

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
) DOCKET NO. 26029
[Redacted],)
)
)
) Petitioners.) DECISION
)
_____)

[Redacted] (Petitioners) protested the Notice of Deficiency Determination dated September 20, 2013, asserting additional income tax, penalty, and interest for taxable years 2009, 2010, 2011, and 2012 in the total amount of \$65,327. Petitioners disagreed that their contributions to the [Redacted] were overstated and the goods and services received by auction were understated. Petitioners further disagreed with the adjustment to their Idaho investment tax credit. The Tax Commission, having reviewed the file, hereby issues its decision.

BACKGROUND

The Income Tax Audit Bureau (Bureau) selected Petitioners’ 2009 and 2010 Idaho individual income tax returns to examine the investment tax credit that flowed through to Petitioners from their wholly-owned limited liability companies. Upon review of Petitioners’ returns, the Bureau decided to expand the scope to include Petitioners’ 2011 and 2012 income tax returns for a review of Petitioners’ Schedules A, C, and E for all the years.

The Bureau requested documentation from Petitioners, which Petitioners provided. The Bureau reviewed the information provided and determined Petitioners did not accurately report their charitable contributions on certain auction items. The Bureau determined the fair market value of the auction items was either 1) understated or 2) there was not enough documentation to substantiate the contribution. The Bureau also disallowed some of the investment tax credit

claimed on investment property that was determined not to be qualified investment property. The Bureau sent Petitioners a Notice of Deficiency Determination, which Petitioners protested.

Petitioners' protest letter spoke specifically to the adjustments made to their charitable contributions. Petitioners argued that the Acknowledgment of Contribution statements they received from [Redacted], for the items they received at auction, were good faith estimates of the fair market values of the goods and services they received. Petitioners stated all excess amounts paid were properly and fully deductible as charitable contributions within the meaning of Treasury Regulation 1.170A-1(h)(1)(i) and Revenue Ruling 67-246. Petitioners believe the auditor did not have complete and actual factual information and she lacked a complete understanding of the facts pertaining to the purchase of the items by auction from [Redacted]. Petitioners requested an informal conference with the Commission.

The Bureau acknowledged Petitioners' protest and referred the matter for administrative review. The Tax Commission reviewed the matter and sent Petitioners a letter that discussed their options for redetermining a protested Notice of Deficiency Determination. Petitioners requested a hearing which was held on June 8, 2015. In attendance at the hearing with Petitioners were [Redacted], Petitioners' attorney, [Redacted], [Redacted], and [Redacted].

Petitioners described themselves as [Redacted]; specifically for [Redacted]. Mr. [Redacted] is a lifetime member of [Redacted]. Petitioners stated Mr. [Redacted] spends about 25 percent of his time with [Redacted]. Petitioners have served as officers and board members of [Redacted]. Mr. [Redacted] was the first Idahoan to successfully acquire an Idaho [Redacted] by auction. Petitioners stated their primary motivation in bidding for the [Redacted].

Petitioners argued the dual payment nature of the contributions; goods and services received and the charitable donation. Petitioners stated Internal Revenue Code section 170

permits a deduction for the portion of a dual payment that consists of a charitable contribution, but not for the portion for which a benefit is received in return. (Citing Sklar v. Comm'r of Internal Revenue, 282 F.3d 610, 620 (9th Cir. 2002)). Petitioners stated the charitable portion of a dual payment entitles a taxpayer to a deduction if the taxpayer intended to make a payment in excess of the fair market value of the goods and services received and actually makes a payment in excess of the fair market value. (See 26 CFR 1.170A-1(h)(1)). Petitioners stated that the items at issue ([Redacted]) are historically valued at the [Redacted]. Petitioners stated they received receipts from [Redacted] that provided the fair market value of the items purchased at [Redacted]. Petitioners stated a taxpayer is entitled to rely on such receipts unless they know or have reason to know the valuation is unreasonable. (See CFR 1.170A-4(h)).

