

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

In the Matter of the Protest of	)	
	)	DOCKET NOS. 17808 & 17996
[Redacted]	)	
Petitioner.	)	DECISION
	)	
	)	

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On November 20, 2003, the Fuels Tax Audit Section (FTA) of the Idaho State Tax Commission (Commission) issued a Notice of Refund Determination (NOR) to [Redacted] denying a request for refund of Idaho motor fuel tax of \$47,819 for the period January 1, 2000, through March 15, 2001.

On February 13, 2004, the FTA issued a Notice of Deficiency Determination (NOD) to [Redacted] proposing Idaho motor fuel tax, penalty, and interest of \$232,439 for the period January 1, 2001, through December 31, 2001.

On December 23, 2003, and April 14, 2004, respectively, timely protests and petitions for redetermination were filed by the petitioner's attorney, [Redacted]. An informal hearing on the NOR was requested by Mr. [Redacted] but, in a later letter, he cancelled this request and instead requested a decision in the matter. No informal hearing was requested for the NOD. The Commission has reviewed the files, is advised of their content, and hereby issues its decision affirming the NOR and the NOD.

In August, 2003 [Redacted] presented to the Commission a request for refund of Idaho motor fuel taxes for [Redacted]. Mr. [Redacted] stated that the refund was based on bad debts from one of [Redacted]'s customers that had filed for bankruptcy. [Redacted] did not claim this refund as a credit on a current fuel distributor's report because [Redacted] cancelled its Idaho fuel distributor license as of August 31, 2002.

On September 22, 2003, [Redacted] provided the FTA with an affidavit in which he stated:

I, [Redacted], Secretary-Treasurer of [Redacted], do herein swear under oath that [Redacted] incurred a bad debt due to it to the [Redacted] and that this bad debt, in part, involved sales of gasoline and diesel upon which the Idaho gas and diesel tax has been remitted to the Commission as required by Idaho Statute. The amount of tax associated with this bad debt \$47,818.50 as detailed in various documents currently in the possession of the Commission. I further state that the bad debt due to the [Redacted] bankruptcy will be claimed on [Redacted]'s State and Federal Corporate Income Tax returns when filed as required by statute.

I declare under penalty of perjury the each and every statement of the above is true and correct, . . .

On October 14, 2003, the Commission's auditor sent Mr. [Redacted] a letter explaining the information needed to document [Redacted]'s bad debt refund claim. In the letter, the auditor requested account receivable bad debt entries, sales and receipt day-sheets, and a schedule of fuels tax refunds for the periods 2001 and 2002 so these amounts could be reconciled with the bad debt written-off on [Redacted]'s income tax returns. Once the bad debt has been reconciled, the auditor would need a detailed list of the bad debt accounts and their amounts (including the number of gallons for each account) included in the claim for refund, a detailed explanation with supporting documentation for collection activities, and an explanation of [Redacted] relationship with the customers who caused the bad debts.

In a letter dated October 16, 2003, addressed to the supervisor of the FTA section, Mr. [Redacted] stated that, pursuant to their telephone conversations on October 14, 2003, they had agreed that the Commission would notify [Redacted] why the Commission has denied [Redacted]'s bad debt tax refund claim. To date, [Redacted] had not received this notification and requested the Commission please deliver, at its earliest convenience, this correspondence to [Redacted].

On October 17, 2003, the supervisor of the FTA section sent this response to Mr.

[Redacted]:

[Redacted]- per your October 16 request, attached is the auditor's review of [Redacted]'s bad debt refund claim. If you have questions regarding the letter or attached rule or wish to submit additional information to demonstrate [Redacted] meets the requirements of Idaho Code 63-2407(6), feel free to contact [Redacted]. Due to the emergency of your request I am faxing you the Commission's response. The original copies will be forthcoming in the mail.

Included with the October 17, 2003, response were IDAPA 35.01.05 Motor Fuels Tax Administrative Rule 180, Internal Revenue Service (IRS) Publication 535, and a letter from auditor [Redacted] in which he stated:

We have reviewed your request for refund of Idaho fuels tax. This request relates to a recent bad debt on sales of gasoline and diesel to [Redacted]. The documentation reviewed included sales and inventory source documents. As indicated in your letter and supporting documentation, this customer of [Redacted] has recently filed for bankruptcy protection, which prompted this refund request.

