

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 15376
[REDACTED],)	
)	AMENDED DECISION
Petitioners.)	
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On December 29, 2000, the Idaho State Tax Commission’s Income Tax Audit Bureau (ITA) issued a Notice of Deficiency Determination to [Redacted] (petitioners), proposing additional income tax, penalty, and interest for the taxable year 1993, in the total amount of \$9,846. The petitioners filed a timely protest and petition for redetermination. The Idaho State Tax Commission (Commission) issued its decision on June 10, 2002, proposing additional income tax, penalty, and interest for the taxable year 1993 in the total amount of \$9,921.

The petitioners filed a notice of appeal on September 6, 2002, appealing the Commission’s decision to the Idaho Board of Tax Appeals (BTA). A hearing was held in front of the BTA on December 6, 2002. At the hearing, the petitioners submitted delinquent Idaho income tax returns for tax years 1989 through 1991. Since the information contained in the delinquent returns had a material impact on the Commission’s decision issued on June 10, 2002, the Commission filed a motion with the BTA requesting that the BTA remand the case back to the Commission for further consideration in light of the returns. The petitioners did not file a response to the Commission’s motion to remand. On January 9, 2003, the BTA issued their order remanding the case back to the Commission.

ITA examined the delinquent returns and on December 20, 2002, ITA issued a Notice of Deficiency Determination for tax years 1989, 1990, 1991, 1995, 1996, 1997, 1998, 1999, and 2000 proposing additional income tax, penalty, and interest in the total amount of \$36,840.

On March 19, 2003, the Commission sent a letter to the petitioners' representative providing the petitioners with the opportunity to discuss the adjustments made to the petitioners' Idaho net operating losses as well as providing the petitioners with the opportunity to request another informal hearing on any new issues raised as a result of the information provided at the BTA hearing. The petitioners did not request a second hearing. Accordingly, the Commission, having reviewed the file, issues its amended decision, which encompasses the aforementioned Notice of Deficiency dated December 29, 2000, the Commission's prior decision dated June 10, 2002, and the Notice of Deficiency Determination dated December 20, 2002.

The petitioners filed their delinquent Idaho income tax returns for tax years 1989 through 2000 as follows:

Tax Year	Month/Year Filed	Filing Status
1989	December 2002	Part-Year Resident
1990	December 2002	Resident
1991	December 2002	Resident
1992	July 1997	Resident
1993	March 1999	Resident
1994	March 1999	Resident
1995	May 2001	Resident
1996	June 2001	Resident
1997	January 2002	Resident
1998	January 2002	Resident
1999	January 2002	Resident
2000	April 2002	Resident

The petitioners' 1989 through 2000 Idaho income tax returns report zero Idaho taxable income.

The December 29, 2000, Notice of Deficiency Determination ITA issued disallowed the net operating loss carryforward deduction claimed on petitioners' 1993 Idaho income tax return as well as a capital loss carryforward that had been incurred in a taxable year prior to 1992 and claimed as a deduction in 1993. These two adjustments formed the basis for the Commission's

decision that was issued on June 10, 2002. Based upon the new information provided at the BTA hearing, the Commission has determined that the previously disallowed capital loss is allowable. Additionally, the Commission finds that the petitioners do not have an amount due for tax year 1993; thus the Commission no longer seeks the \$9,921 amount for tax year 1993 reflected in the Commission's decision dated June 10, 2002. The Commission now turns its attention to the controversy surrounding the petitioners' Idaho net operating loss deduction.

