

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 16697
[REDACTED])	
)	DECISION
Petitioners.)	
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)	

On June 13, 2002, the Idaho State Tax Commission (Tax Commission) issued a Notice of Deficiency Determination to [Redacted] (petitioners), reducing the refund of tax sought by the petitioners from \$2,695 to \$415. The petitioners filed a timely protest and petition for redetermination. The Tax Commission, having reviewed the file, hereby issues its decision.

In General

On January 10, 2002, The Tax Commission's Income Tax Audit Bureau (Bureau) notified the petitioners that the Bureau was reviewing the petitioners' 1999 Idaho income tax return. During the review of the petitioners' 1999 return, the Bureau became aware that the petitioners had filed an amended Idaho income tax return for tax year 1999 in May of 2002. The amended return, which reflected a refund of tax in the amount of \$2,695, was received by the Tax Commission on March 11, 2002; however, the requested refund had not been issued to the petitioners as of May of 2002. The Bureau has taken the amended return into consideration in its Notice of Deficiency Determination dated June 13, 2002.

The petitioners were part-year residents for tax year 1999 and reported their status as such in the return filed with the Tax Commission. The petitioners changed their domicile to Idaho on April 1, 1999. The Bureau in its review of the petitioners' 1999 Idaho income tax return made the following adjustments in arriving at the petitioners' Idaho taxable income:

[REDACTED]

Information per Shareholder (petitioners) Form 1120-S K-1	Amount	Subject to Idaho Income Tax	Amount Reported On Idaho Return as Originally Filed	Increase or (decrease) in Idaho Taxable Income
Interest Income	\$24,685	\$18,514	\$24,685	(\$6,171)
Dividends	3,703	2,777	3,703	(926)
Capital Gain	36,564	27,423	22,801	4,622
Ordinary Income	113,885	85,414	0	85,414
Totals	<u>\$178,837</u>	<u>\$134,128</u>	<u>\$51,189</u>	<u>\$82,939</u>

The Bureau applied Idaho Income Tax Administrative Rule 250 in determining the amount of S corporation income subject to Idaho taxation. As a result of the increase in petitioner's Idaho adjusted income, the amount of allowable itemized deductions and personal exemptions increased by \$15,438 (from \$9,501 to \$24,939) resulting in a net increase in Idaho taxable income of \$67,501 (\$82,939 minus \$15,438). Furthermore, \$124,263 of the \$134,128 of income subject to Idaho taxation was included in the petitioners' [Redacted] taxable income. The petitioners do not dispute the adjustments that the Bureau has made to the petitioners' Idaho taxable income; however, the petitioners dispute the Bureau's calculation of the credit for taxes paid to another state.

The petitioner and the Bureau's disagreement centers around an amount used in the calculation of a ratio for determining one of the limitations placed upon the amount of the credit that a part-year resident can claim. More specifically, the petitioners in their petition for redetermination argue that the amount reported on Idaho Form 39, page 2, Part II, section B, line 2, (hereafter "Line 2") should be the "Idaho Adjusted Income derived in the other state." As support for their position, the petitioners point to language contained in the Tax Commission's instructions for Form 39. The Bureau argues that the amount reported on Line 2 is "other states

adjusted gross income . . . restated to a basis comparable to Idaho adjusted income.”¹ The difference between the two parties is as follows:

Credit for Income Taxes Paid to Other State	<u>Per the Bureau</u>	<u>Per Petitioners</u>	<u>Difference</u>
1. Idaho adjusted income	\$134,128	\$134,128	
2. Other state's adjusted income	212,732	124,263	\$88,469
3. Income tax by both states	124,263	124,263	
4. Idaho tax due (net of credits)	\$8,448	\$8,448	
5. Divide line 3 by line 1	93%	93%	
6. Multiply line 4 by line 5	<u>\$7,857</u>	<u>\$7,857</u>	
7. Other state tax due (less credits)	\$10,260	\$10,260	
8. Divide line 3 by line 2	<u>58%</u>	<u>100%</u>	
9. Multiply line 7 by line 8	\$5,951	\$10,260	(\$4,309)
10. Idaho credit allowed (smaller of line 6 or line 9)	<u><u>\$5,951</u></u>	<u><u>\$7,857</u></u>	(\$1,906)

The Tax Commission after reviewing the applicable Idaho statute, Commission Rules and the instructions for Idaho Form 39, finds that the Bureau was correct in its determination of the amount reported on Line 2 as well as the amount of credit that the petitioners were entitled to.

Idaho Code section 63-3029

In 1982 the Idaho legislature expanded the credit for taxes paid to another state found in Idaho Code section 63-3029 to include part-year residents.² As added by the legislature in 1982, Idaho Code section 63-3029(d) stated

- (d) A part-year resident is entitled to a credit, determined in the manner prescribed by the state tax commission, for income taxes paid to another state, as defined in subsection (a) of this section, in regard to income which is:
- (1) Earned while the taxpayer resided in this state; and
 - (2) Subject to tax in such other state.