The relevant Idaho Code Section that addresses the issue of bad debts as they relate to motor fuels taxes is 63-2407(6) which states:

*(6) For sales made on or after July 1, 1995, taxes previously paid on gallons represented by accounts found to be worthless and actually charged-off for income tax purposes may be credited upon a subsequent payment of the tax provided in this chapter or, if no such tax is due, refunded. If such accounts are thereafter collected, the tax per gallon shall be paid based upon the amount actually received divided by the price per gallon of the original sale multiplied by the appropriate tax rate.*

At this time, there has been no evidence presented that indicates this debt has been charged off on the Income Tax returns of [Redacted]. So, as [Redacted] and I explained in our meeting on Tuesday, October 14, 2003, a refund cannot be processed.

Additional documentation would also need to be provided that would allow us to accurately identify the debt charged off on the income tax returns as the same worthless sales that were assessed the Idaho fuels

tax included in the refund request.

State of Idaho Administrative rule 35.01.05, 180, which outlines refund claim procedures and forms is also enclosed. Your cooperation and assistance in this is appreciated, if you have any questions, please call.  
(Emphasis added)

A letter dated October 29, 2003 was received from Mr. [Redacted] in which he stated:

[Redacted] has received your two Faxes dated October 17, 2003 concerning the above identified bad debt. The first Fax was accompanied by the auditor's review of [Redacted]'s bad debt refund claim. [Redacted] believes this review contains the following errors:

The auditor states that "The documentation reviewed included sales and inventory source documents." [Redacted] questions this statement because all source documents involving this bad debt are located at [Redacted]'s Boise office. When I met with the two auditors from your department on October 14, 2003 in this office, they indicated that they would not examine source documents or any other materials I made available to them until [Redacted] charged off the bad debt on its corporate income tax returns. Therefore, these documents were not reviewed by your department.

Secondly, the auditor states that "At this time, there has been no evidence presented that indicates this debt has been charged off on the Income Tax returns of [Redacted]." In reviewing the concerned Idaho code and rules, I was not able to find where the State of Idaho requires that the bad debt must be charged off on the taxpayers income tax returns. At best, I believe that the auditor's statement is misleading.

Finally, the auditor states that "Additional documentation would also need to be provided that would allow us to accurately identify the debt charged-off on the income tax returns as the same worthless sales that were assessed the Idaho fuels tax included in the refund requests." As I stated above, all documentation concerning this bad is located at our Boise office and the auditor declined to review any of it.

The second Fax was accompanied by a document which reviews Internal Revenue Service procedures concerning bad debts. As you may know, [Redacted] uses the accrual accounting method and the specific charge-off method to recognize bad debt. In the rules concerning totally worthless debts, this document states that "You do not have to make an actual charge-off on your books to claim a bad debt deduction for a totally worthless debt." This statement seems to totally contradict the position which your department has taken to

date.

Please review the above comments and advise [Redacted] of any additional actions needed to be taken to resolve this matter at your earliest convenience.

Mr. [Redacted] claim that the [Redacted] debt to [Redacted] is a totally worthless debt was at that time incorrect because the [Redacted]' bankruptcies had not been discharged. IRS Publication 535, Chapter 14 Bad Debts, Specific Charge-Off Method, Bankruptcy Claim, page 66 states "You may only deduct as a bad debt the difference between the amount owed to you by a bankrupt entity and the amount you received from the distribution of its assets."

On October 29, 2003, the auditor responded by letter to Mr. [Redacted]' letter dated October 29, 2003 in which he stated:

The Tax Commission has received your October 29, 2003 letter regarding your bad debt write-off of fuels tax paid during the years 2000-2003 and the financial documentation you provided to support your refund request. I don't understand your letter, since it does not address the key issues [Redacted] and I discussed with you during our visit to [Redacted] on October 14<sup>th</sup>. Additionally, we sent to your office the Internal Revenue Code forms and publication information, which defines the standards of bad debt recognition for a business.

