

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 17813
[Redacted])	
Petitioner.)	DECISION
)	
)	

On October 27, 2003, the staff of the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayer), proposing additional income tax and interest for the taxable year 2001 in the total amount of \$352.

On December 1, 2003, the taxpayer filed a timely appeal and petition for redetermination. The taxpayer did not request a hearing but rather stated her position in a letter to the Tax Commission. The Tax Commission, having reviewed the file, hereby issues its decision.

The taxpayer filed her 2001 Idaho individual income tax return claiming an "Other subtraction" in the amount of \$4,183. The Income Tax Audit Bureau (Bureau) identified the taxpayer's return as having a potential problem or error. The Bureau examined the taxpayer's return and determined the taxpayer took a deduction that was not available in the Idaho income tax code. The Bureau sent the taxpayer a Notice of Deficiency Determination, which the taxpayer protested.

The taxpayer stated she converted a traditional IRA to a Roth IRA in 1998. She elected to spread the conversion over a four-year period as allowed in the Internal Revenue Code. The taxpayer stated her IRA was converted into a Roth IRA prior to her becoming an Idaho resident. She stated Idaho does not have any claim to funds earned while she was a resident of another state. The taxpayer stated she fulfilled her state tax obligation to the state of [Redacted] at the time the IRA was converted.

The Bureau referred the matter for administrative review, and the Tax Commission sent the taxpayer a letter giving her two alternatives for having the Notice of Deficiency Determination redetermined. The taxpayer chose to present her position in a letter to the Tax Commission.

The taxpayer stated that, beginning in 1991 and through 1997, she contributed to an IRA account from her net income. In contributing to an IRA, the federal government allowed her to deduct up to \$2,000 per year on her federal income tax return. The taxpayer stated all these contributions were made while she was living in [Redacted]. When the federal government recognized Roth IRAs and allowed rollovers from traditional IRAs to Roth IRAs, the taxpayer converted her IRA. In the conversion, the taxpayer was given the choice of paying the deferred tax on the contributions in one year or spreading it out over four years. She chose to pay the tax over four years. The taxpayer stated the rollover was done while she was living in [Redacted]. The funds in question were all earned in [Redacted]. In fact, the Roth account is still in [Redacted]. The taxpayer stated all state tax requirements were met for these funds. She said she doesn't believe Idaho has any authority to collect tax on funds earned in [Redacted], previously taxed in [Redacted], and still remaining in [Redacted].

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 taxpayer stated that, in the conversion of the traditional IRA to the Roth IRA, the federal government required her to include in federal taxable income the deferred income of the traditional IRA. The taxpayer also stated that she elected to spread the tax on conversion over four years as allowed by the Internal Revenue Code. The Tax Commission agreed with the taxpayer's treatment at the federal level. However, the Tax Commission does not agree that the Idaho Code allows the taxpayer to subtract the deferred income included in federal taxable income.

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. The 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, 25 Idaho P. 3d 113 (2001), 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 taxpayer contributed to an IRA while she resided in another state and received no Idaho 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. Therefore, the conversion amount reported for federal purposes must also be reported 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 subtraction" claimed by the taxpayers. Potlatch Corp. v. Idaho State Tax Comm'n, 128 Idaho 387, 913 P.2d 1157 (1996).

The taxpayer stated all state taxes were taken care of in the year of conversion. The Tax Commission is not sure what the taxpayer is referring to here since the state of Nevada does not have an income tax. If the taxpayer is claiming she is being double taxed, which is unlikely coming from Nevada, the Idaho Supreme Court addressed this in 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 taxpayer's conversion of her traditional IRA to a Roth IRA is a distribution of an IRA and reportable to Idaho.

WHEREFORE, the Notice of Deficiency Determination dated October 27, 2003, is hereby APPROVED, AFFIRMED, and MADE FINAL.

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

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2001	\$320	\$39	\$359

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

An explanation of the taxpayer's right to appeal this decision is enclosed with this decision.

DATED this ____ day of _____, 2004.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2004, 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.
