BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 24965
[Redacted],	)	
	)	
Petitioners.	)	DECISION
	)	

The Idaho State Tax Commission's (Commission) Income Tax Audit Bureau (ITA) issued a Notice of Deficiency Determination to [Redacted] (petitioners) proposing additional income tax and interest for taxable year 2008 (taxable year) in the total amount of $1,679. The petitioners filed a timely protest and petition for redetermination (petition). The petitioners were informed of their appeal rights. The petitioners did not request an informal hearing or provide any additional information subsequent to the issuance of the Commission's hearing rights letter. The Commission, having reviewed the file, hereby issues its decision.

I. IN GENERAL

The petitioners timely filed their Idaho resident individual income tax return for the taxable year. The petitioners claimed an Idaho capital gain deduction of $19,132 in arriving at the petitioners' Idaho taxable income for the taxable year.

On February 29, 2012, the ITA issued its Notice of Deficiency Determination (NODD) in which the ITA disallowed the petitioners' $19,132 Idaho capital gain deduction. In its NODD, the ITA set forth the following justification for the disallowance of the deduction:

> The Idaho capital gains deduction was claimed for the tax year 2008 on the gain of the sale of Idaho property. According to your income tax return, the deduction was taken on the gain of the sale of property listed as [Redacted].
>
> **Idaho Code section 63-3022H(3)** provides in part that "qualified property" means the property must have an Idaho situs at the time of sale and must be tangible personal property used in Idaho for at least twelve (12) months by a revenue-producing enterprise.

> **Idaho Code section 63-3022H(4)(b)** defines an "revenue-producing enterprise" as an operation that is engaged in the storage, warehousing, distribution, or sale at wholesale of any products of agriculture, mining or manufacturing.
>
> **Idaho Income Tax Administrative Rule 172.02** provides examples of activities that do not qualify as a revenue-producing enterprise. Transportation activities are specifically identified as an example of an activity that does not qualify as a revenue-producing enterprise **unless the transportation activity is an integral part of a qualifying activity of the taxpayer**. For example, if the taxpayer was engaged in production of a manufactured product and as part of that activity also transported the product to distributors, the transportation activity would be an integral part of a qualifying activity and the property used for transportation would qualify. **But if the taxpayer simply provided transportation for someone else's product, the taxpayer is not engaged in a revenue-producing enterprise.**
>
> According to your Schedule C Profit or Loss From Business, you are engaged in [Redacted]. Your tax preparer stated that you were [Redacted] industry. All assets used in your business are transportation assets such as [Redacted].
>
> According to these findings, your transportation activities are not considered a qualifying activity for the purpose of the Idaho capital gains deduction, as you are providing transportation for someone else and are not engaged in production. As a result, the Idaho capital gains deduction in the amount of $19,132 has been disallowed and your return has been adjusted accordingly.

The petitioners' representative filed the petition, on behalf of the petitioners, disagreeing with the ITA's finding that the petitioners are not entitled to the Idaho capital gains deduction and arguing instead that:

> In your Explanation of Items section of the Notice of Deficiency, you cite Idaho Income Tax Administrative Rule 172.02. Specifically, you reference transportation activities that are non-qualifying activities for purposes of the Idaho Capital Gains Deduction. This reference is to the Rules in effect as of 4/17/11; however, the tax year in question is 2008.
>
> The Rules were amended effective 4/17/11. Idaho Code Section 63-3022H was amended by House Bill Number 388, which was signed by the Governor on 2/16/10, and made effective as of 1/1/10.
>
> The Code and Rules in place for a 2008 income tax return were different than the Code and Rules you have cited. We believe the Code and Rules in place for 2008 income tax returns do in fact allow a capital gains deduction for the sale of the

> equipment sold in 2008. We believe that by virtue of taking action to specifically exclude certain activities from the definition in 2010 and 2011 implies that those activities were originally included, advertently or inadvertently, in the definition. Otherwise, there would be no need to amend the Code and the Rules.
>
> Rule 172.01 in 2008 states, "a revenue-producing enterprise does not include retail sales, professional, managerial, or repair services." The Rule did not exclude [Redacted]. If the [Redacted] in this case, was not a revenue-producing enterprise, a reasonable person would assume it would have been specifically excluded in Rule 172 in 2008; after all, other activities were specifically excluded.
>
> We believe our business was a "revenue-producing enterprise" that was in "the production, assembly, fabrication, manufacture, or processing of any agricultural, mineral or manufacturing product." [Redacted] is an integral part of the production, assembly, fabrication, manufacture, or processing of timber into lumber.