The petitioners' and ITA's calculation of the amount of Idaho net operating loss for each year was as follows:

Tax Year	Per Petitioners		Per ITA	
	Idaho Net Operating Loss	Amount of Net Operating Loss Applied	Idaho Net Operating Loss	Amount of Net Operating Loss Applied
Pre-1989	(\$322,573)		\$-0-	
1989	(45,420)		25,351	
1990	(10,897)		5,895	
1991	(6,341)		3,198	
1992	(30,329)		20,799	
1993		\$119,180		\$65,705
1994	(32,152)			361
1995	(44,710)		2,047	
1996	(84,749)		4,518	
1997	(20,183)		27,806	
1998		55,872		23,548
1999		178,678		-0-
Totals	(\$778,354)	<u>\$353,730</u>	\$89,614	<u>\$89,614</u>
	353,730		89,614	
Carryover to 2000	<u>(\$424,624)</u>		<u>\$-0-</u>	

Petitioners' calculations for tax years 1991 through 1999 were obtained from a schedule titled "Detail NOL Carryover Worksheet Substitute Idaho Form 56 FYE 12/31/00" attached to the petitioners' 2000 Idaho income tax return. On this same schedule the petitioners reported a net operating loss from tax year 1990 of \$378,890. In looking at the petitioners' 1990 Idaho income tax return, it is clear that the petitioners did not have a 1990 net operating loss of this

magnitude. It appears that the petitioners lumped together pre-1990 losses with their 1990 loss in arriving at the \$378,890 figure. Therefore, the amounts reflected under the title “per petitioners” for tax years 1990, 1989, and pre-1989 were obtained from information contained in the petitioners’ 1989 through 1991 Idaho and federal income tax returns.

ITA’s calculations were obtained from the schedule titled “Computation of Net Operating Loss” attached to the Notice of Deficiency Determination dated December 20, 2002.

The petitioners claimed the \$424,624 of Idaho net operating loss carryforward as a deduction in arriving at their 2000 Idaho taxable income. ITA allowed no deduction for a net operating loss carryforward in 2000 and allowed a substantially reduced amount in tax year 1999 and prior. The difference between the petitioners’ method and that of ITA is due primarily to the petitioners treating losses incurred before they moved to Idaho as a deduction in computing their Idaho taxable income. Additionally, the petitioners’ apparent use of the federal method of determining their Idaho net operating loss rather than Idaho’s calculation found in Idaho Code section 63-3021 substantially overstated the amount of Idaho net operating loss that could be claimed as a deduction in subsequent years.

Net Operating Losses Incurred Prior To Moving To Idaho

ITA’s Position

In determining the amount of Idaho net operating loss available as a deduction for tax years 1989 through 2000, ITA cites Idaho Code section 63-3022 as authority for denying the petitioners a deduction for any business loss that was incurred before the petitioners moved to Idaho in 1989.

Petitioners' Position

In the petitioners' petition for redetermination, the petitioners, through their representative, made the following argument:

If the taxpayer had been a resident of the State of Idaho during the time that the operating . . . had been incurred and utilized for federal tax purposes, the taxpayer would have had the benefit of those deductions and losses for State of Idaho tax purposes. Thus, to the extent that these tax attributes are subject to restoration into federal income due to recovery of depreciation deductions or taxable reduction of the debt used to fund the losses, the taxpayer would be exposed to State of Idaho taxation with respect to items of loss and deduction recovery that were never allowed for Idaho tax purposes. The taxpayer is being denied these deductions solely because the taxpayer was a nonresident of the State of Idaho when these tax attributes were generated and such denial has the result of levying taxation without regard to the taxpayer's real economics.

Thus, the . . . statutes of the State of Idaho discriminate between residents and nonresidents in a manner that cannot be adequately justified by the State of Idaho. The State of Idaho is merely seeking to obtain a tax windfall from a taxpayer that may have no economic gain during the life of his respective business and investment activities by only considering the income portion of the activities.

Therefore, the . . . statutes are unconstitutional under the Privileges and Immunities Clause, U.S. Constitution, Article IV, Section 2, which provides "(t)he citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." The Supreme Court of the United States has determined that provisions of a state law that effectively deny only nonresident taxpayers an income tax deduction are not consistent with the constitutional command of the Privileges and Immunities Clause. *Lunding v. New York Tax Appeals Tribunal*, 522 U.S. 287(1998). . . .

