

Audit's Notice also denied a \$14,492 Small Employer Investment Tax Credit and a \$16,000 Small Employer New Jobs Tax Credit Petitioners claimed for tax year 2020. Audit stated that Form 89SE must be filed and receive approval before claiming any credits allowed under the Idaho Small Employer Incentive Act of 2005 and that no such form was filed by any of Petitioners' companies. Audit also stated that no pass-through entities were found reporting any of the credits on Form ID K-1.

The Notice provided Petitioners a 63-day period to file a written protest of the Notice, which ended on February 3, 2023. On February 3, 2023, Petitioners submitted an online response disagreeing with the Notice, stating that they received Forms ID K-1 from one of their companies showing the credits and providing copies to support their claim, along with Idaho Form 83 and Idaho Form 85, which indicate that [REDACTED] [REDACTED] [REDACTED] qualified for the claimed credits. Within their response, they wrote, "We believe these amounts to be true and accurate and valid pass-through credits for our individual return."

Audit sent Petitioners a letter on February 17, 2023, requesting all information required for a valid protest by March 17, 2023. On March 17, 2023, Petitioners submitted an online response containing all the necessary information and attached Idaho Form 89SE. In their written response, they referenced the previously submitted Forms 83 and 85 and stated, "We believe we have properly taken these credits [and] as such the [Notice] is incorrect."

Audit sent Petitioners a letter on March 30, 2023, acknowledging Petitioners' response and requesting additional information by April 20, 2023. Specifically, Audit requested documentation showing capital investment Petitioners made in their project and increased employment. On April 20, 2023, Petitioners provided the requested documentation via an online response.

Audit sent Petitioners a letter on May 18, 2023, acknowledging Petitioners' timely protest, further stating that they (Audit) didn't change their determination based on the information Petitioners provided. Audit went on to provide these reasons for continuing to deny the credits:

- Idaho Form 89SE must be filed prior to claiming any credits under the Idaho Small Employer Incentive Act of 2005.
- [REDACTED] [REDACTED] [REDACTED] did not make a capital investment in new plant and building facilities of at least \$500,000.
- [REDACTED] [REDACTED] [REDACTED] did not show that each new employee earned over the required \$19.23 per hour.
- Documentation did not show that health benefits were provided to each new employee.
- [REDACTED] [REDACTED] [REDACTED] did not maintain the increased level of employment over the life of the project.
- The facility built during the project is owned by another company and the increased employment was not obtained during the project.

On June 1, 2023, Petitioners submitted an online response to Audit's letter. They included several documents to refute the above reasons for denying the credits. These included an annual report with the Idaho Secretary of State showing that [REDACTED] [REDACTED] [REDACTED] was a member of the limited liability company that owned the property, that the business offered medical insurance benefits to employees, and that employees earned more than \$19.23 per hour. In a written statement, Petitioners expressed continued disagreement with Audit's determination that they did not qualify for the credits. They wrote that the information provided as reasoning for not changing that determination is incorrect and provided explanation with reference to the additional documents they provided. They stated, "We absolutely believe that we are exactly who the legislature intended when they wrote this piece of legislation." Petitioners asked Audit to "reach out to discuss."

On June 5, 2023, Audit spoke with Petitioners on the phone and explained why they did not qualify for the credits. Audit indicated that the matter was being referred to the Tax Commission's Appeals unit (Appeals) for administrative review.

On August 8, 2023, Appeals sent a letter explaining the options available for redetermining a protested Notice, requesting a response within 30 days. On September 8, 2023, Petitioners sent Appeals an email, attaching a written response with additional documentation of employee pay rates and employer health coverage costs. In their statement, they wrote that Audit never requested some of the information used to disqualify Petitioners from the credits. They stated that they invested well over the required amounts for a new building in Idaho which houses not only [REDACTED] [REDACTED] employees but all their employees. They indicated they claimed the credit only for [REDACTED] [REDACTED] but their entire workforce is a united team; if they had counted all their employees, they would have far exceeded the minimum number of new employees required. They stated the reason they have multiple entities is for insurance and accounting purposes and entity limited liability, which is advised by many legal and business advisers. They wrote that they believe the legislature's intent in passing the laws creating the credits they claimed was to apply to companies exactly like theirs and to encourage companies to invest in Idaho, to build beautiful safe buildings, and to increase work opportunities for Idahoans. Appeals acknowledged receipt of the email and attachments on the same day.

