

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 25948
[Redacted],)	
)	
Petitioner.)	DECISION
_____)	

On June 20, 2013, 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 sales tax, use tax, and interest for the period July 1, 2009, through June 30, 2012, in the total amount of \$11,044.

On August 13, 2013, the taxpayer filed a timely appeal and petition for redetermination of the Notice. The Commission wrote on September 23, 2013, advising the taxpayer of its right to an informal hearing. At the taxpayer's request, the Commission held an informal hearing on January 7, 2014. Present at the informal hearing were [Redacted], [Redacted], and [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 modifying audit findings.

Background and Audit Findings

The taxpayer sells [Redacted] to local [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. After its review, the Bureau determined that there were errors in sales, fixed asset purchases, and ordinary purchases. At issue in this case is the Bureau's imposition of tax on non-taxed sales of three specific products: [Redacted], all of which were sold to customers in the [Redacted] industry. The taxpayer agrees with the Bureau's imposition of sales and use tax in all other respects.

Idaho Code § 63-3622(a) states that all sales in Idaho are presumed to be subject to sales tax and the burden of justifying a non-taxed sale lies with the seller. When a purchaser executes a valid exemption claim form (Form ST-101 in this case), the seller is relieved of the obligation to collect tax, unless the sale is “taxable as a matter of law” (Idaho Code § 63-3622(g)).

In the present case, the taxpayer sold the previously mentioned products to customers in the [Redacted] industry. The taxpayer maintained valid exemption claim forms on file showing that the customers claimed exemption from sales tax under Idaho Code § 63-3622D, known as the “production exemption.” The statute establishing the production exemption has sections that specifically exclude the purchase and use of certain tangible personal property, regardless of how the property is used. When one of these exclusions applies to a sale of property, the sale never qualifies for the production exemption, and, therefore, it is “taxable as a matter of law”, regardless of any customer’s claim to the exemption.

The Bureau does not question whether the taxpayer obtained proper exemption documentation for these non-taxed sales, but rather asserts the sale of these particular products is specifically excluded from the production exemption by law.

Analysis

[Redacted]The Bureau identified the relevant exclusion for the [Redacted] and the [Redacted] as the purchase and use of [Redacted] with a unit price less than \$100 (Idaho Code § 63-3622D(g)(1)). The Bureau asserts that both products are [Redacted] with a unit price less than \$100 and therefore, a production exemption claim cannot apply to any sale of these products. Based on this reasoning, the Bureau asserts that sales of these products are “taxable as a matter of law.”

The taxpayer disagrees with the Bureau's determination that these products are [Redacted]. As the cost is not in dispute (the product retails for a few dollars), the deciding factor is whether the product is a [Redacted]. Consequently, the remainder of the discussion will focus on that issue.

The term "hand tool" is specially defined in the production exemption as "an instrument used or worked by hand" (Idaho Code § 63-3622D(f)(1)). Due to the breadth of this definition, the Commission has traditionally applied the term to a wide variety of property. A hammer, a broom, a lumber crayon, and a pencil are just a few examples of property that the Commission has treated as hand tools in the past.

[Redacted] The first product the Bureau determined was a hand tool is the [Redacted]. This is a [Redacted] used to treat the [Redacted] of the [Redacted] before [Redacted]. On a [Redacted], [Redacted] must be cleaned, treated with sanitizing solution (if required), and dried just prior to [Redacted]. The [Redacted] worker will fill the [Redacted] with disinfectant, take the [Redacted], and clean each [Redacted] in order to meet this requirement.

The taxpayer maintains that this item should fall under [Redacted] equipment and should qualify for the production exemption.

The Commission concedes that the purchase and use of an [Redacted] would probably qualify for the production exemption in the absence of the hand tool exclusion; however, the exclusion does exist. The Commission agrees with the Bureau's determination that the [Redacted] is a hand tool and as such the sale of this product does not qualify for the production exemption.

[Redacted]The second product the Bureau determined were hand tools were [Redacted]. This product consists of a [Redacted]. Similar to a [Redacted]. The product is most commonly

used to [Redacted]. The [Redacted] makes it possible to hold the product without getting [Redacted] on the hands. Once the [Redacted] is consumed, the [Redacted] cannot be refilled.

The taxpayer argues that [Redacted] are not a tool at all, but a material in a container, similar to buying a can of spray paint. The taxpayer points out that there is a specific holder that can be purchased separately from the product that is specially designed to fit the product. The taxpayer argues that the holder is the hand tool, while the product itself is nothing more than a refill of material.

The Commission agrees that there is a distinction between a hand tool and the material applied by the tool. A previous decision has been issued by the Commission holding the sale of [Redacted] subject to sales tax because they were identified as hand tools, which creates a precedent that cannot be overlooked. Idaho Code § 63-3046 states that, “[a] decision shall serve as precedent for the tax commission in future protest determination unless information excised, court decisions, changes in the Idaho Code, or changes in applicable administrative rules overrule, supersede, modify, distinguish, or otherwise make inapplicable the written decision of the tax commission.”