¹ Page 3, Explanation of Items, attached to the Notice of Deficiency Determination dated June 13, 2002.

² 1982 Idaho Session Laws, Chapter 8, Section 1, page 11.

In 1995, Idaho Code section 63-3029(d)(1) was amended to read “Earned while the taxpayer is domiciled in this state; and” (emphasis added).³ In 1998, Idaho Code section 63-3029 under went a substantial rewrite in order to “to clarify circumstances in which an Idaho taxpayer is entitled to an Idaho income tax credit for taxes paid to other states.”⁴ After the rewrite, Idaho Code section 63-3029 read as follows:

63-3029. Credit for income taxes paid another state or territory. (1)

A resident individual shall be allowed a credit against the tax otherwise due under this chapter for the amount of any income tax imposed on the individual, an S corporation, partnership, limited liability company, or trust of which the individual is a shareholder, partner, member, or beneficiary (to the extent attributable to the individual as a result of the individual's share of the S corporation's, partnership's, limited liability company's or trust's taxable income in another state), for the taxable year by another state on income derived from sources therein while domiciled in Idaho and that is also subject to tax under this chapter.

(2) For purposes of this section, "state" shall include any state of the United States, the District of Columbia, or any possession or territory of the United States.

(3) The credit provided under this section shall not exceed the proportion of the tax otherwise due under this chapter that the amount of the adjusted gross income of the taxpayer derived from sources in the other state as modified by this chapter bears to the adjusted gross income of the taxpayer as modified by this chapter. This limitation applies to all individuals whether the tax paid to the other state is paid by the individual or by an S corporation, partnership, limited liability company, or trust. Further, the credit shall not exceed the tax paid to the other state.

(4) To substantiate the credit allowed under this section, the state tax commission may require a copy of any receipt showing payment of income taxes to the other state or a copy of any return or returns filed with such other state, or both.

(5) No credit allowed under this section shall be applied in calculating tax due under this chapter if the tax upon which the credit is based has been claimed as a deduction, unless the tax is restored to income on the Idaho return.

(6) The credit shall not be allowed if such other state allows a credit against taxes imposed by such state for taxes paid or payable under this act.

(7) For purposes of this section an income tax imposed on an S corporation, partnership, limited liability company, or trust includes:

(a) A direct tax imposed upon the income for the taxable year of the S corporation, partnership, limited liability company or trust; and

³ 1995 Idaho Session Laws, Chapter 111, section 30, page 347.

⁴ 1998 Idaho Session Laws, Chapter 10, section 1, page 108.

- (b) An excise or franchise tax that is measured by the income for the taxable year of the S corporation, partnership, limited liability company, or trust.
- (8) For purposes of subsection (7) of this section, an excise or franchise tax is "measured by income" only if the statute imposing the excise or franchise tax provides that the base for the tax:
 - (a) Includes:
 - (i) Revenue from sales;
 - (ii) Revenue from services rendered; and
 - (iii) Income from investments; and
 - (b) Permits a deduction for the cost of goods sold and the cost of services rendered.
- (9) A part-year resident is entitled to a credit, determined in the manner prescribed by the state tax commission, for income taxes paid to another state in regard to income which is:
 - (a) Earned while the taxpayer is domiciled in this state; and
 - (b) Subject to tax in such other state.
- (10) If the interest in an S corporation, partnership, or limited liability company was held for less than the entire taxable year, the share attributable to the individual shall be allocated in the same manner as for federal purposes.

The language contained in Idaho Code section 63-3029(9) is the same language found in its predecessor Idaho Code section 63-3029(d) both of which allow a part-year resident an Idaho Code section 63-3029 credit “determined in the manner prescribed by the state tax commission” on income that was 1) earned while the part-year resident was domiciled in Idaho and 2) subject to tax in another state.

Idaho Income Tax Rules or Regulations

From November of 1982 until the restructuring of the Idaho income tax rules in 1997, the manner prescribed by the state tax commission is found in Idaho Income Tax Administrative Rule 086 (Rule 086) and its predecessor Idaho Income Tax Regulation 29 (Reg. 29). Both Rule 086 and the Reg. 29 contained the following examples applicable to part-year residents:

EXAMPLE 1: If the income being taxed jointly by Idaho and the other state is less than the amount being taxed by either Idaho or the other state, compute the amount of the credit under Step A or B, below.

STEP A

$$\frac{\text{Same income being taxed jointly by Idaho and the other state}}{\text{Idaho Adjusted Income}} \times \frac{\text{Idaho Tax} = \text{Idaho tax on income}}{\text{taxed by both states}}$$

STEP B

$$\frac{\text{Same income being taxed jointly by Idaho and the other State}}{\text{Other States Adjusted Gross Income}} \times \frac{\text{Other State Tax} = \text{Other States}}{\text{tax on income taxed by both states}}$$

The allowable credit is lesser of Step A or B.

EXAMPLE 2: If the income reported to the other state is being taxed 100% by Idaho, compute the credit under Step A, above. The credit is limited to the lesser of the amount so computed or to the amount of tax paid to the other states.