Idaho Law And Analysis

The starting point for computing Idaho taxable income is federal taxable income as defined in the Internal Revenue Code. Idaho Code section 63-3002. In computing Idaho taxable income, any federal net operating loss is added to federal taxable income. See Idaho Code

section 63-3022(c) for tax years 1989 through 1997 and Idaho Code section 63-3022(b) for tax years 1998 through 2000. Any Idaho net operating loss is then subtracted. See Idaho Code section 63-3022(d)(1) for tax years 1989 through 1997 and Idaho Code section 63-3022(c)(1) for tax years 1998 through 2000. However, a loss incurred in business activities not taxable by Idaho may not be subtracted from federal taxable income. See Idaho Code section 63-3022(d)(2) for tax years 1989 through 1997 and Idaho Code section 63-3022(c)(2) for tax years 1998 through 2000.

The Idaho legislature has spoken with respect to the type of net operating loss that will be allowed as a deduction in arriving at Idaho taxable income for both residents and nonresidents. To the extent that a resident's or nonresident's Idaho taxable income, subject to certain modifications, is less than zero, the resident or nonresident has an Idaho net operating loss. Idaho Code section 63-3021. To the extent that a resident or nonresident has an Idaho net operating loss, the Idaho net operating loss, subject to the carryback and carryforward provisions of the Idaho Code, is deductible. See Idaho Code section 63-3022(c)(1) or (d)(1) depending on the year at issue. Any loss incurred in business activities not taxable by Idaho may not be subtracted from federal taxable income. See Idaho Code section 63-3022(c)(2) or (d)(2) depending on the year at issue. Therefore, in the case at hand, the operating losses that the petitioners incurred in business activities prior to moving to Idaho are not allowable deductions under Idaho law.

Petitioners' Constitutional Argument

The petitioners argue that disallowing the deductions that they incurred prior to moving to Idaho is unconstitutional. The petitioners argue that Idaho Code section 63-3022 violates the Privileges and Immunities Clause found in Article IV, Section 2 of the U.S. Constitution. As

support for their position, the petitioners cite *Lunding v. New York Tax Appeals Tribunal*, 522 U.S. 287, 118 S.Ct. 766 (1998).

The *Lunding* case dealt with the disallowance of a nonresident's deduction for alimony expenses. The Court in *Lunding* stated that:

Although the Privileges and Immunities Clause does not prevent States from requiring nonresidents to allocate income and deductions based on their in-state activities in the manner described in *Shaffer* and *Travis*, those opinions do not automatically guarantee that a State may disallow nonresident taxpayers every manner of nonbusiness deduction on the assumption that such amounts are inevitably allocable to the State in which the taxpayer resides. Alimony obligations are unlike other expenses that can be related to activities conducted in a particular State or property held there. And as a personal obligation that generally correlates with a taxpayer's total income or wealth, alimony bears some relationship to earnings regardless of their source. . . .

Id. at 782.

The Commission does not have the authority to declare an act of the Idaho legislature unconstitutional, *Wanke v. Ziebarth Const. Co.*, 69 Idaho 64, 75, 202 P.2d 384, 391 (1948); however, the Commission is empowered to review the facts and circumstances presented in an administrative protest in light of the prevailing constitutional limitations and to provide its opinions and insights into whether a violation of the federal or Idaho constitution has occurred.

Id.

The *Lunding* case dealt with nonresidents being denied a deduction for a personal expense (alimony) that New York residents were entitled to claim. The case before the Commission deals with losses that were incurred prior to the petitioners becoming subject to Idaho's jurisdiction to tax rather than nonresidents being denied a deduction for a personal expense that residents could deduct. Thus, the facts in this case are vastly different than the facts

in the *Lunding* case, and the Commission does not believe that the courts would find the *Lunding* case to be applicable.

The courts have long held that, because state legislatures must draw some distinctions in light of “local needs,” they have considerable discretion in formulating tax policy. *Madden v. Commonwealth of Kentucky*, 309 U.S. 83, 88 (1940). In formulating Idaho’s tax policy, the Idaho legislature has made clear the type of loss carryforwards that will not be allowed as a deduction in arriving at Idaho taxable income. The Idaho legislature has specifically excluded as a deduction in arriving at Idaho taxable income the type of loss carryforward that the petitioners are seeking to deduct.