II. ANALYSIS AND FINDING

The petitioners argue that the [Redacted], in this case [Redacted], under the Idaho statute and rules that were in place for taxable year 2008, would qualify as a revenue-producing activity, and the gain on the sale of [Redacted] equipment would qualify for the section 63-3022H, Idaho Code, capital gains deduction.

A. Section 63-3022H, Idaho Code

Section 63-3022H, Idaho Code, governs the Idaho capital gains deduction. In 2008, section 63-3022H, Idaho Code, stated, in pertinent part,[1]

> 63-3022H. Deduction of capital gains. (1) If an individual taxpayer reports capital gain net income in determining taxable income . . . sixty percent (60%) . . . of the capital gain net income from the sale . . . of qualified property shall be a deduction in determining Idaho taxable income.
> . . .
> (3) Property held by . . . an individual is "qualified property" under this section if the property had an Idaho situs at the time of sale and is:
> . . .
> (b) Tangible personal property used in Idaho for at least twelve (12) months by a revenue-producing enterprise;

[1] The statutory language 2008 is identical to the statute's current language as of the date of this decision except that an amendment was made in 2010 to define real property. The 2010 amendment is inapplicable to the "revenue-producing enterprise" issue in this docket. See 2010 Idaho Session Laws ch. 5, sec. 1, pg. 6, H. B. 388.

> . . .
> (4) As used in this section "revenue-producing enterprise" means:
> (a) The production, assembly, fabrication, manufacture, or processing of any agricultural, mineral or manufactured product;
> (b) The storage, warehousing, distribution, or sale at wholesale of any products of agriculture, mining or manufacturing;
> . . .

Section 63-3022H, Idaho Code, is silent with respect to the transporting of [Redacted] or the harvesting of [Redacted] as an activity qualifying as a revenue producing activity.

B. Idaho Income Tax Administrative Rules

For 2008, Idaho Income Tax Administrative Rule 172, IDAPA 35.01.01.172 (2008 edition) stated:

> **172. IDAHO CAPITAL GAINS DEDUCTION -- REVENUE-PRODUCING ENTERPRISE (RULE 172).** Section 63-3022H, Idaho Code.
>
> **01. In General**. Only the activities listed in Section 63-3022H(4), Idaho Code, qualify as a revenue-producing enterprise. A revenue-producing enterprise does not include retail sales, professional, managerial, or repair services.
>
> **02. Multiple Activities**. If a business is engaged in both revenue-producing and nonrevenue-producing activities, tangible personal property must be used in the revenue-producing activity to qualify for the Idaho capital gains deduction.

Rule 172 as written in 2008 was silent with respect to the transporting of [Redacted] or the harvesting of [Redacted] as an activity qualifying as a revenue producing activity.

In the petition, the petitioners argue that since the transportation of [Redacted] was not identified as a disqualifying activity (i.e. retail sales, professional, managerial, or repair services), under the language of Rule 172 as that rule read in 2008, it would stand to reason that the transportation of [Redacted] would qualify.

Under Idaho income tax law, "[t]he terms "includes" and "including" when used in a definition contained in this act shall not be deemed to exclude other things otherwise within the

meaning of the term defined."[2] Simply because the harvesting of [Redacted] or the transportation of [Redacted] is not listed as a disqualifying activity within Rule 172's (2008 edition) language does not mean that such activities qualify as a revenue-producing enterprise.