Petitioners stated the Bureau's reliance on the standard of a willing buyer and willing seller in the determination of fair market value has no relevance to sales at charity auctions. Petitioners stated the willing-buyer-willing-seller standard of Treasury Regulation 1.170A-1(c) is for the determination of the value of contributed property for a donor but it does not define the fair market value of items purchased at charity auctions. Petitioners stated the standard assumes a "hypothetical" buyer and seller, but since a piece of property was donated there is no actual sale and the presumption of being dedicated to achieving the maximum economic advantage is not present in a charitable endeavor. Petitioners stated using this standard at a charitable auction would essentially conclude that no portion of the amount paid constitutes a charitable donation. Petitioners stated their motive was not to gain the maximum economic advantage, but rather to financially support a charity whose purpose was in line with their interests and objectives. Petitioners stated the Tax Commission should not question the valuation as

determined by [Redacted]. [Redacted] is an expert on [Redacted]. Petitioners argued there is no difference between a [Redacted].

Petitioners stated that if they wanted to [Redacted]. Petitioners stated for them it was not a matter of getting a [Redacted]. Petitioners stated they have been awarded [Redacted].

Petitioners stated the [Redacted], they successfully bid on, were not the [Redacted] as stated in the audit report. Petitioners stated their first [Redacted] was very rudimentary. Petitioners stated that after their [Redacted], when they returned for other [Redacted]. Petitioners stated the living conditions in the villages near [Redacted] were very poor and they desired to help out where they could.

Both the [Redacted]. Petitioners viewed their contributions in excess of the value of any goods or services they received as an investment in the [Redacted].

Regarding the [Redacted] Petitioners were awarded or successfully bid on, the [Redacted] has yet to be given to Petitioners. The [Redacted] was returned to its maker for modification after Petitioners successfully bid on it. The [Redacted] has never been returned to [Redacted] to be given to Petitioners. [Redacted], to make things right with Petitioners, offered and even presented Petitioners with a check for the amount of Petitioners' bid on [Redacted]. Petitioners refused the check and told [Redacted] to consider it as a donation to [Redacted]. A copy of the [Redacted] check to Petitioners was presented to support Petitioners' statements.

In addition to Petitioners' statements during the hearing, the Deputy Director of [Redacted] detailed the benefits of the charitable auctions. They identified the process of how the charities obtained [Redacted]. They also spoke to how the auctions were run and that the event is geared to the whole family with exhibits, speakers, and vendors. Mr. [Redacted] stated in regards to Petitioners' philanthropic nature that he has seen Petitioners bid against themselves

during the auction event. Clearly Petitioners were not seeking to gain the maximum economic benefit on the auctioned items. As to the value of the goods and/or services received by the winning bidder at the auction, Mr. [Redacted] stated the value was determined by the cost that the same item or service could be purchased from a vendor, dealer, or outfitter. Mr. [Redacted] stated that more recently [Redacted] has started to hire [Redacted] so the value is predetermined by the [Redacted].

In addition to Petitioners contesting the disallowance of their charitable contributions, Petitioners stated they disagreed with the adjustment to the investment tax credit claimed for taxable years 2009 and 2010. Petitioners did not have the information available at the hearing but said they would provide the Tax Commission with a recent cost segregation study and a breakdown of the items claimed as qualified investment property. The Tax Commission did receive additional information from Petitioners and followed up with Petitioners regarding that information. Petitioners provided more documentation from which the Tax Commission was able to make its redetermination.

LAW AND ANALYSIS

Charitable Contributions:

Internal Revenue Code (IRC) section 170 allows as a deduction any charitable contribution payment which is made within the taxable year. Subsection (c) defines “charitable contribution” to include a contribution or gift to or for the use of a foundation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals. [Redacted] is an IRC section 501(c)(3) organization which the IRC

identifies as an exempt organization and any contributions to it are considered charitable contributions.

There is no question Petitioners made substantial payments to [Redacted] during 2009 through 2012. However, the Bureau contends Petitioners' payments were for goods and services received and not charitable contributions. Petitioners argued the charitable contributions claimed are the result of the amounts paid during charitable auctions reduced by the fair market value of the goods and services received.

Treasury Regulation section 1.170A-1(c) states,

(c) Value of a contribution in property.

(1) If a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in section 170(e)(1) and paragraph (a) of §1.170A-4, or section 170(e)(3) and paragraph (c) of § 1.170A-4A.

