BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 25277
[Redacted],	)	
	)	
Petitioners.	)	DECISION
	)	

[Redacted] (taxpayers) protest the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated September 20, 2012. The NODD asserted additional liability for Idaho income tax and interest in the total amount of $806 for taxable years 2006 and 2009.

The taxpayers filed their 2009 Idaho income tax return claiming a net operating loss incurred in taxable year 2008. The auditor denied this loss, thereby producing the asserted liability referred to above.

The issue is not whether the taxpayers incurred the loss, but rather, are the taxpayers entitled to carry the loss forward rather than carry the loss to an earlier year.

Idaho Code section 63-3022 stated [2007], 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. <u>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.</u> (Underlining added.)

Rule 201 sets 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 taxpayers' 2008 Idaho income tax return was filed electronically on August 30, 2009. In that return, no information was present indicating that the taxpayers intended to forgo the carryback of the net operating loss. The taxpayers could have carried the loss in question to the second preceding year, 2006, as there was sufficient income to have absorbed the net operating loss. However, the taxpayers did not file a claim for taxable year

2006 to claim this available loss. Upon receiving the notice from the auditor that the net operating loss (NOL) was going to be disallowed on the 2009 return, the taxpayers' CPA advised the auditor that it was at all times the taxpayers' intent to carry forward the NOL. The CPA further stated that the taxpayers knew that they had income to which they could carry back the NOL, but chose not to amend the prior year return because they wanted to carry the NOL forward.

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

> 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).
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> 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 taxpayers' argument is that the lack of an amended return in the preceding years to claim the NOL carryback, with no such notice having been given to the Commission, is sufficient compliance with the election requirement. The Commission disagrees.

A review of the Idaho statute reveals that the carryback of the 2008 net operating loss was *mandatory* absent an election by the taxpayer to forgo the carryback. In this case, the taxpayers made no such election when they filed their 2008 Idaho income tax return. Instead, the taxpayers simply carried the net operating loss forward to 2009. The Idaho statute required the 2008 net operating loss to be carried back to the preceding two tax years before the net operating loss could be carried forward. As a result of having been carried back to the prior two tax years, the taxpayers did not have an Idaho net operating loss carry forward available as a deduction in taxable year 2009.

Therefore, the Commission upholds the auditor's disallowance of the 2008 net operating loss carry forward deduction as a deduction in arriving at the taxpayers' 2009 Idaho taxable income.

THEREFORE, the Notice of Deficiency Determination dated September 20, 2012, and directed to [Redacted], is hereby APPROVED and MADE FINAL.

IT IS ORDERED that the taxpayers pay the following tax and interest (computed to May 22, 2013):

YEAR	TAX	INTEREST	TOTAL
2006	0	0	0
2009	$725	$92	$817
		TOTAL DUE	$817

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

An explanation of the taxpayers' 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.

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