

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 25105
[Redacted],)	
)	
Petitioners.)	DECISION
_____)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated June 26, 2012. The Notice of Deficiency Determination (NODD) asserted additional liability for Idaho income tax, penalty, and interest in the total amounts of \$1,494 and \$903 for 2009 and 2010, respectively.

The only issue in this docket is whether the petitioners are entitled to deduct a net operating loss (NOL) incurred in 2008 on their 2009 and 2010 Idaho income tax returns. The petitioners timely filed their 2008 Idaho income tax return electronically. The auditor disallowed the net operating loss deduction on the 2009 and 2010 returns since the petitioners did not elect to forgo the carryback of the net operating loss. Accordingly, the auditor determined that the loss should have been carried back to 2006 and 2007 where it would have been fully absorbed leaving none of the net operating loss to have been carried forward to 2009 and 2010. At the time that the NODD was issued to the petitioners, the statute of limitations had expired for the filing of a claim to carry the net operating loss back to 2006 or 2007.

The petitioners protested the NODD raising the following objections:

1. On the copy of the return which the petitioners had, the box was checked to forego the carryback, and
2. That the statute of limitations has expired for adjusting the 2008 taxable year.

That the petitioners incurred the loss is not in question. The question to be addressed is whether the petitioners are entitled to carry the loss forward rather than carrying the loss to an earlier year. Idaho Code section 63-3022 [2007] stated, in pertinent part:

(c) (1) A net operating loss for any taxable year commencing on and after January 1, 2000, shall be a net operating loss carryback not to exceed a total of one hundred thousand dollars (\$100,000) to the two (2) immediately preceding taxable years. Any portion of the net operating loss not subtracted in the two (2) preceding years may be subtracted in the next twenty (20) years succeeding the taxable year in which the loss arises in order until exhausted. The sum of the deductions may not exceed the amount of the net operating loss deduction incurred. At the election of the taxpayer, the two (2) year carryback may be foregone and the loss subtracted from income received in taxable years arising in the next twenty (20) years succeeding the taxable year in which the loss arises in order until exhausted. The election shall be made as under section 172(b)(3) of the Internal Revenue Code. An election under this subsection must be in the manner prescribed in the rules of the state tax commission and once made is irrevocable for the year in which it is made. (Underlining added.)

Rule 201 set forth the manner prescribed for making the election to forego the carryback of the net operating loss. It stated, in part:

05. Timing and Method of Electing to Forego Carryback. (3-30-01)

a. Net operating losses incurred in taxable years beginning prior to January 1, 2001. The election must be made by the due date of the loss year return, including extensions. Once the completed return is filed, the extension period expires. Unless otherwise provided in the Idaho return or in an Idaho form accompanying a return for the taxable year, the election referred to in this Subsection shall be made by attaching a statement to the taxpayer's income tax return for the taxable year of the loss. The statement must contain the following information: (3-30-01)

i. The name, address, and taxpayer's social security number or employer identification number; (3-20-97)

ii. A statement that the taxpayer makes the election pursuant to Section 63-3022(c)(1), Idaho Code, to forego the carryback provision; and (7-1-99)

iii. The amount of the net operating loss. (3-20-97)

b. Net operating losses incurred in taxable years beginning on or after January 1, 2001. The election must be made by the due date of the Idaho loss year return, including extensions. Once the completed Idaho return is filed, the extension period expires. The election shall be made by either attaching a copy of the federal election to forego the federal net operating loss carryback to the Idaho income tax return for the taxable year of the loss or following the requirements of Subsection 201.05.a. (3-30-01)

c. If the election is made on an amended or original return filed subsequent to the time allowed in Subsections 201.05.a. and 201.05.b., it is considered untimely and the net operating loss shall be applied as provided in Subsection 201.04.b. (3-30-01)

The petitioners' 2008 Idaho income tax return was filed electronically on April 7, 2009. In that return, no indication was present indicating that the petitioners intended to forego the carryback of the net operating loss. The petitioners could have carried the loss in question to the two prior years. However, the petitioners did not file a claim for either of those years to claim this available loss. Upon receiving the notice from the auditor that the NOL was going to be disallowed on the 2009 and 2010 returns, the representatives for the petitioners advised the auditor that it was their clients' intent to forego the carryback of the net operating loss. They stated, in part, in a letter dated July 9, 2012:

It was at all times the taxpayers' intention to carry forward the NOL for both federal and state filing purposes. The taxpayers were aware that they had income to which they could carry back the net operating loss, but did not amend the prior year returns specifically because they wanted to carry the NOL forward. Had they desired to carry back the NOL, they would have done so prior to the closing of that year. The actual carryforward of the NOL to 2009 is further proof of their election to forego the carryback period.

We would also point out that the 2008 tax year is a closed year and, accordingly, treatment of items arising in that year should not be subject to review or change.

Mr. and Mrs. [Redacted] have timely filed their returns in the past and timely paid all taxes due. In light of their filing history, the fact that carryback years are closed and that the taxpayers used the net operating loss in the first carryforward year otherwise available, we believe that it would be inequitable to deny their refund and further assess interest and penalties.

In a letter dated August 7, 2012, the petitioners raised an additional defense:

The 2008 tax return that generated the net operating loss was originally e-filed. The taxpayers' paper copy of that return, a copy of which is enclosed, shows that the box to forego the carryback was marked; this is in line with the subsequent return filings reflecting the carryforward.

