

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
[Redacted],) DOCKET NO. 25962
Petitioner.)
DECISION
_____)

BACKGROUND

On April 29, 2013, the Audit Bureau (Audit) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to [Redacted](Petitioner) proposing changes to the amended returns for taxable years 2008 through 2011. The Petitioner has elected to be treated as a Subchapter S Corporation (S-corp.) on their [Redacted] income tax returns. An S-corp. is a pass-through entity, therefore all income, expenses, and credits are reported on the owner’s income tax return and no income tax is owed at the entity level. Any adjustments as a result of this audit flow through to the owner’s individual returns. On June 27, 2013, the Petitioner filed a timely protest. On October 3, 2013, the file was transferred to the Legal/Tax Policy Division for resolution. On February 3, 2014, the Commission sent a letter outlining the options for resolving a protested audit.

ISSUES

1. Whether the Petitioner is entitled to the Credits for New Employees claimed on their amended returns.
2. Whether the Petitioner met the requirements to earn a Credit for Research Expense in Idaho.

DISCUSSION

According to the amended returns, the Petitioner conducted an internal study to determine the research credit and new employee credit. Amended returns were filed for all of the above-listed tax years claiming the business credits. A copy of the internal study was requested. After numerous emails from the representative, we still have not received any information. The Commission now makes this decision with the information available in the file.

Issue 1. Whether the Petitioner is entitled to the Credits for New Employees claimed on their amended returns.

There are two different credits that were available during taxable years 2008, 2009, and 2010. There was a \$500 credit and a \$1,000 credit. Both of these credits are based on hiring employees in excess of the average number of employees for the three preceding years. Another requirement is that the employee must have been performing such duties for the employer for a minimum of nine months during the taxable year.

In order to qualify for the \$500 credit, the taxpayer has to meet the definition of a “revenue-producing enterprise.” A revenue-producing enterprise is defined in Income Tax Administration Rule 745.01, and to qualify for the \$1,000 credit, the employee claimed has to be eligible for health insurance, as defined in section 105 of the Internal Revenue Code.

745.01 In General. A revenue-producing enterprise means an Idaho business that begins with a natural resource and produces, assembles, fabricates, manufactures, or processes a value-added product. A revenue-producing enterprise includes a business that conducts or is engaged in the following:

- a. Farming activities identified in Section 464, Internal Revenue Code, that result in a value-added product;
- b. Mining;
- c. Logging;
- d. Extracting a natural resource.

63-3029F. Special credit available—New employees.

(1) Any taxpayer shall be allowed a credit, in an amount determined under subsection (2) of this section, against the tax imposed by this chapter, other than the tax imposed by section 63-3082, Idaho Code, for any taxable year during which the taxpayer's employment of new employees, as defined under section 63-3029E(1), Idaho Code, increases above the taxpayer's average employment for either:

(a) the prior taxable year, or (b) the average of three (3) prior taxable years, whichever is higher. No credit shall be allowed under this section unless the number of new employees equals or exceeds one (1) person.

(2)(a) The credit authorized in subsection (1) of this section shall be:

(i) Five hundred dollars (\$500) per new employee described in subsection (2)(d) of this section; or

(ii) One thousand dollars (\$1,000) per new employee described in subsection (2)(c) of this section, but not both.

(b) The total credit allowed by this section shall not exceed three and one-quarter percent (3.25%) of net income from the taxpayer's corporate, proprietorship, partnership, small business corporation or limited liability company trade or business in which the employment occurred. Additionally, the total amount of this and all other credits allowed under this chapter except for the credits allowed under section 63-3029, Idaho Code, shall not exceed fifty percent (50%) of the tax liability of the taxpayer. The tax liability of the taxpayer shall be the tax after deducting the credit allowed by section 63-3029, Idaho Code.

(c) The one thousand dollar (\$1,000) credit shall apply to an employee who, in the calendar year ending during the taxable year for which the credit is claimed, received annual earnings at an average rate of fifteen dollars and fifty cents (\$15.50) or more per hour worked and who, during such calendar year, was eligible to receive employer provided coverage under an accident or health plan described in section 105 of the Internal Revenue Code.

(d) The five hundred dollar (\$500) credit shall apply to an employee not described in subsection (2)(c) of this section and who is employed in a revenue-producing enterprise as defined in section 63-3029E, Idaho Code.

In the present case, the Petitioner's business does not qualify as a revenue-producing enterprise under this definition, because they do not start with a raw material. The Petitioner claimed the \$500 credit for four new employees in 2008 and 2009. The Petitioner claimed six of the \$1,000 credits in 2009 and four of the \$1,000 credits in 2010. The Petitioner did not provide evidence that the employees were eligible for employer-provided health care and did not provide the evidence that they met the nine month employment requirement.

Issue 2. Whether the Petitioner met the requirements to earn a Credit for Research Expense in Idaho.

The Petitioner claimed a credit for research activities in taxable years 2008, 2009, and 2010.

- 63-3029G. Credits for research activities conducted in this state—Carry forward.
- (1)(a) Subject to the limitations of this section, for taxable years after January 1, 2001, there shall be allowed to a taxpayer a nonrefundable credit against taxes imposed by sections 63-3024, 63-3025 and 63-3025A, Idaho Code, for increasing research activities in Idaho beginning, at the election of the taxpayer, either:
- (i) January 1, 2001, or
 - (ii) The first day of the taxpayer's taxable year beginning in 2001.
- (b) The credit allowed by subsection (1)(a) of this section shall be the sum of:
- (i) Five percent (5%) of the excess of qualified research expenses for research conducted in Idaho over the base amount; and
 - (ii) Five percent (5%) basic research payments allowable under subsection (e) of section 41 of the Internal Revenue Code for basic research conducted in Idaho.

In order for an activity to qualify for the research credit, the taxpayer must show that it meets all the requirements as described in section 41(d). Under section 41(d), the term “qualified research” means research:

1. With respect to which expenditures may be treated as expenses under section 174, (also known as the section 174 test), R&D expenses that are reasonable under the circumstances;
2. Which is undertaken for the purpose of discovering information which is technological in nature, (also known as the discovering technological information test);
3. The application of which is intended to be useful in the development of a new or improved business component of the taxpayer (also known as the business component test); and
4. Substantially all of the activities of which constitutes elements of a process of experimentation for a qualified purpose (also known as the process of experimentation test).

To be considered “qualified research”, the taxpayer must be able to establish that the research activity being performed meets ALL four of the above tests. These tests must be applied separately to each business component of the taxpayer.

When an employee has performed both qualified and nonqualified services, only the amount of wages attributable to the conduct of qualified services may be counted as a Qualified Research Expense (QRE). However, if 80 percent or more of an employee's wages are allocated to the performance of qualified services, then all of the employee's wage can be counted as a QRE.

The statement attached to the amended returns said that the company did an internal study and determined that they were qualified to claim some credits for research activities. Audit requested a copy of the study, but that was never provided. Instead, the Petitioner provided copies of order forms and invoices for what appears to be normal sales to customers. There is no explanation of how this is related to research or what activities qualify as QREs.

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).

200.EXAMINATION OF RECORDS: DEFINITIONS (RULE 200).

Sections 63-3042 and 63-3043, Idaho Code. For purposes of Rules 200 through 204, the following definitions apply:

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.

Having presented no information in support of their position, the Petitioner did not meet their 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 NODD dated April 29, 2013, and directed to [Redacted] is hereby AFFIRMED.

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

DATED this _____ day of _____ 2015.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2015, 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.
