

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

In the Matter of the Protest of )  
 )  
[Redacted], ) DOCKET NO. 21110  
 )  
 ) DECISION  
Petitioner. )  
 )  
 )  
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\_\_\_\_\_ )

PROCEDURAL BACKGROUND

On February 22, 2008, the Income Tax Audit Division of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (Notice) to [Redacted] (Petitioner). The Notice asserted an Idaho income tax liability in the amount of \$73,723 for the taxable years ending November 30, 2004, November 30, 2005, and November 30, 2006.

On April 25, 2008, the Petitioner’s representative filed a Petition for Redetermination asking a Commissioner or designee of a Commissioner to re-examine the proposed deficiency. The Petitioner asked the Commission to accept the returns as originally filed for the taxable years at issue. Specifically, the Petitioner stated that the sales and payroll apportionment factors reported on the returns were correct. The Petitioner indicated that additional information would be provided to document the correctness of the returns.

The Income Tax Audit Division (Division) responded on April 29, 2008, informing the Petitioner that the audit file would be retained by the Division since additional information would be submitted. The Division stated it would retain the file until June 30, 2008, pending the receipt of the additional information which might resolve the audit. The Division also stated that after June 30, 2008, the file would be transferred to the legal department to continue the administrative appeal process.

The correspondence contained in the audit file shows the Petitioner and Division

continued to communicate for several months and eventually reached agreement regarding the numerator of the sales factor. However, the parties could not reach agreement on the denominator of the sales factor or on the numerator of the payroll factor.

On October 20, 2008, the Division notified the Petitioner that absent additional information, it would forward the file to the legal department to continue the appeal process since the Division and the Petitioner had reached an impasse. The Petitioner did not submit additional information, so on November 6, 2008, the Division transferred the file to the legal department.

In a letter dated November 13, 2008, the Commission notified the Petitioner of the various alternatives for resolving the protested deficiency determination. The Commission stated the Petitioner could: (1) schedule an in-person hearing before a Commissioner; (2) schedule a telephone hearing before a Commissioner; and/or (3) submit additional statements, documents, or other materials. The Commission did not receive a response, so the Commission mailed a follow-up letter on January 26, 2009, again informing the Petitioner of his opportunity for a hearing and the submission of additional evidence. Once again, the Commission did not receive a response. Accordingly, the Commission now issues this decision based on the information currently in the audit file.

#### ISSUES PROTESTED

##### 1. Payroll Factor Adjustment

Based on the file, it appears that only one audit adjustment remains at issue. For each of the taxable years at issue, the Petitioner filed returns. The Petitioner reported no payroll in Idaho. The Division adjusted the return to report a pro rata share of the Petitioner's salary as Idaho payroll.

## 2. Sales Factor

Additionally, the Division adjusted the sales numerator for each year, but the Petitioner's representative seems to agree with that particular adjustment. However, the Petitioner subsequently suggested the Division should also adjust the sales denominator reported on the Petitioner's return. Absent additional information, the Division declined to make the requested adjustment.

### DISCUSSION

The Petitioner is a construction company with projects in several states including the state of Idaho. During the taxable years at issue, the Petitioner had two construction projects in Boise, Idaho. The gross receipts of the projects amounted to \$5,443,000 and \$6,400,000 respectively.

When the Petitioner filed income tax returns with Idaho, the Petitioner reported income but reported only net sales to Idaho when apportioning the income among the states in which the Petitioner conducted business. Thus, the issue in this case is how the Petitioner's income should be apportioned among the states for state income tax purposes.

When a business operates in multiple states, the business must apportion its business income. In 1965, Idaho adopted with slight modification the Uniform Division of Income for Tax Purposes Act (UDITPA), Idaho Code § 63-3027. As described by the Idaho Supreme Court:

The Act contains rules for determining the portion of a corporation's total income from a multistate business which is attributable to this state and therefore subject to Idaho's income tax. In general, UDITPA divides a multistate corporation's income into two groups: business income and non-business income. Business income is apportioned according to a three factor formula, while nonbusiness income is allocated to a specific jurisdiction.

American Smelting & Ref'g Co. v. Idaho St. Tax Comm., 99 Idaho 924, 927, 592 P.2d 39, 42 (1979) (citations to statute omitted), *rev'd on other grounds*, ASARCO Inc. v. Idaho State Tax Commission, 458 U.S. 307 (1982).

Each state uses one or more ratios to divide or “apportion” the business income to determine the amount of income subject to each state’s income tax. The most commonly used formula is found in UDITPA, which many other states have adopted either in whole or with modifications.

Idaho’s apportionment formula is set out in Idaho Code § 63-3027(i), which states that “[a]ll business income shall be apportioned to this state . . . by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus two (2) times the sales factor, and the denominator of which is four (4). . . .” Id. The property factor is computed by dividing the Petitioner’s property located in Idaho by its property located everywhere. Idaho Code § 63-3027(k). Likewise, the payroll factor is calculated by dividing the Petitioner’s Idaho payroll by its payroll everywhere. Idaho Code § 63-3027(n). And finally, the sales factor is derived by dividing the company’s Idaho sales by its sales everywhere. Idaho Code § 63-3027(p). Set out as a mathematical formula, the Idaho apportionment formula is represented by the following equation:

$$\frac{\left( \frac{\text{Idaho property}}{\text{Total property}} + \frac{\text{Idaho payroll}}{\text{Total payroll}} + 2 \times \frac{\text{Idaho sales}}{\text{Total sales}} \right)}{4}$$

The result of the above equation is then multiplied by the corporation’s total business

income to arrive at the portion of the business income apportioned to Idaho.

