

Cite as Det. No. 04-0100, 26 WTD 83 (2007)

BEFORE THE APPEALS DIVISION
DEPARTMENT OF REVENUE
STATE OF WASHINGTON

In the Matter of the Petition For Refund of)	<u>D E T E R M I N A T I O N</u>
)	
)	No. 04-0100
)	
...)	Registration No. . . .
)	Document Nos. . . . , . . .
)	Audit Nos. . . . / . . .
)	Docket No. . . .

RCW 82.32.060: TAX REFUNDS – NONCLAIM PERIOD. A taxpayer cannot obtain a refund for tax paid more than four years prior to the year in which the claim for refund is made, unless the taxpayer has executed a written waiver consistent with the terms of RCW 82.32.060(2), or unless the taxpayer seeks a refund of excess tax paid on a deficiency assessment for a period prior to the statutory four-year refund period and the taxpayer files a refund claim within four years of paying the deficiency assessment.

Headnotes are provided as a convenience for the reader and are not in any way a part of the decision or in any way to be used in construing or interpreting this Determination.

Gray, A.L.J. – . . . (taxpayer) filed a petition in 2001 for a refund of tax and interest in the amount of \$ The period covered by the refund petition was the tax years 1995 through 2001. The taxpayer’s petition claimed that it was entitled to receive high-tech tax credits for 1995 and 1996 and additional credits for later periods. The Department of Revenue’s (DOR) Audit Division granted part of the refund claim, but denied the full amount of the taxpayer’s claim. We agree that the taxpayer’s activities were either barred by the [nonclaim period] or did not qualify for additional high-tech tax credits.¹

ISSUES:

1. Whether in this case the tax years 1995 and 1996 are beyond the period of a refund claim filed in 2001; and

¹ Identifying details regarding the taxpayer and the assessment have been redacted pursuant to RCW 82.32.410.

2. Whether legal fees and professional fees for periods from 1997 through 2001 are within the scope of the phrase “qualified research and development expenditures” in RCW 82.04.4452; and
3. Whether the DOR properly gave the taxpayer future instructions on records needed to substantiate its claims for a credit under RCW 82.04.4452.

FACTS:

The taxpayer manufactures and sells [equipment] to . . . industries . . . and other markets. The taxpayer filed a Petition for Refund, in May 2001, in the amount of \$. . . for the tax years 1995 through 2001. As a result of the Petition for Refund, the Audit Division conducted a partial audit of the taxpayer for the period January 1, 1999, through March 31, 2001. In that audit, the DOR concluded the taxpayer performed qualified research and development and qualified for a partial refund under the high-tech tax credit. The Audit Division had earlier conducted an audit of the same taxpayer. . . . The earlier audit (1995 – 1998) resulted in a total tax refund of \$. . . , which was unrelated to the high tech credit. The DOR refunded that amount, plus interest, to the taxpayer in 1999. During the earlier audit, no issue had been raised with respect to an R&D credit.

The Audit Division rejected the taxpayer’s refund petition for 1995 and 1996 as being beyond the claim period allowed by RCW 82.32.060. For subsequent periods, it denied expenditures for legal and professional fees as not being “qualified research and development expenditures” for the tax credit in RCW 82.04.4452.² In addition to legal fees and professional fees, the Audit Division did not allow, as eligible costs, depreciation and patent amortization, overhead costs (including legal fees, utilities, repairs, and general insurance), and the costs associated with a Quality Evaluation “cost center.”

Although it allowed a credit for the 1997 – 2001 period, it instructed the taxpayer that, in the future, it had to maintain adequate records to show that expenditures, on a project by project basis, qualified for the tax credit in RCW 82.04.4452. During the period under review, the taxpayer’s method showed the total of all research and development costs and computed percentages of time spent by personnel on those activities.

ANALYSIS:

Whether the tax years 1995 and 1996 are beyond the period of a refund claim filed in 2001.

