, the contractor improving the real property owes tax on its purchases of materials that become part of the realty. Consequently, the Bureau held the taxpayer liable for use tax on the cost of materials incorporated into real property.

### **Protest**

The taxpayer protested the imposition of Idaho use tax on the purchase of materials incorporated into the real property component of the [Redacted] at issue, specifically [Redacted]. The taxpayer's protest is simply stated. The taxpayer believes that no part of [Redacted] are real property under Idaho law and, therefore, argues that the Bureau's allocation of material costs for two separate tax treatments is arbitrary and lacks foundation. Further, because the taxpayer does not have detailed job costing and considers the entire contract for [Redacted] to be a sale of tangible personal property, the taxpayer states that the Bureau had no ready basis for determining an allocation between realty and personalty for the purpose of imposing a liability.

### **Analysis**

Idaho Code § 63-3621 imposes a use tax on the storage, use, or other consumption of tangible personal property in this state. The use tax is a complementary tax to the sales tax. Every state that imposes a sales tax also imposes a use tax. The use tax rate is the same as the sales tax. A person who pays sales tax to his vendor when buying tangible personal property

does not owe any use tax. Use tax is only due when the purchaser does not pay sales tax at the time of sale.

Idaho Code § 63-3612 states that “the term ‘sale’ means any transfer of title, exchange or barter, conditional or otherwise, of tangible personal property for a consideration...” Sales of real property improvements are not included within this definition and are, therefore, not subject to sales or use tax. Sales and use taxes are imposed only on retail sales which are sales to the ultimate consumer. Idaho Code § 63-3609 defines a retail sale:

**63-3609. RETAIL SALE -- SALE AT RETAIL.** -- The terms “retail sale” or “sale at retail” means a sale for any purpose other than resale in the regular course of business or lease or rental of property in the regular course of business where such rental or lease is taxable under section 63-3612(h), Idaho Code.

*(a) 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.*

*(b) For the purpose of this chapter, the sale or purchase of personal property incidental to the sale of real property or used mobile homes is deemed a sale of real property. . . . (Emphasis added.)*

This states that if the taxpayer is engaged in construction, altering, repairing, or improving real property, he is the consumer of those materials and as such should be paying sales or use tax on all purchases of building materials that will become a permanent part of realty.

The Bureau has held that the construction of the [Redacted] identified previously is a combination of a real property improvement and a sale of tangible personal property based upon the common law three factor test adopted by the Commission to determine when personal property has become a permanent part of realty.

IDAPA 35.01.02.067 states that the three factors are annexation to the realty, either actual or constructive; adoption or appropriation to the use or purpose to which that part of the realty to which it is connected is suitable; and intention to make the article a permanent addition to the realty.

The Commission has applied the three factor test in a review of the [Redacted] at issue and agrees with the Bureau's determination that certain components of these types of [Redacted] are incorporated into the realty upon installation. The annexation test is met in that the materials are physically connected to each other and to the ground in a permanent fashion. The adaptation test is met because the materials in question contribute to each [Redacted] and can be used by successive property owners for that purpose regardless of the type of business using the property. The intent test is met because the building owners are not likely to remove the questioned materials when the property is sold because they bear utility to the building and not to the trade conducted therein. Further, their removal is both costly and awkward. The removed material would not be easily incorporated at a new location.

The Commission views adaptation as follows. If a fixture has utility to the building irrespective of the building's use across multiple owners, that fixture is a real property improvement. In many cases, fixtures of use to a specific business trade, and therefore deemed tangible personal property, will be individually sold or removed when the building changes ownership. The [Redacted], in the current case, can hold or incorporate removable [Redacted] of use to the current occupant of the building, and therefore, are likely to remain with the building.

The taxpayer argued that IDAPA 35.01.02.036 makes it clear that the [Redacted] are subject to Idaho sales tax based upon the total sales price of the completed [Redacted] to the user

and points out that this applies to [Redacted] of whatever description. The section to which the taxpayer refers reads:

[Redacted]

While the Commission acknowledges that IDAPA 35.01.02.036 provides guidance with respect to [Redacted], it maintains that the code and rules are to be viewed as a whole. IDAPA 35.01.02.036 must be read along with IDAPA 35.01.02.067 to explain the differences between real property and tangible personal property. Again, the portion of the [Redacted] that was identified as a real property improvement is the [Redacted], irrespective of the building's use across multiple owners.

The Commission acknowledges that there is a section of the [Redacted], identified as [Redacted], that will be individually sold or removed when the building changes ownership and agrees with the Bureau that this portion of the [Redacted] was taxed appropriately, since the taxpayer was collecting sales tax on the total sales price of the completed [Redacted] for all [Redacted] sold, including those for the [Redacted] at issue. It is acknowledged that this has resulted in the taxpayer collecting sales tax from its customers in excess of what was due because it was collected on the sale of real property improvements. The Commission, however, cannot allow a credit/refund to the taxpayer for "excess tax" it collected from its customers.

For transactions occurring earlier than October 1, 2008, the Commission allows an offsetting of use tax liability with sales tax collected erroneously on real property contracts on a contract by contract basis. On October 1, 2008, the Commission released a statement to all contractors that stated that it would no longer accept sales tax incorrectly collected from a customer as a substitute for the tax the contractor owes on the purchase of contract materials.

As noted, the Bureau had difficulty ascertaining liability, allocating the total sale equally between personalty and realty and further estimating that 20 percent of the realty portion was attributable to materials. Thus, 6 percent of this amount became the use tax liability. The taxpayer disputes the premise of allocating between realty and personalty, but has not provided an alternative. The Commission finds that in the absence of an accurate breakdown based on actual cost accounting records, the estimate used by the Bureau is acceptable.

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 periods November 1, 2008, through October 31, 2011.

The Bureau added interest to the sales and use tax deficiency. The Commission reviewed those additions, found both to be appropriate per Idaho Code sections 63-3045 and 63-3046, and has updated interest accordingly. Interest is calculated through June 30, 2014, 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 December 14, 2012, is hereby APPROVED, in accordance with the provisions of this decision, and is AFFIRMED and MADE FINAL.

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

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$16,315	\$0	\$2,663	\$18,978

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 \_\_\_\_\_ 2014.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2014, 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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