The reason for our departure from your office was due to [Redacted] not presenting us with the financial information we asked you to provide to support your bad debt claim. We asked you for [Redacted]'s accounts receivable journals or financial documentation writing-off the bad debt. Without examining [Redacted]'s revenue sources, payment accounting, and the reduction of receivables by a bad debt write-off on your accounting system, we are not able to verify your bad debt claim. You made a statement to [Redacted] and myself which made us realize you did not have the necessary documentation for income tax purposes available for us to examine. You stated the income tax records and related documentation we needed to conduct the examination were in the possession of [Redacted]'s accountants and legal counsel.

[Redacted]s accounting records were not made available to us since the records were being sorted through for a bankruptcy matter with [Redacted]. You did not furnish [Redacted] and I with any other

information we could use to verify [Redacted]'s bad debt claim. The primary source of bad debt verification usually starts with Federal Income Tax Returns. [Redacted] has not filed federal or state tax returns for the last 3 years.

The intent of our October 14<sup>th</sup> visit was to obtain the documentation, which meets the IRS Publication 535 definition for the bad debt write-off. You told us you would contact your accountants and have the required documentation available for examination. The information was not available when [Redacted] and I went to [Redacted]'s office on October 14<sup>th</sup>. You also stated that you were not sure if all the financial transactions regarding the bad were completed. Since [Redacted] has failed to provide the required information, no determination has been made regarding [Redacted]'s claim.

The IRS income tax criteria for claiming a bad debt from IRS Publication 535 is listed below:

- Amount owed was previously included in gross income for tax purposes.
- A bankruptcy bad debt of amount owed minus amount received through a bankruptcy.
- Documentation showing no longer any chance amount the owed will be paid to [Redacted].
- A specific charge-off transaction when the receivable becomes worthless during a specific tax year.

The Tax Commission requires that [Redacted] provide the documentation as identified above to support its bad debt claim. No documentation regarding revenue has been presented to the Commission; the [Redacted] bankruptcy has not been discharged; and no specific charge-off of worthlessness in [Redacted]'s accounting system has been verified. As a result, the Idaho Tax Commission is unable to validate [Redacted]'s bad debt claim at this time.

If [Redacted] has the required information, please deliver it to the Tax Commission's office on Park Boulevard by November 12, 2003 or call and make an appointment so we can come to your office to review it. If the requested information is not delivered or an appointment made for us to return to your office by November 12<sup>th</sup>, I will issue a determination, which denies [Redacted]'s bad debt claim.

If you have any questions regarding my letter, please call me at 208-334-7536

In his November 6, 2003, letter, Mr. [Redacted] stated:

[Redacted] has received your correspondence of October 29, 2003. [Redacted] objects to several statements contained within that correspondence as explained below:

You state that “Without examining [Redacted]’s revenue sources, payment accounting, and the reduction of receivables by a bad debt write-off on your accounting system, we are not able to verify your bad debt claim.” [Redacted] agrees with this statement. All necessary documents concerning the above are readily available in this office for your inspection. There is no reason that your office cannot examine these documents, and, in fact, [Redacted] has repeatedly requested this examination.

My statement that I made during your brief office visit that I did not have necessary documentation to prepare a corporate income tax return is also correct. I do not have a complete list of such items as long term assets, the related depreciation schedules, long term liabilities, and so on. As we both know, however, these types of documents are not relevant to the matter at hand. A review of previous audits conducted by your office will show that [Redacted] has historically been in total compliance with Statute 63-2429 of the Fuel Tax Act which discusses required records and the retention of those records. Furthermore, a current examination of [Redacted]’s records will show that [Redacted] continues to be in compliance with that Statute, even though [Redacted] is not currently a licensed dealer. These records, when viewed in conjunction with [Redacted]’s banking records, will clearly show that [Redacted] are indebted to [Redacted] by a considerable amount, of which a good portion involves Idaho Fuels Tax. I do not believe any further documents are necessary to conclude this matter. For your assistance, a set of working papers has been submitted to your agency, and, if you do not have those papers or need additional schedules, please advise me.

Your correspondence states that “[Redacted]’s accounting records were not made available to us since the records were being sorted through for a bankruptcy matter with [Redacted].” [Redacted]’s legal and accounting firms are given copies of source documents while the originals are kept on file in this office, a practice common with many businesses.