In a series of emails between November 29, 2023, and July 1, 2024, Appeals requested – and Petitioners provided – additional documentation regarding employees hired to work at the project site between 2019 and 2023 and equipment purchased and placed in service during 2020. Appeals also held a conversation with the Tax Commission's Tax Research group (Tax Research) regarding eligibility for the small employer income tax credits. Based on an analysis of all documentation Petitioners provided to Audit and Appeals, as well as applicable Idaho Code and information obtained from Tax Research, the Tax Commission made a final determination on the matter.

Law & Analysis

Petitioners claimed two small employer income tax credits created under the Idaho Small Employer Incentive Act of 2005. Idaho Code section 63-4403 reads as follows:

63-4403.ADDITIONAL INCOME TAX CREDIT FOR CAPITAL INVESTMENT.

(1) For taxable years beginning on or after January 1, 2006, and before December 31, 2030, and subject to the limitations of this chapter, a taxpayer who has certified that the tax incentive criteria will be met within a project site during a project period shall, in regard to qualified investments made after the beginning of the project period and before December 31, 2030, in lieu of the investment tax credit provided in section 63-3029B, Idaho Code, be allowed a nonrefundable credit against taxes imposed by sections 63-3024, 63-3025 and 63-3025A, Idaho Code, in the amount of three and seventy-five one hundredths percent (3.75%) of the amount of qualified investment made during the project period, wherever located within this state.

(2) The credit allowed by this section shall not exceed sixty-two and five-tenths percent (62.5%) of the tax liability of the taxpayer.

(3) The credit allowed by this section shall not exceed seven hundred fifty thousand dollars (\$750,000) in any one (1) taxable year.

Idaho Code section 63-4405 reads:

63-4405.ADDITIONAL INCOME TAX CREDIT FOR NEW JOBS.

(1) Subject to the limitations of this chapter, for taxable years beginning on or after January 1, 2006, and before December 31, 2030, a taxpayer who has certified that the tax incentive criteria will be met within a project site during a project period shall, for the number of new employees earning more than a rate of twenty-four dollars and four cents (\$24.04) per hour worked, in lieu of the credit amount in subsection (3) of section 63-3029F, Idaho Code, be allowed the credit provided by this section. The number of new employees is the increase in the number of employees for the current taxable year over the greater of the following:

(a) The number of employees for the prior taxable year; or
(b) The average of the number of employees for the three (3) prior taxable years.

(2) The credit provided by this section shall be:

(a) One thousand five hundred dollars (\$1,500) for each new employee whose annual salary during the taxable year for which the credit is earned is greater than twenty-four dollars and four cents (\$24.04) per hour worked but equal to or less than an average rate of twenty-eight dollars and eighty-five cents (\$28.85) per hour worked;

(b) Two thousand dollars (\$2,000) for each new employee whose annual salary during the taxable year for which the credit is earned is greater than an average rate of twenty-eight dollars and eighty-five cents (\$28.85) per hour worked

but equal to or less than an average rate of thirty-six dollars and six cents (\$36.06) per hour worked;

(c) Two thousand five hundred dollars (\$2,500) for each new employee whose annual salary during the taxable year for which the credit is earned is greater than an average rate of thirty-six dollars and six cents (\$36.06) per hour worked but equal to or less than an average rate of forty-three dollars and twenty-seven cents (\$43.27) per hour worked;

(d) Three thousand dollars (\$3,000) for each new employee whose annual salary during the taxable year for which the credit is earned is greater than an average rate of forty-three dollars and twenty-seven cents (\$43.27) per hour worked.

(3) The credit allowed by subsection (1) of this section shall apply only to employment primarily within the project site. No credit shall be earned unless such employee shall have performed such duties for the taxpayer for a minimum of nine (9) months during the taxable year for which the credit is claimed.

(4) The credit allowed by this section shall not exceed sixty-two and five-tenths percent (62.5%) of the tax liability of the taxpayer.

(5) Employees transferred from a related taxpayer or acquired from another taxpayer within the prior twelve (12) months shall not be included in the computation of the credit unless the transfer creates a net new job in Idaho.

Tax Incentive Criteria

Both credits claimed by Petitioners and cited above require a taxpayer to certify “that the tax incentive criteria will be met within a project site during a project period.” This certification is completed by filing Form 89SE, *Certification for Idaho’s Small Employer Tax Incentives*. The tax incentive criteria are provided in Idaho Code section 63-4402(2)(j):

(j) "Tax incentive criteria" means a business entity meeting at a project site the requirements of subparagraphs (i) and (ii) of this paragraph.

(i) During the project period, making capital investments in new plant of at least five hundred thousand dollars (\$500,000) at the project site.

(ii) During a period of time beginning on January 1, 2006, and ending at the conclusion of the project period:

1. Increasing employment at the project site by at least ten (10) new employees each of whom must earn at least nineteen dollars and twenty-three cents (\$19.23) per hour worked during the business entity's taxable year.

