

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 25491
[Redacted],)	
)	
Petitioner.)	DECISION
_____)	

On October 31, 2012, 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). The Notice asserted additional sales tax, use tax, penalty, and interest in the total amount of \$79,029 for taxable periods from October 1, 2008, through September 30, 2011. The taxpayer filed a timely appeal and petition for redetermination on December 20, 2012. At the taxpayer’s request, the Commission held an informal hearing on September 4, 2013.

The Commission, having reviewed the audit file and considered the information provided at the hearing and thereafter, upholds the audit findings for the reasons detailed below.

BACKGROUND

The taxpayer is a [Redacted] and [Redacted]. The Bureau undertook a routine audit of the taxpayer’s records to review compliance with applicable sales and use tax laws. The Bureau found errors in several areas and asserted additional sales and use tax on these items.

Of relevance to this case, the Bureau imposed tax on chemicals purchased and used to sanitize production equipment. The Bureau argues that the use of the chemicals does not qualify for the production exemption as they were used in a “maintenance” or “janitorial” function, which is excluded from the exemption (Idaho Code § 63-3622D(f)).

In appealing the audit findings, the taxpayer's sole point of contention is the imposition of tax on the chemicals described above. For those purchases, the taxpayer disagrees with the Bureau and argues that the production exemption (Idaho Code § 63-3622) applies and, therefore, no tax is due. The taxpayer points to the specific provision in the production exemption for "chemicals and equipment used in clean-in-place systems in the [Redacted] and [Redacted] industries", arguing that it applies to the chemicals at issue in this appeal. The taxpayer concedes that the chemicals are not used *in* a clean-in-place (CIP) system, but argues that the chemicals are identical to those used in CIP systems and are used to sanitize similar equipment. Due to the similarity in use, the taxpayer feels it would be unfair to exempt one use but not the other.

LAW & ANALYSIS

Purchases of tangible personal property in Idaho are subject to tax unless an exemption applies (Idaho Code § 63-3619). The only exemption of relevance in this case is the production exemption (Idaho Code § 63-3622D):

63-3622D. 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:

(1) Tangible personal property which will enter into and become an ingredient or component part of tangible personal property manufactured, processed, mined, produced or fabricated for sale.

(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.

(3) Chemicals, catalysts, and other materials which are used for the purpose of producing or inducing a chemical or physical change in the product or for removing impurities from the product or otherwise placing the product in a more marketable condition as part of an operation described in subsection (a)(2) of this section, and chemicals and equipment used in clean-in-place systems in the food processing and food manufacturing industries.

(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.

(5) Plants to be used as part of a farming operation.

(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. A contractor providing services to a business entitled to an exemption under this section is not exempt as to any property owned, leased, rented or used by it unless, as a result of the terms of the contract, the use of the property is exempt under section 63-3615(b), Idaho Code.

(c) The exemptions allowed in subsections (a)(1), (a)(2), (a)(3) and (a)(4) of this section shall also be available to a business, or separately operated segment of a business, engaged in farming or mining, whether as a subcontractor, contractor, contractee or subcontractee, when such business or segment of a business is primarily devoted to producing tangible personal property which is intended for ultimate sale at retail within or without this state, without regard to the ownership of the product being produced.

(d) The exemptions allowed in subsections (a)(1), (a)(2), (a)(3) and (a)(4) of this section shall also be available to a business, or separately operated segment of a business, engaged in the business of processing materials, substances or commodities for use as fuel for the production of energy, whether as a subcontractor, contractor, contractee or subcontractee, without regard to the ownership of the materials, substances or commodities being processed and irrespective of whether the materials, substances or commodities being processed are intended for ultimate sale at retail within or without this state.

(e) As used in this section, the term “directly used or consumed in or during” a farming operation means the performance of a function reasonably necessary to the operation of the total farming business, including, the planting, growing, harvesting and initial storage of crops and other agricultural products and movement of crops and produce from the place of harvest to the place of initial storage. It includes disinfectants used in the dairy industry to clean cow udders or to clean pipes, vats or other milking equipment.