Idaho Code Section 63-3021 - Net Operating Loss

ITA applied Idaho Code section 63-3021 in determining petitioners’ Idaho net operating loss for the years at issue. Although a portion of the NOL petitioners claimed was disallowed, ITA determined that the petitioners had an Idaho net operating loss for tax years 1989, 1990, 1991, 1992, 1995, 1996, and 1997.

On line 21 of the petitioners’ 2000 federal form 1040, page 1, the petitioners reported a federal net operating loss carryforward of \$424,624 which is the exact same amount that the petitioners are claiming as an Idaho net operating loss carryforward. Thus it would appear that the petitioners are simply using the federal method of calculating a net operating loss to determine their Idaho net operating loss. Idaho law does not support the method employed by the petitioners. The Idaho calculation of a net operating loss is different than the federal calculation. For example, for all of the years at issue, Idaho’s calculation of an Idaho net operating loss would not include the standard deduction or itemized deductions. Idaho Code section 63-3021(b)(4). This probably explains why the petitioners’ calculation of each tax year’s Idaho net

operating loss is different than ITA's calculation. The petitioners have not provided the Commission with any authority to support the method that they employed to calculate each tax year's Idaho net operating loss or shown that ITA's calculation of their Idaho net operating loss was in error. Accordingly, the Commission upholds ITA's determination of the years in which petitioners incurred an Idaho net operating loss and the amount of said loss as shown in the schedules attached to the Notice of Deficiency Determination dated December 20, 2002.

Penalty

In the Notice of Deficiency Determination dated December 29, 2000, for tax year 1993, ITA imposed the substantial understatement penalty in accordance with Idaho Code section 63-3046(d). In its decision dated June 10, 2002, the Commission upheld the imposition of the substantial understatement penalty. However, based upon the new information provided, the Commission finds that for tax year 1993 no substantial understatement of tax exists as defined by Idaho Code section 63-3046(d).

For tax years 1998, 1999, and 2000, in the Notice of Deficiency Determination dated December 20, 2002, ITA imposed a 25% penalty. The petitioners filed their 1998, 1999, and 2000 Idaho income tax returns in 2002, years well beyond their respective due dates. As such, the Commission finds that it is proper to impose the Idaho Code section 63-3046(c) penalty, which states:

In the event the return required by this chapter is not filed, or in the event the return is filed but the tax shown thereon to be due is not paid, there may be collected a penalty of five per cent (5%) of the tax due on such returns for each month elapsing after the due date of such returns until such penalty amounts to twenty-five per cent (25%) of the tax due on such returns.

Tax Year 1993 Excess Withholdings

Based upon a review of the petitioners' 1993 Idaho income tax return as originally filed with the Commission, the Commission found in its decision dated June 10, 2002 that the petitioners were entitled to an offset against their Idaho tax liability of \$334, which had not been taken into consideration in the Notice of Deficiency Determination dated December 20, 2000. Due to the new information provided at the BTA hearing, for tax year 1993, the petitioners had excess withholding of \$299; however, since the statute of limitations found in Idaho Code section 63-3035(e) for obtaining a refund of excess withholding has expired, the statute bars the petitioners from claiming a refund of the excess withholdings.

Permanent Building Fund Tax For Tax Years 1989, 1990, and 1991

On the petitioners' delinquent income tax returns for tax years 1989, 1990, and 1991 the petitioners crossed out the \$10 permanent building fund tax indicating that the petitioners did not have to pay the tax since the petitioners were not required to file. In the Notice of Deficiency Determination dated December 20, 2002, ITA imposed the Idaho Code section 63-3082 Permanent Building Fund Tax since the petitioners were required to file an Idaho income tax return. The petitioners have not protested the imposition of the tax, and the Commission finds that the imposition of the tax was in accordance with Idaho law.