2. Employment increases above the ten (10) new employees described in subparagraph (ii)1. of this paragraph at the project site shall on average earn at least fifteen dollars and fifty cents (\$15.50) per hour worked during the business entity's taxable year. Calculation of the group average earnings shall not include amounts paid to any employee earning more than forty-eight dollars and eight cents (\$48.08) per hour.

3. Earnings calculated pursuant to subparagraph (ii) of this paragraph shall include income upon which Idaho income tax withholding is required under section 63-3035, Idaho Code, but shall not include income such as stock options or restricted stock grants.

4. For purposes of determining whether the increased employment threshold has been met, employment at the project site shall be determined by calculating the increase of such new employees reported to the Idaho department of labor for employment security purposes over the employees so reported as of the beginning of the project period or no earlier than January 1, 2006, whichever is larger; and

5. Maintaining net increased employment in Idaho required by subparagraph (ii) of this paragraph during the remainder of the project period.

In the Notice, Audit wrote¹, “The Form must be filed and receive approval before claiming any incentives allowed under the Act,” referring to Form 89SE. According to information Appeals received in a conversation with Tax Research, receiving prior approval is preferred but not required. Tax Research mentioned approving small employer income tax credits in the past for businesses that filed Form 89SE with the return on which they claimed the credits. Based on this precedent, the Tax Commission determined that Petitioners properly certified that they have or would meet the tax incentive criteria.

Business Entity

Idaho Code section 63-4402(2)(k) states:

(k) "Business entity," for purposes of paragraphs (j) and (e) of this subsection, means either:

(i) A single taxpayer; or

(ii) A single business, a separate division, branch, or identifiable segment, or a group of businesses related through ownership pursuant to section 267 of the Internal Revenue Code. For purposes of this subsection, a "separate division, branch, or identifiable segment" shall be deemed to exist if, prior to the date of application, the income and expense attributable to such a separate division, branch, or identifiable segment could be separately ascertained from the books of accounts and records.

¹ Notice of Deficiency Determination dated December 2, 2022 (Letter ID [REDACTED]) Explanation of Adjustments
Page 1

Internal Revenue Code section 267(b)(11) states that two S corporations are “related through ownership” if the same persons own more than 50% of the stock in each corporation. As mentioned in the previous section of this decision, Petitioners have between the two of them 100% ownership interest in each of their S corporations; it is not uncommon to form multiple companies to handle different aspects of one overall business model. Based on this, the Tax Commission determined that the group of S corporations owned by Petitioners is a business entity for purposes of claiming the Small Employer Investment Tax Credit allowed by Idaho Code section 63-4403 and the Small Employer New Jobs Tax Credit allowed under Idaho Code section 63-3045. This contrasts with Audit’s finding that Petitioners were not entitled to claim the credits because no single business qualified for the credits. The Tax Commission’s determination is supported by precedent cited in Appeals’ discussion with Tax Research. Tax Research indicated that, in the past, a married couple (common owners of a group of S corporations, like Petitioners in this case) were allowed to claim small employer income tax credits because the group of businesses on the whole met the tax incentive criteria where no single business did. The fact that none of the individual businesses owned by the couple met the tax incentive criteria did not exclude them from claiming the credit, nor should it in this case.

Investment in New Plant

Idaho Code section 63-4402(d) defines “investment in new plant” (from Idaho Code section 63-4402(2)(j)(i)) as “qualified investments” or “building or structural components of buildings.” Idaho Code section 63-4402(h) states that qualified investments for purposes of the small employer income tax credits are the same as defined in Idaho Code section 63-3029B – those that qualify for the standard investment tax credit. Qualified investments must be used in Idaho in

a trade or business, have a useful life of at least three years, be property that can be depreciated or amortized, and fall into one of these categories:

- Tangible personal property – machinery and equipment
- Other tangible property
 - Property used as an integral part of manufacturing, production, extraction
 - Furnishing transportation, communications, or utility services
 - Research facilities and bulk storage facilities used in connection with those businesses
- Elevators and escalators
- Single-purpose agricultural or horticultural structures
- Qualified timber property
- Petroleum storage facilities
- Qualified broadband equipment as approved by the Idaho Public Utilities Commission

Nonqualified property includes, but is not limited to, property expensed under Internal Revenue Code section 179, used property in excess of \$150,000 or not acquired by purchase, property not used in Idaho, the portion of property subject to personal use, and vehicles with a gross vehicle weight under 8,000 pounds. Buildings and their structural components do not qualify for normal investment tax credit under Idaho Code section 63-3029B but do count as investment in new plant when determining if an employer meets the tax incentive criteria for the Small Employer Investment Tax Credit under Idaho Code section 63-4403. Only property that qualifies under Idaho Code section 63-3029B will be accounted for in the calculation of the actual credit allowed under Idaho Code section 63-4403. Based on documentation provided during the audit phase and the redetermination phase in this case, the Tax Commission determined that Petitioners made sufficient investment in new plant to exceed the minimum requirement.