Tax refunds are governed by RCW 82.32.060, and 82.32.060(1) describes the window of time in which a refund claim may be made, if it is to be made at all. No refunds may be claimed “for taxes, penalties, or interest paid more than four years prior to the beginning of the calendar year in which the refund application is made or examination of records is completed.” When the

² For the tax years 1997 and 1998, the Audit Division treated those years as a post audit adjustment to the original audit.

taxpayer filed its refund claim in 2001, the tax years 2000, 1999, 1998, and 1997, were open to it. The tax years 1996 and 1995 were already beyond the time authorized for a refund claim. The taxpayer previously received a refund for 1995 and 1996, as the result of the earlier audit. The issue related to this question, raised by the taxpayer in its petition, is whether the *Paccar* case applies.³ In *Paccar*, the Washington Supreme Court held that a taxpayer was entitled to a refund of excess tax paid on a deficiency assessment for a period prior to the statutory four-year refund period, if the taxpayer files a refund petition within four years of paying the deficiency assessment. *Paccar*, 135 Wn.2d at 305. Unlike *Paccar*, there was no deficiency assessment in this taxpayer's case. Instead, the taxpayer received a refund for the earlier audit period, two years before it filed the instant refund claim. The petition for refund is denied on this issue.

Whether legal fees and professional fees are within the scope of the phrase “qualified research and development expenditures” in RCW 82.04.4452.

RCW 82.04.4452 . . . defines “qualified research and development” as having the same definition as in RCW 82.63.010. RCW 82.63.010(14) defines “qualified research and development” to mean:

research and development performed within this state in the fields of advanced computing, advanced materials, biotechnology, electronic device technology, and environmental technology.

Based upon the definition of “qualified research and development,” RCW 82.04.4452 . . . states:

"Qualified research and development expenditures" means operating expenses, including wages, compensation of a proprietor or a partner in a partnership as determined under rules adopted by the department, benefits, supplies, and computer expenses, directly incurred in qualified research and development by a person claiming the credit provided in this section. The term does not include amounts paid to a person other than a public educational or research institution to conduct qualified research and development. Nor does the term include capital costs and overhead, such as expenses for land, structures, or depreciable property.

The two statutory definitions, together, plainly contemplate “qualified research and development expenditures” to be for research and development in the scientific and technical fields described in RCW 82.63.010(14).

The DOR adopted WAC 458-20-24003 (Rule 24003) to administer RCW 82.04.4452 and ch. 82.63 RCW. Rule 24003 expressly excludes “legal expenses,” and impliedly excludes other “professional fees,” in Rule 24003(2)(n)(vii), which states:

³ *Paccar, Inc. v. State*, 135 Wn.2d 301, 957 P.2d 669 (1998).

Qualified research and development expenditures do not include legal expenses, patent fees, or any other expense not incurred directly for qualified research and development.

We conclude that the Audit Division properly excluded these costs from the credit.

Whether the taxpayer maintained adequate records to substantiate its claims for [credit] under RCW 82.04.4452.

RCW 82.32.070 requires all taxpayers to maintain “suitable records as may be necessary to determine the amount of any tax for which he may be liable.” The DOR’s administrative rule regarding record keeping is WAC 458-20-254 (Rule 254). Rule 254(2)(a)(ii) specifically states:

(a) It is the duty of each taxpayer to prepare and preserve all books of record in a systematic manner conforming to accepted accounting methods and procedures. Records are to be kept, preserved, and presented upon request of the department which will demonstrate:

...

(ii) The amounts of all deductions, exemptions, or credits claimed through supporting documentation required by statute or administrative rule, or such other supporting documentation necessary to substantiate the deduction, exemption, or credit.

The Audit Division reviewed the taxpayer’s records in connection with the taxpayer’s refund claim, but found the taxpayer does not itemize its research and development expenditures by project. Instead, the taxpayer computes a percentage of time its personnel spends on projects from the total amount of research and development costs. Although Audit allowed such a computation for the 1997-2001 period, for future periods it required the taxpayer to maintain records from which the Audit Division would be able to verify which costs were qualified research and development costs. As determined by the Audit Division, the taxpayer is required to maintain the documents necessary to substantiate the credit. *Id.*; RCW 82.32.070. Accordingly, we deny the petition as to instruction on records that must be maintained to substantiate the amount of the credit.

DECISION AND DISPOSITION:

The taxpayer’s petition is denied.

Dated this 30th day of April 2004.