

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 21032
[REDACTED])	
)	DECISION
Petitioner.)	
_____)	

On January 15, 2008, the Idaho State Tax Commission’s (Commission) Income Tax Audit Bureau (Bureau) issued a Notice of Deficiency Determination to [Redacted] (petitioner) proposing additional income tax and interest for the taxable years ending August 28, 2004, August 27, 2005, and August 26, 2006, in the total amount of \$8,164. The petitioner filed a timely protest and petition for redetermination. A hearing was held on December 30, 2008. The Commission, having reviewed the file, hereby issues its decision.

The petitioner protests the Bureau’s disallowance of Idaho investment tax credit and the Bureau’s determination that the petitioner was not entitled to an additional exclusion for certain foreign dividends when calculating its Idaho taxable income. The petitioner agreed with other adjustments made by the Bureau and has remitted the amount of tax plus interest associated with those adjustments.

I. Idaho Investment Tax Credit

The dispute between the Bureau and the petitioner over investment tax credit relates primarily to outdoor advertising signs. The petitioner claimed costs associated with [Redacted] signs affixed to its buildings and outdoor advertising signs and fixtures affixed to poles located in the petitioner’s parking lots.

As in effect during the audit period, Idaho Code section 63-3029B allowed a credit of 3 percent of the taxpayer’s qualified investments made during the taxable year. Except for a motor vehicle under eight thousand (8,000) pounds gross weight, 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 1990.

Internal Revenue Code section 48(a) defines the “section 38 property” that was eligible for the federal investment tax credit 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 investment tax credit rules that are incorporated by reference in Idaho Code section 63-3029B, real property is ineligible for both federal and Idaho investment tax credit.

a. Neon signs attached to the petitioner’s building

Treas. Reg. 1.48-1(c) states, in pertinent part:

Definition of tangible personal property. If property is tangible personal property it may qualify as section 38 property irrespective of whether it is used as an integral part of an activity (or constitutes a research or storage facility used in connection with such activity) . . . For purposes of this section, the term “tangible personal property” means any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures). . . . Tangible personal property includes all property (other than structural components) which is contained in or attached to a building. Thus, such property as . . . neon and other signs, which is contained in or attached to a building constitutes tangible personal property for purposes of the credit allowed by section 38. . . . (Emphasis added.)

The costs associated with the [Redacted] signs attached to the petitioner’s building qualify for the Idaho investment tax credit.

b. The petitioner’s outdoor advertising signs

The eligibility of outdoor advertising sign structures for investment credit has been the subject of both litigation and significant administrative consideration by the Internal Revenue Service. The seminal case in this area is *Whiteco Industries, Inc. v. Commissioner*, 65 T.C. 664

(1975). In *Whiteco*, the Tax Court established five criteria for determining whether outdoor advertising billboards are tangible personal property, eligible for investment credit, or inherently permanent property, ineligible for investment credit. These five criteria were published in IRS Rev. Rul. 80-151, and the Internal Revenue Service would apply the criteria on a case by case basis.

Subsequent to *Whiteco*, the eligibility of outdoor sign structures was also litigated in *Southland Corp. v. United States*, 611 F.2d 348 (Ct. Cl. 1979), and *Standard Oil Co. of Indiana v. Commissioner*, 77 T.C. 349 (1981). In *Southland*, metal support poles were generally a steel tube 20 feet long and 8 inches in diameter; the steel tubes were set in concrete 6 feet below ground level in a concrete foundation. The sign faces attached to the steel support tubes were either approximately 6 by 7 feet or 8 by 10 feet. In *Standard Oil*, the metal poles were either 15 to 17 feet high or 90 to 110 feet high; these poles were generally attached to a concrete foundation 5 to 8 feet in depth by means of anchor bolts embedded in the foundation.