In 2011, Idaho Income Tax Administrative Rule 172, IDAPA 35.01.01.172 (2011 edition), was amended to read as follows:

> **172. IDAHO CAPITAL GAINS DEDUCTION -- REVENUE-PRODUCING ENTERPRISE (RULE 172).** Section 63-3022H, Idaho Code. (3-20-97)
>
> **In General**. Only the activities listed in Section 63-3022H(4), Idaho Code, qualify as a revenue-producing enterprise. (4-7-11)
>
> **02. Nonqualifying Activities**. Examples of activities that do not qualify as a revenue-producing enterprise include the following: (4-7-11)
>
> **a.** Retail sales; (4-7-11)
>
> **b.** Professional or managerial services; (4-7-11)
>
> **c.** Repair services or other service related activities; (4-7-11)
>
> **d.** Transportation activities, unless they are an integral part of the taxpayer's qualifying activity; (4-7-11)
>
> **e.** Telephone, cable, and internet services; (4-7-11)
>
> **f.** Agricultural services, such as horse training, veterinarian services, and crop dusting. (4-7-11)
>
> **03. Multiple Activities**. If a business is engaged in both revenue-producing and nonrevenue-producing activities, tangible personal property must be used in the revenue-producing activity to qualify for the Idaho capital gains deduction. (3-20-97)
>
> **04. Examples**. (4-7-11)
>
> **a.** A taxpayer's Idaho business includes buying wool and processing it into yarn, using the yarn to manufacture clothes, and selling the clothes to the customers. Only part of the taxpayer's business activity qualifies as a revenue-producing enterprise. The activity related to retail sales does not qualify as a revenue-

[2] Section 63-3012, Idaho Code.

> producing enterprise and any tangible personal property used in that activity does not qualify for the Idaho capital gains deduction. (4-7-11)
>
> **b.** A taxpayer's Idaho business includes cutting timber in a forest, transporting the logs to a sawmill, processing the logs into plywood, and selling the plywood to a furniture manufacturer. The entire business qualifies as a revenue-producing enterprise, including the selling activity, because the selling activity is at wholesale. (4-7-11)
>
> **c.** A taxpayer's Idaho business includes growing potatoes and operating a long-haul trucking business unrelated to the potato operations. Only the portion of the Idaho business involved in activities necessary to the growing of potatoes qualifies as a revenue-producing enterprise. Tangible personal property used in the taxpayer's long-haul trucking business does not qualify for the Idaho capital gains deduction. (4-7-11)

The language contained within Rule 172 (2011 edition) simply reflects the Commission's interpretation of the statutory language that was in existence not only in 2011 but also in existence in 2008. Furthermore, in 2012, Idaho Income Tax Administrative Rule 001, IDAPA 35.01.01.001, was amended and included within that amendment was a requirement that "To the extent allowed by statute, rules in this chapter will be applied on their effective date to all taxable years open for determining tax liability." As such, given the facts and circumstances in this docket, it was not improper for the ITA to look to Rule 172's (2011 edition) language for guidance on what does or does not qualify as a revenue-producing enterprise.

Rule 172's (2011 edition) example 04.a treats [Redacted] activity of a taxpayer as a revenue-producing enterprise and includes a taxpayer's transportation of the [Redacted] as part of the <u>taxpayer's</u> revenue-producing enterprise. However, per Rule 172.02.d and Rule 172.04.c (2011 edition), transportation activities do not qualify as a revenue-producing enterprise unless the transportation activity is an integral <u>part of a qualifying activity of the taxpayer</u>. Thus the ITA was correct in disallowing the petitioners' capital gains deduction on the gain from the sale

of the [Redacted] that were used by the petitioners as part of providing transportation services for another person that was engaged in a revenue-producing enterprise.

It is the petitioners' burden of proving error on the part of the deficiency determination. Albertson's, Inc. v. State Dept. of Revenue, 106 Idaho 810, 814, (1984); Parsons v. Idaho State Tax Comm'n, 110 Idaho 572, 574 (Ct. App. 1986). Since the petitioners have not met this burden of proof, the Commission upholds the ITA's determination.

THEREFORE, the NODD dated February 29, 2012, and directed to the petitioners is hereby AFFIRMED by this decision.

IT IS ORDERED that the petitioners pay the following amount of tax and interest:

YEAR	TAX	INTEREST	TOTAL
2008	$1,472	$262	$1,784

Interest is calculated through May 31, 2013, and will continue to accrue at the rate set forth in Idaho Code section 63-3045.

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 _____ 2013.

IDAHO STATE TAX COMMISSION

_____

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2013, 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.

_____