The three-factor apportionment formula, by means the location of a business's property, payroll, and sales, approximates the extent of the business activity in a given state. Container Corporation of America v. Franchise Tax Bd., 463 U.S. 159 (1983). Most states that impose a tax on corporate income use some variation of the three-factor apportionment formula. Many states, including Idaho, have modified the traditional three-factor formula so that the sales factor is double weighted.

In this case, it is undisputed that the income at issue is business income. That is to say, the income is derived from the operation of the primary business, namely construction. The issue in this case is how the sales factor and payroll factor of the apportionment factor should be determined.

1. Sales Factor

When the Petitioner reported its sales factor, the Petitioner reported only the net proceeds from the two construction projects in its sales factor numerator. However, the governing Idaho statute states that the term "sales" means all "gross receipts" of the taxpayer that constitute business income. See Idaho Code § 63-3027(5). When the Division adjusted the reported sales numerator from the report net proceeds to the larger "gross receipts" pursuant to the statute, the Petitioner's representative agreed.

However, the Petitioner then contended that the reported sales denominator also should be adjusted. The Division declined to make the requested adjustment.

Upon further examination, the Commission finds the Division acted properly in not adjusting the sales denominator. [Redacted].

The Commission is mindful that, for federal purposes, a construction contractor generally

reports sales under the percentage of completion method. See Internal Revenue Code § 460. Idaho has adopted the same method for construction contractors. See Idaho Income Tax Rule 580.01 (IDAPA 35.01.01.580.01) entitled MTC Special Industries, Construction Contractors. As evidenced in the audit file, the Division employed the percentage of completion method when determining the Idaho sales numerator. As evidenced by the Petitioner's federal returns, it appears the sales "everywhere" denominator also is based on the percentage of completion method. In short, the sales factor numerator and denominator use a consistent accounting method.

Aside from the Petitioner's claim that the sales denominator should be adjusted, there is no evidence in the file to suggest that an additional adjustment would be appropriate. Absent additional information from the Petitioner, the Commission affirms the audit determination.

## 2. Payroll Factor

The returns filed by the Petitioner did not include any payroll in the Idaho numerator of the payroll factor. The Division assumed that a contractor could not complete projects worth five million and six million without incurring some payroll costs in Idaho. The Petitioner's representative agreed but stated that most of the work was performed by subcontractors rather than employees of the Petitioner. Therefore, the Idaho payroll was minimal.

As a result, the Division included in the Idaho numerator of the payroll factor only a portion of the salary drawn by the owner of the Petitioner's construction company. The Division prorated the owner's salary to Idaho based on the same ratio that the gross receipts of the Idaho construction projects bore to the Petitioner's total sales realized from construction projects.

The Petitioner objected to the estimation saying he only spent a limited amount of time in Idaho. However, other than this conclusory statement, the Petitioner offered no documentation or information to refine the Division's estimate.

The Commission finds that the Division's estimate of Idaho payroll is reasonable. Based on the lack of information submitted by the Petitioner, the Commission upholds the audit adjustment.

#### CONCLUSION

Based on the current record, and absent some legal or factual basis for upsetting the audit staff's determination, the Commission must reject the Petitioner's claims of error. See Albertson's, Inc. v. State, Dept. of Revenue, 106 Idaho 810, 814, 683 P.2d 846, 850 (1984) (The burden of proof is on the taxpayer to prove that the decision of the Commission is incorrect).; Parsons v. Idaho State Tax Commission, 110 Idaho 572, 574-575 n.2, 716 P.2d 1344, 1346-1347 n.2 (Ct. App. 1986) (a State Tax Commission deficiency notice is presumed to be correct, and the burden is on the taxpayer to show that the deficiency is erroneous). In this case, the Petitioner has failed to meet its burden of proof. The audit determination therefore is upheld.

WHEREFORE, the Notice of Deficiency Determination dated February 22, 2008, is hereby APPROVED, AFFIRMED, and MADE FINAL.

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

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2004	\$ 9,593	\$ 480	\$2,731	\$12,804
2005	17,707	2,656	3,975	24,338
2006	31,668	4,750	5,147	<u>41,565</u>
		TOTAL AMOUNT DUE		<u>\$78,707</u>

Interest is calculated through September 25, 2009, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid.

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

An explanation of the petitioner's right to appeal this decision is enclosed. As set forth in the enclosed explanation, you must deposit with the Commission 20 percent (20%) of the total amount due in order to appeal this decision. The 20 percent deposit in this case is \$15,741 and will be held as security for the payment of taxes until the appeal is finally resolved.

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.

[Redacted]