New Employment

According to Idaho Code section 63-4402(2)(e), a “new employee” is an individual who was not already an existing employee and who meets the following criteria during the tax year:

- Employed primarily within the project site
- Subject to Idaho income tax withholding

- Covered for unemployment insurance purposes
- Eligible to receive employer coverage under a health benefit plan
- Performs duties on a regular full-time basis

Individuals already employed by the business entity who transfer to the project site, employees transferred from a related business entity, and employees acquired from an acquisition of another business entity within the prior 12 months do not qualify as new employees. The number of new employees at a project site is based on the mathematical average of the number of employees reported to the Idaho Department of Labor for employment security purposes during the tax year in question.

Petitioners sent Appeals copies of relevant reports submitted to the Idaho Department of Labor for 2019 through 2023 for each S corporation they own. Petitioners also sent information about their employees including name, hire date, last date of employment (if applicable), and hourly pay rate. Based on all the information provided, the Tax Commission determined that Petitioners met the hiring requirements shown in Idaho Code section 63-4402(2)(j)(ii)(1-5).

The Tax Commission having determined that Petitioners met the tax incentive criteria for the small employer income tax credits for tax year 2020, the question to answer now is how much credit they qualify for.

Additional Income Tax Credit for Capital Investment

This credit is authorized under Idaho Code section 63-4403. Petitioners filed Form 83, *Small Employer Investment Tax Credit*, and claimed a credit of \$14,492. The credit is calculated at 3.75% of the qualifying investments made during the tax year. Based on this, Petitioners implied they placed \$386,458 of qualifying equipment into service during 2020. After a series of email exchanges, Petitioners showed that the total cost of new qualifying equipment placed in service in

2020 was \$220,417 and the total cost of used qualifying equipment placed in service in 2020 was \$165,210.

As noted prior, the maximum value of used equipment allowable for calculating the credit is \$150,000. The Tax Commission determined that Petitioners were eligible to claim \$13,891² in Small Employer Investment Tax Credit. This results in additional tax due of \$601 (\$14,492 - \$13,891).

Additional Income Tax Credit for New Jobs

This credit is authorized under Idaho Code section 63-4405. Petitioners filed Form 85, *Small Employer New Jobs Tax Credit*, and claimed a credit of \$16,000. The credit for new employees can range from \$1,500 to \$3,000 per qualifying employee, depending on the individual's hourly rate of pay. The Tax Commission identified four new employees who met the qualifying criteria³ for 2020. They had the following hourly rates: \$27.78; \$34.83; \$58.28; and \$65.73. Based on these figures, Petitioners qualified for a credit of \$10,000 for tax year 2020. This results in additional tax due of \$6,000 (\$16,000 - \$10,000).

Other income tax adjustments

In addition to the small employer income tax credit adjustments just identified, the Notice contained a pass-through adjustment from a separate Notice issued to one of Petitioners' S corporations. That Notice was not protested, so the adjustment of \$492 is passed through to Petitioners. The result is additional tax due of \$492 for 2020.

² \$220,417 new equipment + \$150,000 used equipment for a total of \$370,417 qualifying costs x 3.75%

³ Hired during the project period, worked full-time, worked primarily at the project site, and worked for a minimum of nine months during the tax year

Penalty and interest

The Bureau added interest and penalty to Petitioners' tax deficiency. After agreeing to the amount of additional tax due for tax year 2020, Petitioners expressed disagreement with the addition of interest and penalties. The Tax Commission reviewed those additions and found them to be appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046.

Conclusion

The Tax Commission determined that Petitioners met the tax incentive criteria and qualify to claim the Small Employer Investment Tax Credit and the Small Employer New Jobs Credit. However, the amount of credit they claimed on their 2020 Idaho individual income tax return was not calculated correctly.

THEREFORE, the Notice dated December 2, 2022, and directed to [REDACTED] is hereby MODIFIED and MADE FINAL.

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

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2019	\$0	\$0	\$0	\$0
2020	7,093	1,419	746	<u>9,276</u>
				\$9,258

The Tax Commission DEMANDS immediate payment of this amount. Interest is calculated in accordance with Idaho Code section 63-3045.

An explanation of Petitioners' right to appeal this decision is enclosed.

DATED this _____ day of _____ 2024.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2024,
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:



Receipt No.