(2) The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. If the contribution is made in property of a type which the taxpayer sells in the course of his business, the fair market value is the price which the taxpayer would have received if he had sold the contributed property in the usual market in which he customarily sells, at the time and place of the contribution and, in the case of a contribution of goods in quantity, in the quantity contributed. The usual market of a manufacturer or other producer consists of the wholesalers or other distributors to or through whom he customarily sells, but if he sells only at retail the usual market consists of his retail customers. (Underlining added.)

IRC section 6115 discusses contributions that are made under quid pro quo arrangements or dual payment scenarios. It states,

IRC section 6115 - Disclosure related to quid pro quo contributions.

(a) Disclosure requirement.

If an organization described in section 170(c) (other than paragraph (1) thereof) receives a quid pro quo contribution in excess of \$75, the organization shall, in connection with the solicitation or receipt of the contribution, provide a written statement which—

- (1) informs the donor that the amount of the contribution that is deductible for Federal income tax purposes is limited to the excess of the amount of any money and the value of any property other than money contributed by the donor over the value of the goods or services provided by the organization, and
 - (2) provides the donor with a good faith estimate of the value of such goods or services.
- (b) Quid pro quo contribution.

For purposes of this section, the term “quid pro quo contribution” means a payment made partly as a contribution and partly in consideration for goods or services provided to the payor by the donee organization. A quid pro quo contribution does not include any payment made to an organization, organized exclusively for religious purposes, in return for which the taxpayer receives solely an intangible religious benefit that generally is not sold in a commercial transaction outside the donative context.

The goods and services Petitioners bid on at [Redacted] auctions were donated to, acquired by, or contracted with [Redacted]; the [Redacted] from governmental agencies, the [Redacted] from a [Redacted]. Each of these entities or individuals regularly sells the items auctioned off by [Redacted] and each of the items auctioned had a readily available fair market value. This was the value [Redacted] placed on the auctioned items and was the value [Redacted] documented to the auction winner as required by IRC sections 170(f)(8) and 6115.

The Idaho [Redacted] Petitioners won at auction is a [Redacted] specifically provided for in the Idaho Code governing [Redacted] in the state of Idaho. (*See* Idaho Code section 36-408(5)). The [Redacted] for the purpose of raising funds to research and manage [Redacted] in Idaho. The [Redacted] is pulled from the regular quota of [Redacted] and is distinguishable from regular [Redacted] in that the successful bidder can choose the area to [Redacted], with one exception, and the lifetime rule does not apply if the successful bidder [Redacted]. These distinguishable characteristics are also true of the special [Redacted] and the Governor’s [Redacted]. These characteristics likely create a certain [Redacted] more than the general [Redacted].

Both the [Redacted]. [Redacted] has been awarded most of the [Redacted], which it auctioned off at its annual conventions. The successful bidder gets [Redacted], if needed, which is paid for out of the proceeds of the auction. In addition, [Redacted].

Upon the sale of the auctioned items, [Redacted] provides a statement of value of the items received to the successful bidder. [Redacted] values the [Redacted] at either the cost of a [Redacted], and the [Redacted] if one is needed. Any other goods and services included with [Redacted] values at the going rate. More recently [Redacted] has contracted with certain [Redacted] and has used their contract price as the value of the goods and services received.

The sale of [Redacted] is only done through and by [Redacted]. By statute, [Redacted] is permitted to auction off [Redacted]. [Redacted] is also permitted to sell [Redacted]. The auction [Redacted] were devised to provide funding for [Redacted] in Idaho. [Redacted] has been the contracting agent to promote and sell the auction [Redacted] for many years. When the winning bid is determined, [Redacted] is notified [Redacted]. The [Redacted] is issued at the price of either a resident or non-resident [Redacted], depending on the residency status of the winning bidder; the same as all other [Redacted] issued by [Redacted]. The price of [Redacted] is statutorily set by the Idaho legislature.

The [Redacted], the [Redacted], and the [Redacted] (yet to be awarded), offer a few advantages over a [Redacted] drawn through the regular lottery process. These advantages or benefits likely enhance the value these special [Redacted] over the value of the regular lottery [Redacted]; however, the fact remains the [Redacted] as part of its regular course of business, and the value of [Redacted] are priced by the Idaho legislature. Therefore, in the case of the [Redacted], as long as there is a donative intent any excess paid over the price of [Redacted] is considered a charitable contribution.