In *Southland*, the Court of Claims concluded that “pole signs,” which included the head, faces, pole, foundation, concrete, and cost of installation, were tangible personal property eligible for investment credit. Similarly, in *Standard Oil*, the Tax Court concluded that the sign heads, light fixtures, and sign poles designed to be attached to concrete foundations were tangible personal property eligible for investment credit. The Tax Court further concluded in *Standard Oil* that concrete foundations were inherently permanent property ineligible for investment credit.

Based upon the facts before the Commission, the sign structures at issue in *Southland* and *Standard Oil* are similar to those at issue in this case. Accordingly, the petitioner’s outdoor advertising signs qualify for the Idaho investment tax credit.

II. Internal Revenue Code section 965 temporary dividends received deduction

a. Federal Taxable Income

Internal Revenue Code section 965 created under the American Jobs Creation Act of 2004 allows U.S. companies a one-time election entitling a taxpayer to an 85 percent deduction in arriving at federal taxable income for eligible dividends from foreign subsidiaries subject to certain criteria and restrictions. The election applies to actual cash dividends, not to any deemed dividends or foreign tax credit gross-ups. Distributions of previously taxed income, with certain exceptions, are excluded. No deduction shall be allowed under Internal Revenue Code section 243 or 245 for any dividend for which a deduction is allowed under section 965. Internal Revenue Code section 965(c)(4). Taxpayers can elect to claim the deduction from either the last tax year that begins before October 22, 2004, or the first tax year that begins during the one-year period commencing on October 22, 2004. The election is made by attaching federal Form 8895.

The petitioner made the election to claim the temporary dividends received deduction on its taxable year ending August 26, 2006. The petitioner claimed a deduction of \$35,047,727 (85 percent of \$41,232,620) in arriving at its federal taxable income for taxable year ending August 26, 2006.

b. Idaho Taxable Income

The petitioner filed a water's-edge combined report group return for each of the years at issue. Under Idaho law, federal taxable income is the petitioner's starting point when determining a taxpayer's Idaho taxable income. Idaho Code section 63-3002. One of the steps in determining the amount of the petitioner's Idaho taxable income when filing a combined report is a determination of the amount of business income subject to apportionment. In arriving

at the amount of business income subject to apportionment, certain statutory adjustments are required. One such statutory adjustment is Idaho Code section 63-3022(d) which states that “In the case of a corporation, add the amount deducted under the provisions of sections 243(a) and (c), 244, 245 and 246A of the Internal Revenue Code (relating to dividends received by corporations) as limited by section 246(b)(1) of said code.” Idaho law does not require that the Internal Revenue Code section 965 temporary dividends received deduction be added back.

Since Idaho law did not require an add back of the Internal Revenue Code section 965 deduction, this has lead to disagreement between the petitioner and the Bureau over the calculation of Idaho’s version of a dividends received deduction found in Idaho Code section 63-3027C. Idaho Code section 63-3027C(c) and (d), reads as follows:

- (c) For purposes of this section:
 - (1) Dividends received from payors incorporated outside the fifty (50) states and District of Columbia, to the extent taxable, shall be treated as income subject to apportionment.
 - (2) The income of corporations filing elections under section 936 of the Internal Revenue Code shall be deemed dividends received from payors incorporated outside the fifty (50) states and District of Columbia.
 - (3) Eighty-five per cent (85%) of all dividends described in subsection (c)(1) or (c)(2) of this section shall be excluded from income subject to apportionment.
 - (4) The dividends subject to apportionment shall be in lieu of any expenses attributable to such dividend income.
 - (5) Any actual dividend received from a corporation filing an election under section 936 of the Internal Revenue Code shall be eliminated from income.
- (d) Any dividend from any payor required to be combined under the water’s-edge election shall be eliminated from the calculation of apportionable income. Dividends received from a corporation described in section 922 of the Internal Revenue Code (defining “FSC”) will be treated as follows:
 - (1) Dividends received from an FSC will be eliminated in the proportion that FSC federal taxable income for the year, out of which the dividend was paid, bears to the total FSC income before taxes for such year.

