BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 19113
[REDACTED]	)	
Petitioner.	)	DECISION
	)	
	)	

On August 17, 2005, the Income Tax Audit Division of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (hereinafter the "Petitioner"), asserting additional corporate income tax and interest in the amount of $293,142 for the taxable years ending January 28, 2001, February 3, 2002, and January 31, 2003. On October 20, 2005, the Petitioner filed a petition for redetermination of the proposed deficiency. The Petitioner requested an informal conference before the Commission.

On March 7, 2006, the Tax Commission conducted an informal conference to discuss the Audit Division's deficiency determination with the Petitioner. The Petitioner's representatives participated by means of telephone. Staff from the Audit Division appeared in person. The Petitioner submitted additional information to the Tax Commission on April 26, 2006, concerning the Idaho new employees credit the Petitioner claimed concerning the 2001 taxable year. The Tax Commission submitted the information to the Audit Division for its consideration. On May 1, 2006, the Audit Division stated it had reviewed the information; however, the Division declined to modify its proposed deficiency. As a result, the Tax Commission deemed the matter to be fully submitted on May 1, 2006.

Issues

The Audit Division examined and adjusted the returns filed by Petitioner. The adjustments result in the Notice of Deficiency Determination referenced above. In its Petition for Redetermination, the Petitioner asked the Tax Commission to reconsider three of the audit adjustments:

1. The Division's disallowance of intercompany eliminations regarding dividends paid by affiliated [Redacted];

2. The Division's partial disallowance of the Idaho new employees tax credit claimed by the Petitioner on its taxable year 2001 return; and

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3. The Division's partial disallowance of the investment tax credit the Petitioner claimed on its return for each of the taxable years in question.

During the informal conference, the Petitioner withdrew its protest concerning the [Redacted]. As a result, the Tax Commission affirms the Notice of Deficiency with respect to the [Redacted] and will not address that issue further in this decision.

Holding

The Tax Commission has reviewed the audit file and the information presented by the Petitioner. For the reasons stated below, the Tax Commission affirms the Audit Division regarding the partial disallowance of the Idaho "new employees" tax credit claimed by the Petitioner. However, based on the additional documentation and testimony presented by the Petitioner, the Tax Commission grants the redetermination of the investment tax credit requested by the Petitioner. The Tax Commission modifies the Division's deficiency determination to reflect the increased credit.

Discussion

The Petitioner operates a [Redacted]. For the taxable year 2001, the Petitioner claimed a credit for a number of new employees hired during the year pursuant to Idaho Code section 63-3029F. The Audit Division disagreed with the manner in which the Petitioner calculated the number of new employees that qualified for the credit. The Division subsequently recomputed the number of qualifying employees and decreased the credit claimed by the Petitioner.

During all three taxable years at issue, the Petitioner claimed an investment tax credit pursuant to Idaho Code section 63-3029B. Under the statute, a taxpayer is entitled to a credit for qualified investments in depreciable property. After reviewing invoices, the Audit Division determined part of the property claimed by the Petitioner constituted inventory rather than depreciable property. The Audit Division requested additional documentation to verify the claimed credit, but the requested documentation was not made available during the audit. Lacking additional documentation from the Petitioner, the Audit Division removed the unqualified property from the credit calculation and reduced the investment tax credit claimed in each of the three taxable years.

The Tax Commission will address the adjustments to each tax credit below.

The New Employees Tax Credit

The Petitioner claimed the credit for new employees on its return filed for the taxable year ending February 3, 2002. The Audit Division reviewed the Petitioner's calculation of new employees and concluded the calculation overstated the number of new employees. The tax credit is governed by Idaho Code section 63-3029F which provides in pertinent part:

> **63-3029F. SPECIAL CREDIT AVAILABLE -- NEW EMPLOYEES**. (1) Any taxpayer shall be allowed a credit, in an amount determined under subsection (2) of this section, against the tax imposed by this chapter, other than the tax imposed by section 63-3082, Idaho Code, for any taxable year during which the taxpayer's employment of new employees, as defined under section 63-3029E(1), Idaho Code, increases above the taxpayer's average employment for either: (a) the prior taxable year, or (b) the average of three (3) prior taxable years, whichever is higher. No credit shall be allowed under this section unless the number of new employees equals or exceeds one (1) person.

> (i) Five hundred dollars ($500) per new employee described in subsection (2)(d) of this section; or
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> (ii) One thousand dollars ($1,000) per new employee described in subsection (2)(c) of this section, but not both.

The difference between the Audit Division's calculation of new employees and the Petitioner's calculation is based on a difference of statutory interpretation.

Idaho Code section 63-2029E defines the term "new employee" and sets forth specific criteria that each employee must meet in order to qualify for the credit.

> **63-3029E. DEFINITIONS -- CONSTRUCTION OF TERMS**. As used in this section and in section 63-3029F, Idaho Code:
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> (1) (a) "New employee" means a person subject to Idaho income tax withholding whether or not any amounts are required to be withheld, employed by the taxpayer in a trade or business, and covered for unemployment insurance purposes under chapter 13, title 72, Idaho Code, during the taxable year for which the credit allowed by section 63-3029F, Idaho Code, is claimed. A person shall be deemed to be so engaged if such person performs duties on:
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> (i) A regular full-time basis; or
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> (ii) A part-time basis if such person is customarily performing such duties at least twenty (20) hours per week.
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> No credit shall be earned unless the new employee shall have performed such duties for the taxpayer for a minimum of nine (9) months during the taxable year for which the credit is claimed.