As for the [Redacted], in addition to [Redacted], Petitioners received [Redacted] services. The process of [Redacted] and outfitting was the same as for the Idaho [Redacted]. It is unknown from the facts, but presumably the government agencies issuing the permits in [Redacted] have the same relationship with [Redacted]. The Bureau asserted the purchases at auction of [Redacted] are equivalent to purchasing commercial [Redacted] from [Redacted] specializing in [Redacted]. Petitioners argued the auctions they were successful in winning were not the same as those provided by commercial [Redacted]. Petitioners stated that when an [Redacted] was included as part of the package, the amount of their charitable contribution was reduced by the value of the services provided.

Petitioners could have purchased [Redacted] and paid far less than what was paid at the auction. Granted the acquisition of [Redacted] at auction did allow Petitioners some additional [Redacted] not necessarily available with the traditional granting or purchasing process. But it also allowed Petitioners to channel their funds in support of the management and preservation of [Redacted]. Nevertheless, [Redacted] was an agent for the governing bodies selling [Redacted] as part of their governmental oversight. Therefore, the value of [Redacted] is the value regularly sold by the government agencies and any excess is a charitable contribution.

Investment Tax Credit:

Petitioners claimed an investment tax credit on qualified investments made by their wholly owned limited liability companies (LLCs). The Bureau disallowed a portion of the flow-through credit from [Redacted] for taxable years 2009 and 2010. The Bureau disallowed investments that were not readily identifiable as qualified investment property from the documentation Petitioners provided for taxable year 2009. The Bureau also disallowed the

amount of credit attributable to the bonus depreciation claimed on the qualified investment property for both taxable years 2009 and 2010.

Idaho Code section 63-3029B provides for a credit on the acquisition of certain qualified investment property placed in service during the taxable year. The Idaho Code defines qualified investment as property defined in Internal Revenue Code sections 46(c) and 48, with a few exceptions. Buildings and their structural components do not qualify as a qualified investment. In 2009 and 2010, [Redacted] made some improvements to a building (2009) and did a major expansion/addition to another building (2010). Petitioners determined certain expenditures were qualified investments and claimed the investment tax credit on those expenditures. The Bureau determined, from the documentation presented, that Petitioners claimed a credit on items properly classified as structural components of a building. Consequently, the Bureau disallowed the investment tax credit on those items.

Idaho Code section 63-3029B(8) further restricts the definition of qualified investments to exclude, “any amount for which a deduction is allowed under section 168(k) or section 179 of the Internal Revenue Code in computing Idaho taxable income.” [Redacted] claimed bonus depreciation (IRC section 168(k)) on some of the qualified investments claimed in 2009 and all of the qualified investments claimed in 2010. The Bureau disallowed the credit attributable to the bonus depreciation claimed.

As part of the additional information in support of their investment tax credit, Petitioners provided a cost segregation report prepared in 2015. The report was a breakdown of the construction costs to expand [Redacted] building in 2010. The report segregated the construction costs into IRC section 1250 property and IRC section 1245 property. The report gave an opinion as to what were structural components of the building and what were non-structural components.

Generally, the non-structural components of a building qualify as qualified investments for the Idaho investment tax credit.

Petitioners' cost segregation report reported total construction costs incurred significantly higher than what Petitioners reported on [Redacted] depreciation schedule. This being the case, the Tax Commission questioned the reliability of the cost segregation report. Nevertheless, based upon statements made by Petitioners' tax preparer, the Tax Commission believes Petitioners are entitled to additional investment tax credit.

Therefore, the Tax Commission took the information presented in Petitioners' cost segregation report and determined what additional costs [Redacted] incurred that could be qualified investments. The resulting adjustment to Petitioners' investment tax credit is shown in Appendix I.

Corresponding Adjustments:

The Bureau's adjustments for the Idaho state tax add back and to Petitioners' credit for taxes paid to another state were as a result of the adjustment to Petitioners' charitable contributions. Because the Tax Commission reversed the Bureau's determination on the charitable contributions, the corresponding adjustments for the Idaho state tax add back and the credit for taxes paid to another state are also reversed.

