

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 15624
[Redacted],	)	
	)	DECISION
Petitioners.	)	
_____	)	

On June 6, 2001, the staff of the Taxpayer Accounting Bureau of the Revenue Operations Division of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayers), proposing income tax and interest for the taxable year 2000 in the total amount of \$163.59.

On May 29, 2001, the taxpayers filed a timely appeal and petition for redetermination. The taxpayers did not request a hearing but rather chose to submit additional statements in support of their position. The Tax Commission, having reviewed the file, hereby issues its decision.

The taxpayers filed their 2000 Idaho individual income tax return claiming "Other subtractions" in the amount of \$7,578. The Tax Commission's automated system identified the taxpayers' return as having a potential problem or error. The Taxpayer Accounting Bureau (Bureau) reviewed the taxpayers' return and determined the taxpayers took a deduction that was not available in the Idaho income tax code. The Bureau sent the taxpayers a correction notice; the taxpayers wrote back stating they disagreed with the Bureau's correction.

The taxpayers stated they converted a traditional IRA to a Roth IRA in 1998. They elected to spread the conversion over a four-year period as allowed for federal purposes. The taxpayers stated they did not receive any benefit from the state of Idaho or any other state when the contributions were made to the traditional IRA. However, a tax benefit was received for federal purposes, hence the reason for spreading the conversion over four years. The taxpayers

stated the money was simply rolled over into the Roth IRA. Idaho should not be allowed to tax this income, it would not be fair.

The Bureau did not agree with the taxpayers' explanation of the "Other subtractions", so it sent the taxpayers a Notice of Deficiency Determination and referred the case for administrative review. The Tax Commission sent the taxpayers a letter setting forth their options for having the Notice of Deficiency Determination redetermined. Included with the letter, the Tax Commission sent the taxpayers a copy of a recent Idaho Supreme Court decision that dealt with the ability to tax IRAs.

The taxpayers chose to submit an additional statement. They stated they were in full disagreement with the decision of the Idaho Supreme Court. The taxpayers said this is a clear case of double taxation. They stated taxes were paid on the income put into the IRA in the states where they previously lived, and there was no deferred income status on the state level. The taxpayers stated that the Idaho courts stated in Idaho State Tax Com'n v. Stang, 135 Idaho 800, 25 P.3d 113 (2001), "If there is any ambiguity in the law concerning tax deductions, the law is to be construed strongly against the taxpayer." The taxpayers said there is no ambiguity, they are being double taxed plain and simple.

Idaho Code section 63-3002 states the intent of the Idaho legislature by the adoption of the Idaho Income Tax Act,

[T]o make the provisions of the Idaho act identical to the provisions of the Federal Internal Revenue Code relating to the measurement of taxable income, . . . subject only to modifications contained in the Idaho law; . . . to impose a tax on residents of this state measured by Idaho taxable income wherever derived . . .

Idaho Code section 63-3011B defined the term "taxable income" as federal taxable income as determined in the Internal Revenue Code.

Idaho Code section 63-3011C defined the term "Idaho taxable income" as taxable income as modified pursuant to the Idaho adjustments specifically provided for in the Idaho income tax act.

The taxpayers stated the conversion of the traditional IRA to the Roth IRA required them to include in federal taxable income the deferred income of the traditional IRA. The taxpayers also stated they elected to spread the conversion over four years as allowed by the Internal Revenue Code. The Tax Commission agrees that this was allowable and is the proper treatment at the federal level. However, the Tax Commission does not agree with the taxpayers that this income is not reportable to Idaho.

As stated in Idaho Code section 63-3002, Idaho taxable income is to be identical to federal taxable income subject to modifications specified in the Idaho Code. Therefore, the conversion amount reported for federal purposes is also reportable to Idaho. Since Idaho has no specific exemption or deduction for modifying taxable income when a traditional IRA is converted to a Roth IRA, the Tax Commission must enforce the law as written and disallow the "Other subtractions" claimed by the taxpayers. Potlatch Corp. v. Idaho State Tax Comm'n, 128 Idaho 387, 913 P.2d 1157 (1996).

