

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 0-389-408-768
)	
Petitioner.)	DECISION
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(Petitioner) protested the Notice of Deficiency Determination (Notice) issued by the staff of the Sale/Fuels Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission). The Notice proposed sales and use tax, penalty, and interest for the audit period January 1, 2014, through June 30, 2018, in the amount of \$462,228.

The Commission hereby upholds the Bureau’s Notice for the reasons detailed below.

Background and Audit Findings

Petitioner is a retail and service shop for tires, wheels, and automobile accessories. At the time of the review, Petitioner operated 11 retail locations in Idaho, 4 of which were opened during the audit period. Petitioner also conducted retail sales to Idaho customers on its online platform. The Bureau conducted a sales and use tax audit of Petitioner’s Idaho locations for the period stated above. reviewing retail sales and purchases for proper taxation. The review showed a questionable optional warranty process used to replace damaged tires, non-taxed services agreed to be rendered as part of the sale, and un-taxed materials used to complete services and repairs on customer owned tires. These issues affected both sales and use tax for the audit period.

On September 25, 2020, the Bureau issued a Notice on non-taxed sales of \$5,433,321 and non-taxed supplies and replacement parts used by Petitioner of \$911,852. Petitioner appealed the Notice, identifying four main issues with the audit:

1. Use tax applied to tires replaced under the Certificate for Repair, Refund, or Replacement (Certificate) program.
2. Taxing the sale of Installation and Life of Tire Maintenance contracts.
3. Taxing supplies used to service customer owned tires.
4. Penalty Assessment.

The Bureau acknowledged the protest and sent the case to the Appeals Unit (Appeals). Petitioner was sent an introduction letter and an informal hearing was scheduled for July 14, 2022. The hearing consisted of discussions about optional warranties, service contracts, and the projection procedures used in the calculation of the use tax. Petitioner was asked to provide additional information on the issues outlined in their protest. Petitioner is purportedly refunding the original sales tax paid by their customer, then charging sales tax again on the sale of new tires. However, the Commission could not obtain physical evidence of this taking place and Petitioner did not provide sales invoices for tire replacements. Petitioner did provide two affidavits from corporate employees making sworn statements of procedures and policy concerning certificates along with some sales invoices for siping and studding services on customer owned tires. In March of 2023, Petitioner provided the last of the information it wished to have considered and requested a decision on its case.

Relevant Tax Code and Analysis

Petitioner has asked for reconsideration of four main issues that would affect the amount of tax due shown in the Notice. Each issue is discussed below.

Optional Maintenance Contracts

The first issue concerns optional motor vehicle service contracts sold with the purchase of new tires. The Bureau determined Petitioner owed use tax on the cost of tires it replaced as part of

its Certificate for Repair, Refund, and Replacement Program. Petitioner is claiming this is double taxation and has been litigated previously in Michigan (

- - and Washington (

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Michigan and Washington appellant court decisions reversed denied refund request made by Petitioner. Both courts determined Petitioner could not retain the original sales tax collected and remitted and then collect sales tax again on the replacement tires sold to customers. The courts ruled the Certificates allowed buyers the option to cancel the transaction if the tire is not repairable or replaceable. In essence, the court looked at the Certificate as a mechanism for the buyer to rescind the sale if they chose to. Because of the return option in the Certificate, the optional warranties did not qualify as a service contract.

Petitioner is asking that the order of the transaction be ignored when determining liability for tax. The order of the transaction and what is purchased determines who is responsible for the tax on the transaction. In Idaho, all facts and documentation are used to determine the taxability of a transaction. The Certificates sold to customers misrepresent the Certificates purpose and unfairly shifts the tax burden onto Petitioner's customers. To understand this, we need to look at the business practices and policies of Petitioner and the order in which these events take place. The Commission cannot arbitrarily ignore parts of a transaction that would allow Petitioner to classify the sale as something more beneficial to them.

When a customer purchases new tires from Petitioner, the purchase includes lifetime tire maintenance & rotations, balancing, air pressure checks, and flat repair. The purchase also allows customers to bring back tires for a refund if unsatisfied. Petitioner states on its website there is no

time limit for returns or exchanges. Petitioner's website states the following about returns and exchanges, "If you choose to exchange a product for another, your account will be charged for the new item and credited for the return." The lifetime service and return policy is included in the purchase of all new tires without the purchase of a Certificate. When we take this information into account, we can determine the Certificates for Repair, Refund, or Replacement are an optional additional warranty, for unrepairable, damaged tires with a tread of at least 3/32, that when purchased is in addition to the manufacturer's warranty. The Commission was able to obtain images of business literature from their website explaining the purpose of the Certificates. Petitioner asserts on its website that the Certificates are "limited warranties" that are exclusive warranties of _____ and are in addition to the warranties of the manufacturer. Despite Petitioner's current representations, it appears the Certificates were treated as warranties for the period in question. The title of the Certificate is misleading in that it implies repairs and refunds are included as part of the purchase of the Certificate.

