

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 15625
[Redacted],)	
)	DECISION
Petitioners.)	
_____)	

On May 15, 2001, the staff of the Revenue Operations Division of the Idaho State Tax Commission issued a Correction Notice to [Redacted] (taxpayers), proposing additional income tax for the taxable year 2000 in the amount of \$2,439.

On May 29, 2001, the taxpayers filed a protest of the Correction Notice. The taxpayers requested a hearing, which was held via a telephone conference on August 23, 2001. The Tax Commission, having reviewed the file, hereby issues its decision.

The taxpayers timely filed their 2000 Idaho individual income tax return claiming an other subtraction from gross income of \$102,661. The taxpayers subtracted a lump sum distribution from their pension plan. The taxpayers subtracted the lump sum distribution on the theory that Idaho followed federal law. For federal purposes the distribution was not included in gross income because the taxpayers elected a special 10-year averaging available to individuals born before 1936.

However, the taxpayers did not fully exclude the lump sum distribution from Idaho tax. The taxpayers modified the federal form for computing federal tax on the distribution to fit Idaho's taxing scheme. They included a 10-year averaging of the tax, the same as they did for federal, on their 2000 Idaho income tax return.

The Revenue Operations Division (Division) received and reviewed the taxpayers' 2000 return and determined the taxpayers' reporting of the lump sum distribution did not agree with Idaho's statute on lump sum distributions. The Division corrected the taxpayers' return and sent

them a correction notice. The taxpayers disagreed with the correction and sent the Division a letter of protest.

The Tax Commission contacted the taxpayers regarding their protest giving them two alternative methods for redetermining the deficiency. The taxpayers requested a telephone conference with a commissioner. The following is a summary of the taxpayers' position.

The Tax Reform Act of 1986, as amended, included a grandfather clause for individuals born before 1936. Section 1122(h)(3) and (5) of the Tax Reform Act of 1986 provided that an individual who has attained age 50 before January 1, 1986, can elect the provisions of section 402(e)(1) of the Internal Revenue Code of 1986, substituting references to 5-year averaging for 10-year averaging.

Idaho Code section 63-3022(k) stated that an individual receiving a lump sum distribution must add the taxable amount of the lump sum distribution deducted from gross income pursuant to section 402(d)(3) of the Internal Revenue Code (IRC). The taxpayers stated that the law in effect for taxable year 2000 does not include 10-year averaging under IRC section 402(d)(3). IRC section 402(d) for tax year 2000 addresses the taxability of beneficiary of certain foreign situs trusts. It does not address 10-year averaging of lump sum distributions.

Since the Idaho statute referenced a repealed and modified section of the IRC, there is no valid or rational basis for adding lump sum distributions to income as provided in Idaho Code section 63-3022(k). However, Idaho does follow the determination of federal taxable income per Idaho Code section 63-3002, and therefore, should allow the 10-year averaging election for lump sum distributions.

The taxpayers also submitted an amended return for 2000 that they wanted the Tax Commission to include in its decision. The amended return had the net effect of reducing the taxpayers' taxable income. The taxpayers received corrected information from their S-corporation and they found they did not qualify for an IRA deduction.

Idaho Code section 63-3022(k) provides for the addition of lump sum distributions not included in federal taxable income. For the taxable year 2000, section 63-3022(k) stated,

Add the taxable amount of any lump sum distribution deducted from gross income pursuant to section 402(d)(3) of the Internal Revenue Code.

In 1999 and prior years, IRC section 402(d)(3) provided a deduction for lump sum distributions received in the taxable year to the extent the amount was included in gross income. The deduction was allowed because section 402(d)(1) imposed a separate tax on lump sum distributions. The separate tax was based on a 5-year averaging method.

Effective in 2000, section 402 was amended to repeal subsection (d). Subsection (d) was replaced with a new subsection (d) that does not contain a paragraph (3) and does not allow a deduction for lump sum distributions. This change was made by section 1401 of P.L. 104-188 (the "Small Business Job Protection Act of 1996", (SBJPA) 110 Stat. 1755, 1789).

Therefore, at first glance the addition required by Idaho Code section 63-3022(k) would seem to be moot in 2000 since no deduction for lump sum distributions existed "pursuant to section 402(d)(3) of the Internal Revenue Code."

However, for one class of taxpayers, those born before 1936, the prior 402(d)(3) remained in effect. The change to IRC section 402(d) was made by section 1401 of SBJPA. Subsection (c) of section 1401 provided the effective dates for section 1401 of SBJPA. Subsection (c) states,

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 1999.

(2) RETENTION OF CERTAIN TRANSITION RULES.—The amendments made by this section shall not apply to any distribution for which the taxpayer is eligible to elect the benefits of section 1122(h)(3) or (5) of the Tax Reform Act of 1986. Notwithstanding the preceding sentence, individuals who elect such benefits after December 31, 1999, shall not be eligible for 5-year averaging under section 402(d) of the Internal Revenue Code of 1986 (as in effect immediately before such amendments).

Therefore, if an individual is eligible to make the election under section 1122(h)(3) or (5) of the 1986 Tax Reform Act, (TRA) the amendment to section 402(d) does not apply – except as to 5-year averaging – and the prior version of section 402(d) is still applicable to that individual in taxable year 2000. This is true even though the language of the old subsection (d) disappeared from the IRC after 1999.

TRA section 1122 made extensive amendments to IRC section 402 and particularly to lump sum distributions. To mitigate the effect of these changes on older individuals, Congress provided in subsection (h)(3) and (5) an election to individuals who attained age 50 before January 1, 1986. This subsection allows those individuals to make an election to use 10-year averaging for lump sum distributions. It is this election that subsection (c) of section 1401 SBJPA refers.

Therefore, if an individual, for federal tax purposes, makes the election under TRA section 1122(h) and pays tax based on 10-year averaging, then in 2000 the deduction allowed by IRC section 402(d)(3) as it appeared before 2000 is still available to that individual in computing federal taxable income, despite the disappearance of the language from section 402 allowing the deduction. Having made the election and taken the deduction on his 2000 federal return, that individual must, under Idaho Code section 63-3022(k), add that deduction back to federal taxable income to compute his Idaho taxable income for 2000.

Therefore, the Tax Commission finds the correction the Division made to the taxpayers' 2000 Idaho income tax return appropriate and in compliance with Idaho's statute. The Tax Commission also reviewed the taxpayers' amended return for 2000 and found it acceptable.

WHEREFORE, the Notice of Deficiency Determination dated June 5, 2001, is hereby MODIFIED, in accordance with the provisions of this decision and, as so modified, is APPROVED, AFFIRMED, and MADE FINAL.

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

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2000	\$1,486	\$107	\$1,593

DEMAND for immediate payment of the foregoing amount is hereby made and given.

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

DATED this ____ day of _____, 2002.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2002, 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]

ADMINISTRATIVE ASSISTANT 1