Your correspondence also enumerates four IRS income tax criteria for claiming a bad debt which you state are contained in IRS Publication 535. However, on page 46 of that publication, it states that “You do not have to wait until a debt is due to determine whether it is worthless. A debt becomes worthless when there is no longer any chance the amount owed will be paid. It is not necessary to go to court if you can show that judgment from the court would be

uncollectible. You must only show that you have taken reasonable steps to collect the debt. Bankruptcy of your debtor is generally good evidence of the worthlessness of at least a part of an unsecured and unpreferred debt.” It also states that “You do not have to make an actual charge-off on your books to claim a bad debt deduction for a totally worthless debt.” These statements seem to be in contrast to the points listed in your correspondence. Idaho statute in this matter is reference to federal statute, a copy of which [Redacted] does not possess. Since your office is requiring [Redacted] to be in compliance with Idaho statutes on bad debt which reference the federal statutes on bad debt, I herein request that you provide [Redacted] with a copy of those referenced federal statutes.

I believe time is important in this matter, and especially so if your agency needs to file a proof of claim in the [Redacted] bankruptcy proceedings. Therefore, I request you give this matter your prompt attention.

On November 20, 2003, the FTA section issued a NOR denying [Redacted]’s bad debt refund claim because [Redacted] did not meet the requirements of Idaho Code section 63-2407(6) which states in pertinent part “For sales made on or after July 1, 1995, taxes previously paid on gallons represented by accounts found to be worthless and actually charged-off for income tax purposes may be credited upon a subsequent payment of the tax provided in this chapter or, if no such tax is due, refunded. . . .” [Redacted] had not filed its Idaho income tax returns for the years 2000, 2001, and 2002 and the [Redacted]’ bankruptcy had not been discharged.

On December 23, 2003, Mr. [Redacted] filed a petition for redetermination of the refund denial. In the petition Mr. [Redacted] requested the refund claim be increased to \$105,712.75 based on a new method in computing the claim. In the new method, expenses such as rent and property taxes were included in the refund calculation. It is the Commission’s position that only sales of fuel can be used to calculate the amount of the fuels tax bad debt refund due to [Redacted] Mr. [Redacted] also claimed that [Redacted] did not have to file its income tax returns to claim a bad debt based on some court rulings.

In Busch v. U.S., 61 F. Supp. 567, (D. Minn. 1945), the taxpayer loaned a specified

amount of money to an individual who did not pay back the loan and then skipped town. This is entirely different from a taxpayer in a bankruptcy proceeding that has not been discharged. The federal cases are not relevant to the Idaho statute's requirement that the debt be actually charged off from income tax.

A tentative informal conference was scheduled on December 29, 2003 by Mr. [Redacted]. On December 30, 2003, Mr. [Redacted] called [Redacted] concerning the informal conference. Mr. [Redacted] then called the Commission and said [Redacted] did not want a conference after all and requested a decision be issued in this matter.

On January 6, 2004, Mr. [Redacted] sent another letter concerning [Redacted]'s bad debt refund claimed. In this letter he stated that he had attached Exhibit AA and BB which were copies of [Redacted]'s fuels tax reports for the tax periods February and June, 2000. Mr. [Redacted] stated that [Redacted] is not required to file income tax returns to claim a bad debt credit for fuel taxes because the Commission allowed [Redacted] to claim bad debt deductions on both reports for sales made by [Redacted] to the Nez Perce Tribe when income tax returns had not been filed. [Redacted]'s previously claimed bad debt credits cited by Mr. [Redacted] were processed (not audited or reviewed, just processed) by the Commission. Processing the claims is not a determination by the Commission of the return's correctness. They remain subject to audit.

On January 12, 2004, the Commission's Tax Policy Specialist called Mr. [Redacted] to request more readable schedules for the schedules sent with [Redacted]'s protest letter dated December 23, 2003.

Mr. [Redacted] provided more readable schedules with his letter dated January 14, 2004.

On January 28, 2004, the Tax Policy Specialist (Policy Specialist) sent a letter to Mr.

[Redacted] which stated:

The Idaho State Tax Commission has reviewed the amended fuels tax bad debt refund claim for [Redacted] and would like you to provide an explanation of exactly how the credit amount of \$105,712.75 on Exhibit S was calculated.

Please provide a list of all bad debt credits claimed on [Redacted] fuel distributor returns from July 1, 1995 to August 31, 2002. This list should consist of the month/year, debtor's name, and amount for each bad debt claim.