Excess Grocery Credit For Tax Years 1989, 1990, and 1991

On the petitioners' delinquent income tax returns for tax years 1989, 1990, and 1991 the petitioners did not claim the Idaho Code section 63-3024A Grocery Credit. In the Notice of Deficiency Determination dated December 20, 2002, ITA adjusted petitioners' income tax returns to allow the grocery credit; however, ITA denied the petitioners a refund of the excess grocery credit since the statute of limitations found in Idaho Code section 63-3024A for

obtaining a refund of excess grocery credit had expired. The petitioners have not protested the denial of the excess grocery credit. The Commission finds that the statute of limitations bars the petitioners from claiming a refund of the \$13, \$35, and \$35, excess grocery credit for tax years 1989, 1990, and 1991, respectively.

FINDINGS

It is well established in Idaho law that a taxpayer claiming a deduction, exemption, or credit bears the burden of establishing his or its entitlement to the same, both as to law and fact. Further, statutes allowing deductions and exemptions are "construed strongly against the taxpayer." *Potlatch Corp. v. Idaho State Tax Com'n*, 128 Idaho 387 (1996), citing *Hecla Mining Co. v. Idaho Tax Com'n*, 108 Idaho 147, 151, 697 P.2d 1161, 1165 (1985). The U.S. Supreme Court stated in *New Colonial Ice Company, Inc. v. Helvering*, 292 U.S. 435, 54 S.Ct. 788, that "[w]hether and to what extent deductions shall be allowed depends upon legislative grace; and only as there is clear provision therefore can any particular deduction be allowed." The Court further stated that "[o]bviously, therefore, a taxpayer seeking a deduction must be able to point to an applicable statute and show that he comes within its terms."

The Commission finds that the petitioners have not met their burden of establishing that (1) they are entitled to a deduction for the losses incurred before they moved to Idaho; (2) ITA's calculation of the petitioners' Idaho net operating loss for tax years 1989, 1990, 1991, 1992, 1995, 1996, and 1997 as shown in the Notice of Deficiency Determination dated December 20, 2002, is in error; (3) the amount of net operating loss carryforward or carryback allowed by ITA as a deduction in arriving at petitioners' Idaho taxable income for tax years 1993, 1994, 1998, 1999, and 2000 is in error; (4) the imposition of the penalty or permanent building fund tax is in

error; and (5) the petitioners are entitled to excess withholding for tax year 1993 or excess grocery credit for tax years 1989, 1990 and 1991.

WHEREFORE, the Notice of Deficiency Determination dated December 29, 2000, the Notice of Deficiency Determination dated December 20, 2002, and the Commission's decision originally issued for docket number 15376 on June 10, 2002, are hereby MODIFIED and, as so modified, are APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners are barred from claiming a refund of the following excess withholding or excess grocery credit:

YEAR	EXCESS GROCERY CREDIT OR EXCESS IDAHO WITHHOLDINGS
1989	(\$13.00)
1990	(\$35.00)
1991	(\$35.00)
1993	(\$299.00)
Subtotal	(\$382.00)
Barred by Statute of Limitations	\$382.00
TOTAL REFUND DUE	<u>\$0.00</u>

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

YEAR	REFUND	TAX	PENALTY	INTEREST	TOTAL
1995					\$0.00
1996					\$0.00
1997					\$0.00
1998		\$1,379.00	\$345.00	\$429.00	\$2,153.00
1999		\$13,208.00	\$3,302.00	\$3,147.00	\$19,657.00
2000		\$11,073.00	\$2,768.00	\$1,750.00	\$15,591.00
Subtotal	\$0.00	\$25,660.00	\$6,415.00	\$5,326.00	\$37,401.00
Remittance				(\$1,984.20)	(\$1,984.20)
TOTAL DUE	<u>\$0.00</u>	<u>\$25,660.00</u>	<u>\$6,415.00</u>	<u>\$3,341.80</u>	<u>\$35,416.80</u>

Interest is calculated through August 15, 2003, and will continue to accrue at the rate set forth in Idaho Code section 63-3045.

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 with this decision including information on the requirement to deposit with the Commission twenty percent (20%) of \$35,416.80 (i.e. the tax, penalty and interest), before filing an appeal with the Board of Tax Appeals or an action in District Court.

DATED this ____ day of _____, 2003.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2003, 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]
[Redacted]

Receipt No.
