

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
) DOCKET NO. 25355
[Redacted],)
)
)
) Petitioner.) DECISION
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_____)

BACKGROUND

On August 16, 2012, the Audit Division (Audit) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to [Redacted] (Petitioner), proposing income tax, penalty, and interest for taxable years 2008 through 2010 in the total amount of \$39,985. On October 17, 2012, the Petitioner’s accountant filed a timely protest. The file was transferred to the Tax Policy Section (Policy) on February 7, 2013, for resolution. The Commission sent a letter dated February 28, 2013, to the Petitioner and their representative under a limited Power of Attorney (POA) explaining the options for resolving a protested audit.

ISSUES

1. Whether Audit was correct under Idaho Code section 63-3027(r)(2) to source sales to Idaho, based on a ratio in proportion to other taxable years, in the calculation of the Idaho sales factor for taxable year 2008.
2. Whether the imposition of a negligence penalty under Idaho Income Tax Administration and Enforcement Rule 410.01 is appropriate.

DISCUSSION

When calculating the apportionment factor for taxable year 2008, the Petitioner reported zero sales for Idaho. Then, without explanation, they recorded Idaho sales amounts for taxable years 2009 through 2010. The NODD was prepared using an Idaho sales amount for taxable

year 2008 that was in the same proportion to the payroll as 2009 and 2010. Audit sent the Petitioner a letter, dated November 13, 2012, requesting information supporting its position.

The Petitioner's accountant requested until November 30, 2012, to provide data. On November 30, 2012, the Petitioner asked for more time until January 31, 2013, to send information. After no reply from the Petitioner or their representative, Audit issued the NODD. The "Cost of Performance" argument was first raised by the Petitioner's representative in the protest letter, offering several court cases and explaining the statute and its application.

Audit Position – The auditor made an estimate of the Idaho sales based on an estimate of the flow-through sales from [Redacted] ([Redacted]). That [Redacted] estimate was formed by looking at the subsequent two years Idaho tax returns. The sales tended to be close to a multiple (3 times) of the payroll.

Petitioner's Position – The Petitioner is comparing the costs incurred in Idaho to the total everywhere costs. In the answer to the auditor's questions on the costs of performance, the Petitioner compared the Idaho payroll ratio 0.6828 percent to the California payroll factor. The flaw in that logic is that it would presume that the payroll and other costs in California were incurred to generate sales in Idaho. The Cost of Performance principle is asking where the costs of generating the Idaho revenue were incurred, not the size of the Idaho costs in comparison to the everywhere costs. That is the purpose of the apportionment factor itself.

Quoting from Docket No. 21735;

"The Commission finds that the "transactional" approach is more in line with Idaho's interpretation of the statutory language and is less susceptible to abuse and manipulation. The language contained within Idaho Income Tax Administrative Rule 550.05 dealing with special rules and examples supports a "transactional" interpretation." In the examples that follow, also

cited by the Petitioner, the starting point is the gross receipts in Idaho and then analyzes the costs that were incurred to produce that revenue.” Underline added.

After the NODD was transferred to Policy, the Petitioner’s POA answered the original audit letter. The answers were limited to [Redacted], saying that the Petitioner is a holding company and has little of its own expenses. The answers were limited because they begin with the attitude that there is so little cost incurred in Idaho compared to [Redacted] and elsewhere that it does not warrant looking. One of the questions in the letter the auditor sent to the Petitioner asks for a 51 state breakdown of the apportionment factors. Their response shows no Idaho sales. In researching the possible activities within Idaho, it was discovered, as a matter of public record, the State of Idaho employee’s pension plan has significant investments in some of the Petitioner’s funds. So, there are undoubtedly some Idaho sales. The correct approach to determine the Idaho sales to be sourced to Idaho for apportionment factor purposes would be to analyze those sales, and the costs that were necessary to produce those sales, to assess whether the greater portion of those costs were incurred in Idaho or outside of Idaho.

LAW AND ANALYSIS

The Idaho taxable income of corporations and partnerships that do business both within and without Idaho is calculated according to Idaho Code § 63-3027 and the related rules.

63-3027(i) (1) says in part “ ... Idaho Code, all business income shall be apportioned to this state under subsection (j) of this section 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)...”

Idaho Code section 63-3027(r)(2):

(r) Sales, other than sales of tangible property, are in this state, if:

...