The Commission finds the matter to be parallel to a federal matter addressed by the Fifth Circuit Court of Appeals which stated, in part, the following:

Taxpayers assert that even if their Form 4625 Line 11 entry did not literally comply with the requirements of Temporary Regulation 7.0(d), they have nevertheless substantially complied with the requirements of section 172(b)(3)(C) so that strict adherence to the regulation was unnecessary.

Although regulatory requirements that relate to the substance or essence of a statutory provision of the Internal Revenue Code must be strictly complied with, a line of cases from the United States Tax Court has established that "substantial compliance with regulatory requirements may suffice when such requirements are procedural and when the essential statutory purposes have been fulfilled." American Air Filter v. Commissioner, 81 T.C. 709, 719 (1983). In a number of cases the court has determined that a taxpayer has substantially complied with a statute of the tax code, even though he failed to follow the strict procedures for making an election as set forth in a regulation promulgated pursuant to the statute. See, e.g., American Air Filter, *id.*; Taylor v. Commissioner, 67 T.C. 1071 (1977); Columbia Iron & Metal Co. v. Commissioner, 61 T.C. 5 (1973). Where regulatory requirements relate to the substance or essence of statutes requiring elections, however, the court has rejected assertions of substantial compliance. See, e.g., Penn-Dixie Steel Corp. v. Commissioner, 69 T.C. 837 (1978); Dunavant v. Commissioner, 63 T.C. 316 (1974); Valdes v. Commissioner, 60 T.C. 910 (1973).

The primary inquiry, then, concerns the "essence" of section 172(b)(3)(C), and whether the election requirement relates to that essence or is merely procedural or directory. Taxpayers point us to the legislative history of the statute, which indicates that the statute was drafted out of congressional concern that because of adverse economic conditions in the years just prior to 1976, many taxpayers would not generate sufficient income in existing carryover periods to enable them to use their large operating loss carryovers: "[i]n order to reduce the possibility that this problem will arise in the future, the committee has decided to provide a loss carryover option under which eligible business taxpayers *may elect a longer loss carryover in lieu of the loss carryback to which they are otherwise entitled.*" S.Rep. No. 938, 94th Cong., 2d Sess. 198, *reprinted in* 1976 U.S.Code Cong. & Ad.News 2897, 3439, 3629 [our emphasis]. Taxpayers argue that it is clear from this statement of legislative intent and from the plain language of the statute itself that the only condition or requirement of the statute is that the taxpayer be entitled

to a carryback period under section 172(b)(1). Taxpayers were entitled to a carryback period in 1976, and seem to conclude that they thereby substantially complied with the statute, arguing that the requirement of an election statement is merely procedural.

If by this taxpayers mean that no election of any kind is essential to the statute, the argument can be dismissed out of hand; the plain language of the statute requires not only that a taxpayer be entitled to a net operating loss carryback, but also that he make an “irrevocable” election “to relinquish the entire carryback period with respect to a net operating loss for [the] taxable year...” 26 U.S.C. § 172(b)(3)(C). Were taxpayers' argument correct, every taxpayer with a net operating loss would automatically be held to have substantially complied with the statute without taking any steps to make an election or having desired to so elect at all.

Young v. Commissioner, 783 F.2d 1201, 1205 (5th Cir. 1986).

The Commission finds that the requirements for making the election clearly provide that since the return was filed by the original due date, the election to forego the carryback of the NOL must have been made by the original due date, April 15, 2009. The petitioners' argument is that since their paper copy of the return filed with the Commission shows that they elected to forego the carryback, this should be considered to have been sufficient compliance with the election requirement. The Commission disagrees. Accordingly, the 2008 NOL is not an allowable deduction on the petitioners' 2008 Idaho income tax return.

The petitioners also contend that the statute of limitations had expired for the Commission to adjust the 2008 Idaho income tax return. The petitioners cited no authority for this position. Idaho Code § 63-3068 limits the time that the Commission is allowed to issue an NODD to taxpayers. No NODD was issued to the petitioners for 2008.

Income Tax Administrative Rule 201 stated, in part:

201. NET OPERATING LOSS CARRYBACKS AND CARRYOVERS
(RULE 201).

Section 63-3022(c), Idaho Code.

(7-1-99)

* * *

02. Adjustments to Net Operating Losses. (3-20-97)

a. Adjustments to a net operating loss shall be determined pursuant to the law applicable to the loss year. (3-20-97)

b. Adjustments to a net operating loss deduction may be made even though the loss year is closed due to the statute of limitations. (3-20-97)

Clearly, Rule 201 allows for the adjustment of the deduction on the 2009 and 2010 Idaho income tax returns for which the NODD was issued. Further, the burden of proof regarding deductions is on the taxpayer. In addressing this issue, the U.S. Supreme Court stated the following:

Whether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed.

* * *

Obviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms.

New Colonial Ice Co., Inc. v. Helvering, 292 U.S. 435, 440 (1934).

The Commission finds that the petitioners have failed to carry their burden of proof that they are entitled to the deduction sought.

THEREFORE, the Notice of Deficiency Determination dated June 26, 2012, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax, penalty, and interest (computed to November 30, 2012):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2009	\$1,295	\$65	\$141	\$1,501
2010	816	41	50	907
			TOTAL DUE	<u>\$2,408</u>

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

An explanation of the petitioners' right to appeal this decision is enclosed.

DATED this _____ day of _____ 2012.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2012, 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.