The Petitioner and the Audit Division disagreed on how these statutory criteria apply when computing the number of new employees that qualify for the credit.

As stated in Idaho Code section 63-3029F, the number of new employees is determined by comparing the average number of employees employed in the year for which the credit is claimed to the average number of employees employed in previous taxable years. The Petitioner and the Audit Division agreed that, for purposes of determining the employment average, only employees: (1) for whom Idaho tax has been withheld; (2) covered for unemployment purposes; and (3) performing duties on a regular full-time or part-time basis, shall be included when computing the increase in the average number of employees for the year in which the credit is claimed.

However, the parties disagreed on the application of the nine-month requirement. The Petitioner stated that, "Once the increase in the average number of these new employees is established, the credit is limited to the number of qualifying new employee who worked at least nine months during the tax year for which the credits are claimed. . . . the limitation of working nine month of the tax year should be applied to the employees for whom a credit is claimed, not to determining the increase in net new qualifying positions that those employees fill."

In essence, the Petitioner interprets the statutes to mean that the nine-month requirement applies <u>after</u> the increase in average employment is computed. Conversely, the Audit Division takes the position that the nine-month requirement applies <u>as part</u> of the computation of the increase in the average of employees.

In reviewing the statute, the Tax Commission cannot find any indication that the nine-month requirement should be applied differently than the other "new employee" criteria provided in subsection (a) of Idaho Code section 63-3029E(1). Rather, a reading of Idaho Code section 63-3029E indicates that all of the criteria set forth in subsection (a) of the statute must be applied when determining the mathematical average. Specifically, subsection (c) of the statute states:

> (c) **The number of employees during any taxable year for any taxpayer shall be the mathematical average of the number of employees** reported to the Idaho department of labor for employment security purposes during the twelve (12) months of the taxable year **which qualified under paragraph (a) of this subsection**. In the event the business is in operation for less than the entire taxable year, the number of employees of the business for the year shall be the average number actually employed during the months of operation, providing that the qualifications of paragraph (a) of this subsection are met.

Idaho Code section 63-3029E (1) (c) (bolding added). This specific reference indicates that, when computing the average increase in the number of employees, the employees included in the computation must qualify under subsection (a). The statute does not provide for deferring application of the nine-month requirement until after the increase in the average number of employees is determined.

The Investment Tax Credit

The disallowed property for the credit claimed in regard to taxable year ending January 28, 2001, involved certain [Redacted] the Petitioner purchased from a [Redacted] manufacturer. The [Redacted] manufacturer sells [Redacted] in truckload quantities. During the years in question, several of the Petitioner's retail stores purchased large quantities of [Redacted]. The purchasing stores typically were new stores preparing for opening. During the audit, the Petitioner was unable to document how the property was used in its operation; however, the Audit Division noted that for sales tax purposes, the Petitioner treated the purchases as "[Redacted]." Absent additional documentation, the auditors determined the [Redacted] was inventory which did not qualify for the credit.

The Division's adjustment to the credit claimed for the taxable year ending January 31, 2003, involved several different types of property including certain [Redacted] equipment but also a variety of the property that was not labeled or categorized. This property also was initially categorized as inventory by the Petitioner. Again the primary issue regarding this property appears to be primarily a lack of documentation provided at the time the Division conducted the audit.

However, during the redetermination process, the Petitioner provided documentation and testimony explaining how the Petitioner used the property. The Petitioner stated that what was perceived as [Redacted] was in fact "[Redacted] installed in the retail location to be used in displaying items held for sale to customers." The Petitioner presented invoices and other documents in support of its statements. Similarly, the Petitioner explained that the property in dispute for the taxable year ending January 31, 2003, consisted of cash registers, register equipment, and scanner equipment installed and used at retail stores, rather than property held for resale to customers.

Based on these statements and the documentation provided during the redetermination process, the Tax Commission finds the Petitioner has met its burden of proof. Accordingly, the Petitioner is entitled to the full amount of investment tax credit claimed on its returns for the taxable years in question.

Conclusion

WHEREFORE, the Notice of Deficiency Determination dated August 17, 2005, is hereby MODIFIED and MADE FINAL.

IT IS ORDERED and THIS DECISION DOES ORDER that the Petitioner pay the following tax and interest:

YEAR	TAX	PENALTY	INTEREST	TOTAL
1/28/2001	$43,538	$ -0-	$15,440	$58,978
2/3/2002	$107,816	$ -0-	$30,009	$137,825
1/31/2003	$80,821	$ -0-	$17,434	$98,255
			TOTAL DUE	$295,058

Interest is calculated through January 22, 2007.

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. As set forth in the enclosed explanation you must deposit with the Tax Commission 20 percent of the total amount due in order to appeal this decision. The 20 percent deposit in this case is $59,012 and will be held as security for the payment of taxes until the appeal is finally resolved.

DATED this ________ day of _________________________, 2006.

IDAHO STATE TAX COMMISSION

____
COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of ________________, 2006, 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.

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