EXAMPLE 3: If the only income being taxed by Idaho is the same income being taxed jointly by both states and the same income being taxed jointly by both states is less than the amount being taxed by the other state, compute the credit under Step B. The credit is limited to the lesser of the amount so computed or to the amount of tax paid to Idaho.

In 1996 the Tax Commission promulgated two entirely new complete sets of rules replacing the Idaho Income Tax Administrative Rules that included Rule 086. The new sets of rules were titled IDAPA 35.01.01, Idaho Administrative Income Tax Rules and IDAPA 35.02.01, Idaho Administrative and Enforcement Rules. Neither of the new Rules contained former Rule 086's language or provided any guidance with respect to the calculation of the credit. In 1998, Idaho Income Tax Administrative Rule 700 was added to provide some additional information regarding the credit; however, Rule 700 did not contain any language that would determined the manner in which a part-year resident would calculate the credit. As such, the Tax Commission did not have a rule in place that prescribes the manner in which a part-year resident calculates the credit for the tax year 1999; however, the manner in which the calculation

is made was reflected in Tax Commission's 1999 Idaho Form 39, Idaho Supplemental Schedule and accompanying instructions.

Idaho Form 39, Idaho Supplemental Schedule, and Accompanying Instructions

Taxpayers, including part-year residents, have used Idaho Form 39 since 1984 to calculate the credit allowed under Idaho Code section 63-3029. For tax year 1999, Form 39, page 2, Part II, section B calculation and accompanying instructions were as follows:

Form 39, page 2, Part II, section B,

B. Credit for Income Taxes Paid to Another State by Part-Year Residents. See instructions, pages 23 and 24. Nonresidents cannot claim this credit. Idaho residents on active military duty, complete Section C below.		
1. Idaho adjusted income from line 44, Column B, Form 43.....	1.	Attach a copy of the income tax return and a separate Form 39 for each state for which a credit is claimed.
2. Other state's adjusted income.....	2.	
3. Amount on lines 1 and 2 taxed by both states.....	3.	
4. Idaho tax, line 55, Form 43.....	4.	
5. Divide line 3 by line 1. Enter percentage here.....	5.	
6. Multiply line 4 by line 5.....	6.	
7. Other state's tax due less its income tax credits.....	7.	
8. Divide line 3 by line 2. enter percentage here.....	8.	
9. Multiply line 7 by line 8.....	9.	
10. Enter the smaller of lines 6 or 9 here and on line 56, Form 43.....	10.	

Idaho Form 39 instructions contained on pages 23 and 24 read, in pertinent part:

PART II. SECTION B. INCOME TAXES PAID TO ANOTHER STATE BY PART-YEAR RESIDENTS . . .

When the same income is taxed by both Idaho and another state, you may be entitled to a credit for taxes paid to the other state. Use this section to compute the credit. . . .

Line 2 *Enter the amount of Idaho adjusted income derived in the other state.* In computing the income derived in the other state, you must reverse any adjustments to federal taxable income allowed by the other state that are not applicable to Idaho. If you reported your income derived in the other state by filing an:

- *Individual return, enter your adjusted gross income from the other state restated to a basis comparable to Idaho adjusted income.* For example, if the other state taxes interest received from U.S. obligations, deduct this amount from the other state's adjusted gross income as Idaho does not tax this interest. **Emphasis Added**

Finding

Since 1982, the language contained in the examples found in the Commission's Rule 086 or Reg. 29 as well as that part of the instructions for Line 2 specifically dealing with an "individual return" has either been "Other States Adjusted Gross" or "adjusted gross income from the other state restated to a basis comparable to Idaho adjusted income" when calculating a part-year resident's allowable credit. Since the Line 2 instructions for tax year 1999, when read in its entirety, states that for an "individual return" the amount to report on Line 2 is the "adjusted gross income from the other state restated to a basis comparable to Idaho adjusted income," the use of the phrase "Idaho adjusted income derived in the other state" under the general instructions for Line 2 appears to be nothing more than an unfortunate choice of wording.⁵ The use of the other states adjusted gross income restated to a basis comparable to Idaho adjusted income is consistent with the manner prescribed in former Rule 086 and Reg. 29 and with Idaho Code section 63-3029(9), which, limits the amount of credit for income taxes paid to Utah in regard to income which was 1) earned while the petitioners were domiciled in Idaho and 2) subject to tax in [Redacted].

WHEREFORE, the Notice of Deficiency Determination dated June 13, 2002, is hereby APPROVED, AFFIRMED, and MADE FINAL and the petitioners are entitled to a refund of tax in the amount of \$415 plus any interest due to the petitioners in accordance with Idaho law.

An explanation of the petitioners' rights to appeal this decision is enclosed with this decision.

⁵ In the instructions for the 2002 Idaho Form 39R, the phrase "Idaho adjusted income derived in the other state" has been replaced with "the total portion of federal adjusted gross income derived in the other state, modified to reflect Idaho additions and subtractions." The Line 2 specific instruction for an "individual return" remains the same.

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]

Certified Mail No. [Redacted]