(2) The portion of FSC dividend not eliminated under paragraph (1) of this subsection will be subject to the eighty-five per cent (85%) exclusion provided for in subsection (c)(3) of this section.

(e) For purposes of this section:

(1) Amounts included in income by reference to subpart F of part III of subchapter N of chapter 1 of the Internal Revenue Code shall constitute dividends from payors outside the fifty (50) states and District of Columbia;

(2) Amounts included in income under part VI of subchapter P of chapter 1 of the Internal Revenue Code shall constitute dividends from payors outside the fifty (50) states and the District of Columbia; and

(3) Deemed distributions defined by Section 78 of the Internal Revenue Code shall be excluded from the income of the water's-edge combined group.

Where no water's-edge spreadsheet is filed, the percentage to be applied under section 63-3027C(c) is 80 percent not 85 percent. Idaho Code section 63-3027E(b). The petitioner did not file the water's-edge spreadsheet, thus, the 80 percent rate, not the 85 percent rate, is applicable in this case.

As previously discussed, when arriving at its federal taxable income, the petitioner claimed a \$35,047,727 temporary dividends received deduction in arriving at federal taxable income for the taxable year ending August 26, 2006. The cash dividend of \$41,232,620 less the federal deduction is \$6,184,893.

When the petitioner filed its Idaho corporate income tax return for the taxable year ending August 26, 2006, the petitioner, when calculating its income subject to apportionment, claimed an Idaho Code section 63-3027C(c)(3) deduction in the amount of \$4,947,914 (80 percent of \$6,184,893). Under the petitioner's approach, only \$1,236,979 of the original \$41,232,620 of foreign dividends remains in income subject to apportionment.

The Bureau disagreed with the approach taken by the petitioner and argued in its NODD that:

For FYE 8/26/06, the company reported a deduction of 85% of such dividends under the provisions of IRC sec 965. Idaho has no provision for add back of the dividends received deduction allowed under IRC section 965. Therefore, the company has already been allowed an 85% exclusion of foreign dividends, as allowed in the computation of federal taxable income, and accordingly in the computation of income subject to apportionment. No further exclusion is allowed under the Idaho statutes.

As previously discussed, since the petitioner did file the waters-edge spreadsheet, under Idaho's statute, the petitioner is only entitled to 80 percent, not an 85 percent exclusion of certain foreign dividends. The Bureau did not require the 5 percent difference between the 85 percent federal deduction and the 80 percent exclusion under Idaho law be added back into income subject to apportionment since the Bureau could not find any authority under Idaho law that would require the add back of the 5 percent difference.

Idaho Code section 63-3027C(c)(1) states that "Dividends received from payors incorporated outside the fifty (50) states and District of Columbia, to the extent taxable, shall be treated as income subject to apportionment." Emphasis added. Idaho Code section 63-3022(d) requires taxpayers to add back the federal deduction for certain dividends. For example, the Internal Revenue Code section 243 dividends received deduction is required to be added back as part of the calculation of Idaho taxable income effectively requiring that the entire dividend be included as part of the calculation of Idaho taxable income. However, the same cannot be said for the 85 percent Internal Revenue Code section 965 temporary dividends received deduction. Since Idaho law does not require the temporary dividends received deduction to be added back, only 15 percent of the dividends are included as part of the calculation of Idaho taxable income. Accordingly, for the case at hand, since only \$6,184,893 of the \$41,232,620 dividends were

required to be part of the calculation of Idaho taxable income, the petitioner was correct in treating the \$6,184,893 of dividends as being eligible for the exclusion found in Idaho Code section 63-3027C(c)(3).

WHEREFORE, the Notice of Deficiency Determination dated May 28, 2008, is hereby MODIFIED, AFFIRMED, and MADE FINAL.

Since the petitioner has already remitted the additional amount due on the uncontested adjustments, no additional amount is due.

An explanation of the petitioner's rights to appeal this decision is enclosed.

DATED this ____ day of _____, 2009.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2009, 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.