(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:

(1) Hand tools with a unit purchase price not in excess of one hundred dollars (\$100). A hand tool is an instrument used or worked by hand.

(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.

(3) Property used in transportation activities.

(4) Machinery, equipment, tools or other property used to make repairs. This subsection does not include repair parts that become a component part of tangible property exempt from tax under this section or lubricants, hydraulic oil, or coolants used in the operation of tangible personal property exempt under this section.

(5) Machinery, equipment, tools or other property used to manufacture, fabricate, assemble or install tangible personal property which is:

(i) Not held for resale in the regular course of business; and

(ii) Owned by the manufacturer, processor, miner, farmer or fabricator;

provided, however, this subsection does not prevent exemption of machinery, equipment, tools or other property exempted from tax under subsection (a)(2) or (a)(3) of this section.

(6) Any improvement to real property or fixture thereto or any tangible personal property which becomes or is intended to become a component of any real property or any improvement or fixture thereto.

(7) Motor vehicles and aircraft.

(8) Tangible personal property used or consumed in processing, producing or fabricating tangible personal property exempted from tax under this chapter in sections 63-3622F and 63-3622I, Idaho Code.

(9) Tangible personal property described in section 63-3622HH, Idaho Code.

(h) Any tangible personal property exempt under this section which ceases to qualify for this exemption, and does not qualify for any other exemption or exclusion of the taxes imposed by this chapter, shall be subject to use tax based upon its value at the time it ceases to qualify for exemption. Any tangible personal property taxed under this chapter which later qualifies for this exemption shall not entitle the owner of it to any claim for refund.

There is no question that the taxpayer qualifies for the production exemption in its use of much of its equipment and materials. The Bureau only held the use of the chemicals taxable because of the exclusion in subsection (f). In reviewing the relevant code and rules, the Commission finds no additional explanation or definition for what might fall under “maintenance and janitorial equipment and supplies.” However, it is interesting that subsection (a)(3) specifically exempts the use of “chemicals and equipment used in clean-in-place systems in the [Redacted] and [Redacted] industries.” In reviewing this provision, the Commission cannot help but come to the conclusion that in the absence of that statutory language, the use of those chemicals and equipment would be taxable. Further, the language is specific in its application to

those chemicals “used *in*” CIP systems. As noted previously, the taxpayer concedes that it does not use the chemicals *in* a CIP system. Therefore, the taxpayer’s use of the chemicals in this case seems to fall outside of the exemption allowed by the statute.

In correspondence subsequent to the hearing, an employee of the taxpayer argued that the term “clean-in-place system” was ambiguous and included manual sanitization by a person like the method employed by the taxpayer. The Commission performed research of its own, primarily focused on CIP system vendors. Though the term can be applied to a variety of equipment, it was consistently applied to systems with automated cleaning processes (i.e. no human intervention) that did not require disassembly of the equipment to perform the cleaning. Of course, manual maintenance and disassembly is sometimes required of a CIP system like any other equipment, but a CIP system generally seems to be designed to run on its own.

In addition, because tax exemptions are a matter of legislative grace rather than a guaranteed right, the exemption must be strictly and narrowly construed against the taxpayer and in favor of the state. Idaho State Tax Commission v. Haener Bros., 121 Idaho 741, 828 P.2d 304 (1992). The Commission is sympathetic to the taxpayer’s argument that the use of the chemicals is very similar in function, if not form, to that of a CIP system. However, the Commission is bound by the laws as written and finds no ambiguity in the production exemption as it applies to this case. Therefore, the Commission agrees with the Bureau’s imposition of tax.

Finally, the Commission approves of the Bureau’s imposition of penalty and interest as appropriate per Idaho Code §§ 63-3045(6) and 63-3046(a).

THEREFORE, the Notice dated October 31, 2012, and directed to [Redacted] is AFFIRMED by this decision.

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

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$67,850	\$3,393	\$7,294	\$78,537
		PREPAYMENT:	<u>(\$75,000)</u>
		REMAINDER DUE:	<u>\$ 3,537</u>

Interest is calculated through August 29, 2014, and will continue to accrue until the entire liability has been paid.

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.