(2) The income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance. Underline added.

The Petitioner has not answered the primary question raised by Audit. They maintain they are unable to provide the gross sales to Idaho customers. Among other things, Audit asked for a copy of the study and analysis that resulted in the conclusion that the sales are properly sourced to a state other than Idaho. Idaho law and tax administrative rules are very specific on documentation requirements.

A “Cost of Performance” analysis is a fact intensive process. The purpose of our audit process is to review and verify, to the extent possible, the facts and conclusions presented by taxpayers. The starting point is the total Idaho sales and identifying the direct costs incurred in making those sales. The direct costs incurred within Idaho are then compared to the direct costs incurred elsewhere. The Petitioner’s representative insists that there is no way to track the Idaho sales and no direct costs are incurred within Idaho, therefore, it doesn’t matter what the sales within Idaho are, the direct costs will always be greater elsewhere. All Idaho taxpayers are required to provide proper evidence to substantiate the position taken on their income tax returns. The general statement that the company’s headquarters are outside Idaho and direct costs will always be greater outside of Idaho is not sufficient to meet the standards of a Cost of Performance study.

Idaho Administrative and Enforcement Rule:

201. EXAMINATION OF RECORDS: RECORDKEEPING AND PRODUCTION REQUIREMENTS Sections 63-3042 and 63-3043, Idaho Code.

01. In General. a. A taxpayer shall maintain all records that are necessary to a determination of the correct tax liability. Required records must be made available

on request by the Tax Commission or its authorized representatives. The time and place for production shall be reasonable and shall occur during regular business hours. When books and papers are requested they will be relevant and reasonable documentation for the issues under examination. The request for information is relevant if it is germane to or applicable to an audit issue.

Idaho Income Tax Administration Rule 450:

04. Verification of Factors. The taxpayer shall make available the fifty-one (51) state apportionment factor detail when requested by the Tax Commission. Failure to do so may justify the imposition of the negligence penalty provided by Section 63-3046(a), Idaho Code.

The 51 state apportionment factor detail is important to confirm that the total of property, payroll and sales in the apportionment denominators is not greater than the amounts used in the numerators.

Idaho Income Tax Administration Rule 550:

03. Costs of Performance. Costs of performance are the direct costs determined in a manner consistent with generally accepted accounting principles and according to accepted conditions or practices of the taxpayer's trade or business to perform the income producing activity that gives rise to the particular item of income. Included in the taxpayer's cost of performance are taxpayer's payments to an agent or independent contractor for the performance of personal services and utilization of tangible and intangible property that give rise to the particular item of income.

CONCLUSION

First issue – Whether Audit was correct under Idaho Code section 63-3027(r)(2) to source sales to Idaho, based on a ratio in proportion to other taxable years, in the calculation of the Idaho sales factor for taxable year 2008.

As discussed above, a “Cost of Performance” analysis is fact-intensive. Since the Petitioner controls the facts and information, that becomes difficult - if not impossible - especially with a non-public entity, for the Commission to perform the necessary analysis without the cooperation of the Petitioner.

A Notice of Deficiency Determination issued by the Idaho State Tax Commission is presumed to be accurate. Parsons v. Idaho State Tax Com'n, 110 Idaho 572 (Ct. App. 1986). The burden is on the taxpayer to show the deficiency is erroneous. Albertson's, Inc. v. State, Dept. of Revenue, 106 Idaho 810 (1984).

Having presented inadequate information in support of their position during the audit or redetermination process, the Petitioner has failed to meet its burden of proving error on the part of the deficiency determination. Absent information to the contrary, the Commission accepts Audit's calculation of Idaho income tax, penalty, and interest for those years.

THEREFORE, the Notice of Deficiency Determination dated August 16, 2012, and directed to the Petitioner is hereby AFFIRMED as Modified.

| <u>YEAR</u> | <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|------------|----------------|-----------------|-----------------|
| 12/31/08 | \$30,183 | \$4,502 | \$5,828 | \$40,513 |
| 12/31/09 | 240 | 12 | 36 | 288 |
| 12/31/10 | 240 | 12 | 24 | <u>276</u> |
| | | | TOTAL DUE | <u>\$41,077</u> |

Interest is calculated through November 30, 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 Petitioner's 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.
