BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 14967
[REDACTED],	)	
	)	DECISION
Petitioner.	)	
	)	
	)	

On June 8, 2000, the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (the "taxpayer"), proposing additional income tax and interest for tax years ending 08/31/93 and 08/31/94 in the total amount of $142,311.

On August 10, 2000, a timely protest and petition for redetermination was filed by the taxpayer. An informal conference was requested by the taxpayer and held on October 30, 2000.

The Tax Commission has reviewed the file, is advised of its contents, and hereby issues its decision MODIFYING the Notice of Deficiency Determination. After resolution of the numerous protested issues by additional documentation, the issue remaining for decision is whether Idaho investment tax credit (ITC) is allowable on four assets. We hold that the credit is not allowable.

Facts

The taxpayer is a manufacturer. During the audit period, the taxpayer bought and placed in service an acid clarifier tank, a truck loading station, a thickener, and a sampler. The auditor disallowed the credit on these and other assets and projected the results as a sample over a population of claimed assets. During the lengthy protest process, the taxpayer provided additional documentation and the oral testimony of a plant engineer regarding the questioned assets.

The acid clarifier tank replaced wood stave gunnite tanks that were worn out and corroded, and which therefore would have been replaced anyway. The taxpayer installed a meteorological reactor clarifier that uses new technology. The authorization for expenditure ("capital investment

proposal"or "CIP" in the taxpayer's parlance) for this asset was unreadable.

Although it is agreed that the truck loading station incorporates new technology, the taxpayer has provided no evidence to prove that it did not claim the credit in part on real property (such as a driveway or structure). The federal law on which the Idaho credit is based only allows the credit for personal property.

The thickener is a device that stirs a semi-liquid substance. A hydraulic drive previously in place could not handle the heavy resistance of the ore that the taxpayer processes and it broke. It would have been replaced anyway. The new drive is electrical and has multiple drives. On this asset, the capital investment proposal referred to an attachment detailing reasons for the proposed purchase, but the attachment has not been provided.

The sampler is a laboratory apparatus used to test quality. The CIP states that the sampler replaced a previous asset. This conflicted with the oral testimony of the plant engineer, who said that there was no previous asset. The Tax Commission resolves this conflict in favor of the contemporaneous writing and against the testimony of the witness, whose memory may be imperfect on this point.

Law and analysis

As in effect during the audit period, Idaho Code § 63-3029B allowed a credit of 3% of the taxpayer's qualified investments made during the taxable year. A qualified investment is an acquisition of depreciable property that is eligible for the federal investment tax credit as defined in sections 46(c) and 48 of the Internal Revenue Code as in effect before November of 1990, and that "is not purchased as replacement for existing property for reasons other than technical obsolescence . . . ."

Internal Revenue Code § 48(a) defines the "section 38 property" that was eligible for the

federal ITC as tangible personal property. It also allows credit for other tangible property, not including a building or its structural components, if it is used in certain industries that are not relevant here. Thus, under federal ITC rules that are incorporated by reference in I.C. § 63-3029B, real property is ineligible for both federal and Idaho ITC. The burden is on the taxpayer to prove that no ineligible property has been claimed. Here, the truck loading station is disallowed because the taxpayer has not proven that real property was not included in the claimed expenditure.

IDAPA 35.01.01.088 is the Tax Commission's rule on Idaho ITC as in effect during the audit period. It provides as to ineligible replacement property:

> **07**. REPLACEMENT PROPERTY. For purposes of subsection 06.a. of this rule, replacement property means newly acquired property which performs functions that are the same as or similar to functions performed by other property used in a taxpayer's trade or business. Any property which is purchased to replace property which is nonfunctional due to wear and tear will be deemed to be replacement property and will not qualify for the credit. Any property which is purchased as replacement property will be presumed to have been purchased for reasons other than technical obsolescence. The taxpayer claiming the credit for replacement property shall have the burden of proving that the replacement property was purchased for reasons of technological obsolescence of existing or previously owned property. To meet the burden, the taxpayer must show by clear and convincing evidence, all of the following.
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> a. The new property must possess enhanced capabilities which render the property it replaces obsolete. Obsolescence may render property economically useless to the taxpayer regardless of its physical condition. Obsolescence is attributable to many causes, including technological improvements and reasonably foreseeable economic changes. Among these causes are normal progress of the arts and sciences, supersession or inadequacy brought about by developments in the industry, products, methods, markets, sources of supply, and other like changes, and legislative or regulatory action.
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> b. There must be a substantial profit motive for obtaining the enhanced capability. To show a substantial profit motive, the taxpayer must show that the enhanced capability actually makes a measurable contribution to the taxpayer's ability to produce the goods and/or deliver the services which constitute all or part of his business either in greater quantity or with improved efficiency. The contribution measured must be sufficient to show that a reasonable and prudent businessman would make the decision to purchase the property in order to obtain the enhanced capability alone, separate and apart from any other motive for purchasing it.

Applying this rule, the sampler was the subject of a conflict in evidence as to whether there was or was not a previous asset. In this circumstance, the Tax Commission applies the taxpayer's burden of proof to find that there was a previous asset, and that the new asset was purchased for reasons other than technological obsolescence.

The previous acid clarifier tank was worn out due to wear and tear and hence the new tank is ineligible replacement property. The thickener was also nonfunctional and the new thickener is also ineligible replacement property.

Conclusion

The Tax Commission finds that the taxpayer's carryover of Idaho ITC to the taxable year ending 08/31/95 is $5,201,454.

WHEREFORE, the Notice of Deficiency Determination dated June 8, 2000, is hereby MODIFIED and, as so modified, is hereby APPPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following taxes, penalty, and interest (computed through 2/19/02)(interest accrues at $34.64 per day):

YEAR	TAX	PENALTY	INTEREST	TOTAL
08/31/93	$148,442	$0	$83,318	$231,760
08/31/94	65,158	0	38,049	103,207
			Less payment 11/3/98	(136,491)
			TOTAL DUE	$198,476

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 with this decision.

DATED this _____ day of _____, 2001.

IDAHO STATE TAX COMMISSION

_____
COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2001, 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. [Redacted]

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ADMINISTRATIVE ASSISTANT 1