Per Idaho Code 63-3622D(g)(1), the production exemption does not exempt “hand tools with a unit purchase price below one hundred dollars (\$100).” This same code section defines a hand tool to be, “an instrument used or worked by hand.” See also, IDAPA35.02.01.10.06. Sales Tax rule 079.05.c, reads, “A hand tool with a unit price of one hundred dollars (\$100) or less, regardless of how necessary the tool may be to production, how directly it may be used in the process, or how specialized it may be.”, is not exempt. Three different sales tax rules provide as follows:

IDAPA 35.02.01.083.08.e.:

“A hand tool, regardless of how necessary its use may be to production or how directly it may be used, is specifically excluded from the production exemption if the unit price of the tool is one hundred dollars (\$100) or less. A hand tool is an instrument used or worked by hand. Examples of hand tools in the farming and ranching industry include emasculators, branding irons, tattoo kits such as crimpers and rollers, eartag applicators, calf pullers, syringes and needles, buckets, sponges, balling guns, shovels, wheelbarrows, ropes, cattle prods, whips, wrenches, drills, and power tools. Hand tools do not include such things as feed bags, tack, halters and lead ropes, cow magnets, and weaning rings. These items, depending on use, may qualify for the exemption. If a halter and lead rope are purchased by a horse trainer, no exemption applies. If a halter and lead rope are purchased by a rancher to be used on his stock horse, no tax applies.”

Sales Tax Rule 103:

02. Unit. A unit, as applied to hand tools, means a single, distinct part or object which can be used by itself to perform a specific function. For example, a screwdriver can be used by itself to tighten or loosen a screw. When units, such as screwdrivers, are sold in sets to a manufacturer who will use the tools primarily and directly in the production process, i.e., to assemble product, a per unit price must be computed to determine if the purchase qualifies for the over one hundred dollars (\$100) per unit exemption. When a manufacturer purchases a set of twenty (20) wrenches for one hundred twenty-five dollars (\$125) to be used in product assembly, the purchase is taxable because the per unit price of the hand tools is less than one hundred dollars (\$100). (7-1-93)

03. Component. A unit may be composed of two (2) or more components. A component is a distinct part which must be physically attached to another part to perform a specific function. A component alone has no utility. For example, a drill bit must be physically attached to a drill in order for the bit or the drill to have utility. Together they become a unit which can perform a specific function. Single components or sets of components, sockets, drill bits, etc., are taxable unless they will be physically joined to another component, ratchet, drill, etc., to form a unit which exceeds one hundred dollars (\$100) in cost. For example, drill bits which are physically attached to a five hundred dollar (\$500) drill press to perform a specific function in a production process are exempt from the tax.

Sales Tax Rule 128.07.b.:

Example: A farmer completes an ST-101 claiming a production exemption on the purchase of a fifteen dollar (\$15) hammer and a case of motor oil. The retailer must collect the sales tax on the sale of the hammer, but is not liable for the collection of the sales tax on the sale of the motor oil. The retailer cannot rely on the exemption certificate when selling the hammer because, as a matter of law, the sale of hand tools with a unit price of one hundred dollars (\$100) or less is

excluded from the production exemption. But the retailer can rely on the exemption certificate when selling goods, such as the motor oil, which the farmer could put to either a nontaxable use (e.g., oil for a tractor), or a taxable use (e.g., oil for a licensed pickup truck).

Based upon the law, the prior decision of the Commission is overruled. The Idaho Supreme Court stated in W. Home Transp., Inc. v. Idaho Dep't of Labor, 155 Idaho 950, 318 P.3d 940, 943 (2014), that,

“When there is controlling precedent on questions of Idaho law ‘the rule of stare decisis dictates that we follow it, unless it is manifestly wrong, unless it has proven over time to be unjust or unwise, or unless overruling it is necessary to vindicate plain, obvious principles of law and remedy continued injustice.’ ” *Greenough v. Farm Bureau Mut. Ins. Co. of Idaho*, 142 Idaho 589, 592, 130 P.3d 1127, 1130 (2006) (quoting *Houghland Farms, Inc. v. Johnson*, 119 Idaho 72, 77, 803 P.2d 978, 983 (1990)). “While we are cognizant of the importance stare decisis plays in the judicial process, we are not hesitant to reverse ourselves when a doctrine, a defense, or a holding in a case has proven over time to be unjust or unwise.” *State v. Maidwell*, 137 Idaho 424, 426, 50 P.3d 439, 441 (2002).