Use Tax:

The Bureau asserted a use tax on Petitioners for the tangible personal property Petitioners received from [Redacted] auctions. Use tax is an excise tax imposed on the storage, use, or other consumption of tangible personal property within Idaho. (Idaho Code section 63-3621) Tangible personal property purchased in another state, where no sales tax was paid, and brought into Idaho is subject to use tax. Petitioners' winning bids at the [Redacted] auctions awarded Petitioners with certain tangible personal property. Since sales tax was not paid or collected on the auction items Petitioners purchased and more than likely those items were stored, used, or consumed in Idaho, Petitioners owe use tax on the value of the items.

Idaho Code section 63-3621 states, the value of property is presumed to be a recent sales price. Winning bids at auction are considered the selling price of the item. Therefore, Petitioners owe use tax on the auction items purchased. However, Petitioners argued and provided proof that the auctioned item, [Redacted], was never received and that their winning bid

was converted a cash donation to [Redacted]. Petitioners also argued that for one of their donations all they received was their [Redacted] attached to a large [Redacted]. The Tax Commission reviewed the information presented and found the use tax addition should be reduced by the cash donation and [Redacted].

CONCLUSION

Petitioners' made considerable contributions to [Redacted] through charitable auctions. [Redacted] provided Petitioners with Acknowledgment of Contribution statements stating the contribution made and the value of any goods and services received. In regards to the [Redacted] Petitioners won at auction, [Redacted] at the purchase price set by the government agency issuing the [Redacted]. [Redacted] and acted as an agent for the governmental entity. Since the governmental entity regularly sells [Redacted], the fair market value of the [Redacted] is the price at which [Redacted] regularly sells. Therefore, the Tax Commission reverses the adjustment to Petitioners' charitable contributions.

Petitioners purchased tangible personal property in 2009 and 2010 that constituted qualified investment property for the Idaho investment tax credit. Errors were made in the determination of the basis of the qualified investment property in both the qualifying property and the adjustment due to depreciation. As a result, the Tax Commission recomputed the Idaho investment tax credit and modified the adjustment made to Petitioners' 2009 and 2010 Idaho income tax returns.

Petitioners acquired tangible personal property from [Redacted] auctions. Petitioners brought some of those items purchased into Idaho and consumed, stored, or used the items in Idaho. Since no sales tax was paid on the purchase of the items, Petitioners owed a use tax on the items when the items were brought into Idaho. The Bureau asserted use tax on all the auction

acquired tangible personal property Petitioners bid on and won. However, Petitioners provided evidence showing some of the items never came into Idaho. Therefore, the Tax Commission adjusted Petitioners' use tax to account for only those items received by Petitioners and brought into Idaho.

THEREFORE, the Notice of Deficiency Determination dated September 20, 2013, and directed to [Redacted] is AFFIRMED as MODIFIED by this decision.

IT IS ORDERED that Petitioners pay the following tax and interest:

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2009	\$ 1,318	\$287	\$ 1,605
2010	(10,761)	0	(10,761)
2011	0	0	0
2012	0	0	0
		TOTAL DUE	<u>(\$ 9,156)</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 _____ 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.

Appendix I
Adjustment to Idaho Investment Tax Credit

2009:	Reported	Allowed	Adjustment
Qualified Investments	\$75,825	\$75,825	\$ 0
Less: Bonus Depreciation	0	37,913	37,913
Qualified Investment Property	75,825	37,912	37,913
Credit Earned	2,275	1,137	1,138
Flow-through Credit	1,252	1,252	0
Total Credit Available	\$ 3,527	\$ 2,389	\$ 1,138

2010:	
Qualified Investments ([Redacted])	\$967,773
Less: Indirect Costs	299,639
Amount Previously Claimed	229,818
Additional Qualified Investment Property	438,316
Additional Investment Tax Credit	\$ 13,149

Use Tax Adjustment:	Per Audit	Per Decision	Change
Use Tax			
2009	\$ 180	\$ 180	\$ 0
2010	2,688	2,388	300