It appears from the amendments to [Redacted]'s leases that property taxes were the responsibility of the lessor, [Redacted], not the lessee and should not be used in the calculation of the fuels tax bad debt claim.

In a letter dated February 11, 2004, Mr. [Redacted] responded to the policy specialist's letter by stating in pertinent part:

. . . Attached to this letter as Exhibit CC is a letter from [Redacted] that explains in more detail how the refund claim was calculated.

The Tax Commission's second request, for a list of all bad debt credits claimed by [Redacted] July 1, 1995 to August 31, 2002, is overly broad. I understand from our phone conversation on January 30, 2004, that the purpose of this request is to ensure that [Redacted] has not already submitted a refund claim for the same bad debt. I have spoken with [Redacted], and both have assured me that no refund claim on any fuel sold to the [Redacted] has ever been submitted to the Tax Commission.

The Tax Commission is correct that the amendments to the leases did place the responsibility to pay property taxes on [Redacted] has eliminated the real property taxes from the debts owed by the [Redacted] and has recalculated the bad debt refund claim, which now totals \$88,778.75. Attached to this letter as Exhibits DD and EE are spreadsheets showing the recalculated refund claim.

[Redacted]'s exhibit provided by Mr. [Redacted] with his December 23, 2003, and February 11, 2004, letters use the difference between all of [Redacted]' charges and payments to [Redacted] to calculate the bad debt claim. The exhibits show all fuel sold to the [Redacted] as a charge to the [Redacted]. Since Mr. [Redacted] refused to provide information concerning [Redacted]'s previous bad debt claims, it is not possible to tell whether a bad debt credit has already been claimed by

[Redacted] for its fuel sold to the [Redacted].

The [Redacted] method for calculating a bad debt credit for sales to the [Redacted] does not work for three reasons.

1. [Redacted] must start with the first fuel sale that was not paid in full. It appears from Exhibit EE of [Redacted]'s third calculation of its bad debt claim that this occurred in December 2000. The information provided in Exhibit EE only lists the amount of the sale with no reference to the number of gallons of each sale. The payments listed in Exhibit EE appear to be general payments into [Redacted]'s bank account and are not specific to a particular sale of fuel.

2. To complicate matters, [Redacted] has refused to provide information of its bad debt credits that were already claimed on its monthly fuel reports.

3. [Redacted]'s method used to calculate its bad debts from the [Redacted] included charges other than sales of fuel from [Redacted] to the [Redacted]. Idaho Code section 63-2407(6), previously cited, is clear that a bad debt may only be claimed for sale of fuel to the [Redacted], not rents or property taxes.

A NOD was issued to [Redacted] on February 13, 2004, denying all bad debt credits claimed on [Redacted]'s fuel distributor returns for the period January 1, 2001, through November 30, 2001. The auditor stated that [Redacted] has not filed its 2001 income tax return and therefore did not meet the requirements of 63-2407(6) because these amounts were not actually charged-off for income tax purposes.

The tax policy specialist discussed the three reasons why [Redacted] method did not work with [Redacted] during a telephone call with him on March 19, 2004.

On April 14, 2004, Petitioner filed a timely petition for redetermination of NOD issued on February 13, 2004.

In the case of [Redacted]'s NOR it is clear that a proper bad debt credit for [Redacted]'s fuel sales to the [Redacted] cannot be calculated based on the information currently provided to the Commission by [Redacted]. Therefore, no credit or refund will be issued

In the case of [Redacted]'s NOD it has incorrectly used the bad debt credit on its fuel distributor return to make tax free sales to the [Redacted] and the issue concerning the incident of the tax is currently under litigation. Therefore, the disallowance of [Redacted]'s bad debt credits claimed in 2001 is affirmed.

WHEREFORE, the Notice of Refund Determination dated November 20, 2003, and the Notice of Deficiency Determination dated February 13, 2004, are hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that [Redacted] pay the following tax, penalty and interest:

<u>PERIOD</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1/1/2001- 12/31/2001	\$190,941	\$9,547	\$37,255	\$237,743

Interest is computed through September 30, 2004.

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

An explanation of the [Redacted]'s right to appeal this decision is enclosed with this decision.

DATED this \_\_\_ day of \_\_\_\_\_, 2004.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_ day of \_\_\_\_\_, 2004, 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]

[Redacted]

[Redacted]

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