The Michigan and Washington court decisions were made based on a belief that the Certificates were the catalyst that allowed the customer to obtain a refund or services. The Commission does not know if the courts were aware of the actual business practices of Petitioner or whether these facts were considered by the other courts. It appears from the record that the courts believed the Certificate gave the customer a choice of a replacement tire or a refund. Customers do not get to choose which action is taken by Petitioner when honoring the Certificate. Petitioner will only refund customers if they determine they are unable to provide the same or like tire per the Certificates. Petitioner claims in the appeal that the Certificates sold to customers are not meant to be warranties or service agreements. Petitioner states, the agreement is not an

agreement to provide a “no-charge tire replacement.” However, Petitioner’s intent does not determine taxation, the entirety of the transaction determines taxability.

The Commission also noted that the Certificates give Petitioner “Rights of Subrogation” for claims of insurance reimbursements or manufacturer warranty claims on the damaged tire. The subrogation rights give Petitioner the ability to claim a refund from the manufacturers for tires replaced under their certificate. This would create additional tax consequences for Petitioner. Any monies received by Petitioner from the manufacturer on the tire warranty would reduce the amount of tax allowed on refunds (IDAPA 35.01.02.045.03). The “Rights of Subrogation” clause on the Certificate was not discovered during the audit so it is not possible for the Commission to determine the tax consequences without requesting additional information.

When Petitioner repairs or replaces a damaged tire covered by the Certificate, it needs to abide by the Idaho laws that pertain to warranties. IDAPA 35.01.02.049.05, titled Optional Warranty or Service Agreement states:

- 05. Optional Warranty or Service Agreement.** If the warranty or service agreement is optional to the buyer, no sales tax is charged on the sale of the warranty or service agreement. A taxable transaction occurs when the seller of the warranty or service agreement performs the repair. (3-31-22)
- a.** If the seller of the warranty or service agreement performs the repair and purchases parts for the repair or uses parts from his inventory, he will pay sales or use tax upon the parts when they are applied by him. (3-31-22)
 - b.** When a third-party dealer or repair facility performs the repair and bills the seller of the warranty or service agreement, the third-party dealer or repair facility will separately state and charge sales tax on the parts to the seller of the warranty or service agreement. (3-31-22)
 - c.** The seller of the warranty or service agreement will pay sales or use tax on parts for the repairs, even if the buyer qualifies for any exemption under the Idaho Sales and Use Tax Act or rules. (3-31-22)

The rule requires the warrantor (Petitioner) to “pay” sales or use tax when the replacement parts are applied by them. The term “pay” here is important in that it assigns responsibility for the taxes due. Petitioner states they refund the original purchase price of the tire plus sales tax for returned

tires and then charges sales tax on the new tire. However, Petitioner has provided no evidence of an actual transfer of monies or consideration taking place between customers and Petitioner related to the new tire. Furthermore, IDAPA 35.01.02.049.05 states that a taxable transaction does not occur until the seller of the warranty or service agreement performs the repair. This rule applies to any repairs or tire replacements made by Petitioner as they are the seller of the warranties. The Certificate determines Petitioner's sales and use tax liability. Petitioner cannot pass on the responsibility for the tax due and that liability is not relieved until the tax has been paid by them. Petitioner is liable for the tax on any repair or replacement materials once they sell their customer the optional service agreement for the tires (IDAPA 35.01.02.049.05). The purchase of the optional service agreement took place well before Petitioner's replacement of the customers tires. The agreement creates two separate and distinct transactions. The customer is liable for the tax due in the first transaction and Petitioner is liable for the tax on the second transaction.

Idaho Code section 63-3621 explains Petitioner's requirements to alleviate its responsibility for use tax due. The options do not include deferring the liability to their customer. This conclusion is supported by the fact Petitioner is still responsible for the use tax due even when the customer is exempt from tax (IDAPA 35.01.02.049.05(c)). Furthermore, Petitioner's customers would be due a refund of the sales tax charged to them on the replacement tire if they were to submit a refund request to the Commission.

Based on this information the Commission finds the replacement tires are taxable to Petitioner and therefore not a retail sale of a new tire. The tire replacements are not double taxed when the supposed sales tax collected the second time is both incorrect (collected in error) and not supported by a customer receipt.