The taxpayers stated this case is clearly a case of double taxation. Idaho is taxing income that was previously taxed in another state on which the taxpayers received no deferred income status.

A conversion of a traditional IRA to a Roth IRA is a taxable event (Internal Revenue Code section 408A(d)(3)(A)(i)). The conversion is considered a distribution of the traditional IRA but without the premature distribution tax. The Idaho Supreme Court stated in Idaho State Tax Comm'n. v. Stang, *supra*, that distributions from an IRA are includable as taxable income in

the year of the distribution. In this case, the year(s) of distribution are the four years the conversion is spread over. As in Stang, the taxpayers contributed to an IRA while they resided in another state and received no income tax deferral. Nevertheless, the Court said the IRA distribution was taxable by Idaho because the Idaho Code has no provision permitting the distribution to be deducted from income in instances where no deduction was granted for contributions to the IRA.

The taxpayers stated that without the deduction they are being double taxed on the income put into the traditional IRA. However true this may be, the Court stated in Idaho State Tax Comm'n v. Stang, supra,

The Due Process Clause does not prohibit Idaho from taxing the distribution even though California had previously taxed the money when they contributed it to the IRA's. "[T]he Fourteenth Amendment does not prohibit double taxation." *Cream of Wheat Co. v. Grand Forks County*, 253 U.S. 325, 330, 40 S.Ct. 558, 560, 64 L.Ed. 931, 934 (1920). In *Guaranty Trust Co. of New York v. Commonwealth of Virginia*, 305 U.S. 19, 59 S.Ct. 1, 83 L.Ed. 16 (1938), New York taxed income received by a trust in that state, and Virginia taxed that portion of the income distributed to a beneficiary residing in Virginia. The trustees then brought an action to recover the state income taxes paid to Virginia. In holding that the Fourteenth Amendment did not prohibit two states from imposing income taxes on the same income, the United States Supreme Court stated, "Here, the thing taxed was receipt of income within Virginia by a citizen residing there. The mere fact that another state lawfully taxed funds from which the payments were made did not necessarily destroy Virginia's right to tax something done within her borders." *Id.* at 23, 59 S.Ct. at 3, 83 L.Ed. at 19. Likewise, in *Hellmich v. Hellman*, 276 U.S. 233, 48 S.Ct. 244, 72 L.Ed. 544 (1928), the issue was whether the federal government could tax both the profits of a corporation and the amounts distributed to its stockholders from those profits upon the dissolution of the corporation. In holding that the government could impose income taxes both upon the profits of the corporation and upon those same profits when they were distributed to the stockholders, the United States Supreme Court concluded, "When, as here, Congress has clearly expressed its intention, the statute must be sustained even though double taxation results." *Id.* at 238, 48 S.Ct. at 246, 72 L.Ed. at 547.

In summary, the distribution of the \$8,000 from the Stangs' IRA's while they

were residents of Idaho was taxable income under the Idaho Income Tax Code. Although they had paid income taxes to California on the sums that they contributed to their IRA's, Idaho law does not provide a deduction, exemption, or tax credit in that situation. Any such deduction, exemption, or tax credit must come from the legislature, not from the judiciary. Idaho's taxation of the distribution does not violate either the Due Process Clause of the Fourteenth Amendment or the Commerce Clause of the Constitution of the United States. Therefore, the distribution was Idaho taxable income and the Stangs must pay Idaho income tax on that sum.

Therefore, the Tax Commission must uphold the Bureau's determination that the taxpayers' conversion of their traditional IRA to a Roth IRA is a distribution of an IRA and reportable to Idaho.

WHEREFORE, the Notice of Deficiency Determination dated June 6, 2001, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following tax, penalty and interest:

The taxpayers have remitted the amount of the deficiency in full; no DEMAND for payment is necessary.

An explanation of the taxpayers' right to appeal this decision is included with this decision.

DATED this \_\_\_\_ day of \_\_\_\_\_, 2001.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_ day of \_\_\_\_\_, 2001, 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. [Redacted]  
[REDACTED][REDACTED]

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ADMINISTRATIVE ASSISTANT 1