The Commission’s holding in Docket No. 23890 has proven over time to be unjust or unwise. The [Redacted] in question do not fall into the same categories of “[Redacted].” They are also not “screwdrivers” or “drill bits.” They are also not “hammers.” Calling [Redacted] a hand tool under these facts has proven over time to be unwise or unjust.

[Redacted]The Bureau identified the relevant exclusion for the [Redacted] to be “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” (Idaho Code § 63-3622D(f)). The Bureau held that the product is a janitorial supply and, therefore, made the determination that the production exemption cannot apply to the sale of this product. Based on this reasoning, the Bureau asserts that sale of these products are “taxable as a matter of law.”

The taxpayer disagrees with the Bureau's determination that this product is a janitorial supply and states that this product is used by [Redacted] to [Redacted] area and [Redacted] to prevent [Redacted] from spreading throughout the [Redacted]. The substance is a [Redacted] that, when applied to either [Redacted], [Redacted] found in this environment, making it uninhabitable to [Redacted].

Idaho Code § 63-3622D(e) states that “the term ‘directly used or consumed in or during’ a [Redacted] means the performance of a function *reasonably necessary* to the operation of the total [Redacted]” (emphasis added). While the Commission concedes that the purchase and use of [Redacted] may be reasonably necessary to the operation of a [Redacted], the issue that needs to be addressed in this decision is whether the seller would be relieved of the obligation to collect sales tax on the sale of this product when the purchaser executes a valid exemption claim form.

Idaho Code § 63-3622(d) states that “when an exemption or resale certificate, properly executed, is presented to or is on file with the seller, the seller has no duty or obligation to collect sales or use taxes in regard to any sales transaction so documented regardless of whether the purchaser properly or improperly claimed an exemption.”

Idaho Code § 63-3622(g) states that “It shall be presumed that sales made to a person who has completed an exemption or resale certificate for the seller's records are not taxable and the seller need not collect sales or use taxes *unless* the tangible personal property or services purchased are taxable to the purchaser as a matter of law in the particular instance claimed on the exemption certificate”. (Emphasis added.)

These subparts of the statute are not entirely consistent. On one hand, if the purchaser provides a certificate, the seller has no duty or obligation to determine the validity of the claimed exemption even if the purchaser improperly claimed the exemption. In contrast, a seller must

collect the tax if the sale is taxable as a matter of law even if the purchaser has filled out the exemption certificate claiming the exemption. In interpreting statutes, all words of the statute must be harmonized and read together. All sections of the applicable statute must be read together to determine the intent of the legislature. Davaz v. Priest River Glass Co., Inc. 125 Idaho 333, 870 P.2d 1292 (1994). If the statute is ambiguous, then it must be construed to mean what the legislature intended for it to mean. Miller v. State, 110 Idaho 298, 715 P.2d 968 (1986). To determine that intent, not only are the literal words of the statute examined, but also the reasonableness of proposed constructions, the public policy behind the statute, and its legislative history. Lopez v. State Industrial Special Indemnity Fund, 136 Idaho 174, 30 P.3d 952 (2001).

In considering the interpretation of Idaho Code § 63-3622, the Commission must consider the language of the statute by giving effect to every section and construing each section so that it is harmonized with the other sections of the statute. When considering these factors, it is clear that the legislature intended a low threshold for the acceptance of certificates by sellers. Unless the transaction is taxable as a matter of law, the seller has no duty or obligation for the collection of tax. This means that unless the facts show that the seller knows unequivocally that the buyer's purchase is taxable, or if the representations on the invoice and certificate disclose that the claim of exemption is invalid as a matter of law, the certificate will relieve the seller from any potential liability. The seller can rely on the representations of the buyer, even if the representations are not reasonable and the seller has no duty to question or challenge the representations. The seller can only be held liable if the seller's actual knowledge is such that he knows the buyer cannot claim the exemption at the time of sale or if the purchase is taxable as a matter of law.

With respect to the [Redacted], the Commission has determined that the sale of it is not “taxable as a matter of law” and the taxpayer did not know unequivocally that the sale of this product to [Redacted] would not qualify for exemption. The Commission holds that the taxpayer did not have a responsibility to collect sale tax on the sale of [Redacted] if a valid resale exemption certificate was on file.

Conclusion

The Commission revised the deficiency prepared by the Bureau to exclude all sales of [Redacted] and [Redacted] in which a properly completed exemption certificate had been provided. The Commission found the revised deficiency to be a reasonably accurate representation of the taxpayer’s sales and use tax liability for the period July 1, 2009, through June 30, 2012.

The Bureau added interest to the sales and use tax deficiency. The Commission reviewed this addition and found it to be appropriate per Idaho Code §§ 63-3045, and has updated interest accordingly. Interest is calculated through November 28, 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 June 20, 2013, is hereby MODIFIED 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>
\$3,201	\$0	\$544	\$3,745

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.