Life of Tire Maintenance and Installation Contracts

The second issue protested by Petitioner is the taxation of Life of Tire Maintenance and Installation contracts. Petitioner claims they were instructed by the Commission to stop charging tax on these fees in 2015 after a complaint by a customer and discontinued this. Petitioner is claiming these fees are not taxable per IDAPA 35.01.02.065.02 Services not Subject to Sales Tax. It argues (a) Sales tax does not apply to the amount charged for balancing, studding, or siping a tire owned by the customer and (b) Sales tax does not apply to separately stated fee to mount or install a tire whether sold new or owned by the customer.

When determining taxability, the whole law must be reviewed for correct application. IDAPA 35.01.02.065.02 only deals with non-taxable services. IDAPA 35.01.02.065.01 handles taxable services. It states:

01. Services Subject to Sales Tax. Sales tax applies to the amount charged for services agreed to be performed in conjunction with the sale of a tire. Examples of such taxable services are balancing, studding, siping, or similar charges. Sales tax will apply to the total amount charged for the tire, the services, and the materials used to perform the services. (3-31-22)

Petitioner's contention these services are not taxable by law is only partially true and does not stand up in this instance. The lifetime service agreements include taxable and nontaxable services. Idaho Code section 63-3613(b)(4) – does exempt installation and application labor if it is separately stated and not used as a means of avoiding the imposition of sales tax. The installation and mounting charges are not stated separately from the other taxable service fees and are therefore subject to sales tax. Petitioner contends the tires are owned by the customer at the time of sale and, therefore, fit the definition from IDAPA 35.01.02.065.02. Idaho Code section 63-3608 explains that there must be a transfer of tangible personal property for consideration. The transfer of the tangible personal property does not take place until after Petitioner has completed the agreed upon

services as part of the purchase of new tires. Installation and mounting are not included in the sales price, not because they are labor, but because they are specifically excluded by law if separately stated. Thus, the Commission finds that the Life of Tire Maintenance contracts were not separately stated and properly held taxable in accordance with Idaho law.

Supplies Used to Service Tires

The third issue mentioned by Petitioner was the calculation of use tax for materials used in repairing customer-owned tires. Petitioner believes it is cost prohibitive for it to review its records to determine whether it charged sales tax to its customers. The Bureau did not ask for Petitioner to review sales but to provide purchase documentation of materials used in making the repairs of customer-owned tires. IDAPA 35.01.02.065.03 explains that materials used in the performance of a service are taxable to the service provider. It further gives examples of the types of materials and potential methods to account for them. However, Petitioner did not provide the requested information for supplies used. This leads to the second part of this issue which pertains to the methodology used in determining material amounts. Unfortunately, the Bureau mis-communicated how the numbers were obtained. An industry average of \$150 in materials per month for every one million in annual sales was used. Petitioner did not understand why the one million was divided by twelve to obtain the number. The number is divided by twelve to account for the 12 months in the years which are also the tax periods for Petitioner's sales and use tax permit. The Commission has reviewed the calculations and found the numbers were consistent in application. Thus, the Commission finds that projections used to calculate the use tax liability to be correct.

Penalty

The final issue protested was the assessment of penalty. The Commission has reviewed the penalty assessed under IDAPA 35.02.01.410 and Idaho Code section 63-3046 and finds the penalty to be appropriate in accordance with the law. Petitioner was charged a 5% negligence penalty for the audit. The penalty assessment was based upon Petitioner incorrectly shifting tax responsibilities to customers, refusing to provide purchase documents for service materials, and the deficiency being due to a disregard of Idaho sales and use tax law without intent to defraud.

Conclusion

Petitioner was reviewed for sales and use tax compliance. The review discovered Petitioner's business practices caused the underpayment of use tax due to the state of Idaho. The Commission requires Petitioner to provide adequate evidence to establish that the amount asserted in the Notice is incorrect. Petitioner was unable to provide additional information to support a reduction of the original Notice. As a result, the Commission upholds the Notice.

Absent information to the contrary, the Commission finds the Notice prepared by the Bureau to be a reasonably accurate representation of Petitioner's sales and use tax liability for the period January 1, 2014 through June 30, 2018.

The Bureau added penalty and 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 will continue to accrue at the rate set forth in Idaho Code section 63-3045(6) until paid.

THEREFORE, the Notice of Deficiency Determination dated September 25, 2020, is hereby APPROVED, in accordance with the provisions of this decision, and is AFFIRMED and MADE FINAL.

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

<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$380,711	\$19,035	\$106,627	\$487,357

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of Petitioner's right to appeal this decision is enclosed.

DATED this _____ day of _____ 2023.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2023,
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:

Receipt No.
