

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 18034
[REDACTED]))	
)	DECISION
Petitioners.)	
_____)	

On April 2, 2004, the staff of the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayers), proposing income tax and interest for the taxable year 2001 in the total amount of \$1,338.

On May 3, 2004, the taxpayers filed a timely appeal and petition for redetermination. The taxpayers' representative requested a telephone hearing, which was held on June 10, 2004. The Tax Commission, having reviewed the file, hereby issues its decision.

The taxpayers timely filed their 2001 nonresident Idaho income tax return reporting the gain on the installment sale of their Idaho property. The Income Tax Audit Bureau (Bureau) reviewed the taxpayers' return and determined the taxpayers were not entitled to the full amount of the Idaho capital gains deduction claimed on their return. The Bureau also found that the taxpayers did not report the interest income on the installment sale to Idaho. The Bureau corrected the taxpayers' return and sent them a Notice of Deficiency Determination.

The taxpayers protested the Bureau's determination. The taxpayers stated they disagreed with the Bureau's determination of the Idaho capital gains deduction. The taxpayers referenced IDAPA 35.01.01.170.01 Income Tax Administrative Rule that provides, "the Idaho capital gains deduction may not exceed the capital gain net income included in Idaho taxable income." The taxpayers stated that, because their Idaho taxable income includes the entire capital gain, the entire capital gains deduction should be allowed. The taxpayers stated that the original wording of the

Idaho statute does not appear to consider the case of a nonresident taxpayer filing an Idaho return to report Idaho capital gains. A strict reading of the statute results in extremely unfair treatment to the nonresident taxpayer that realizes significant capital losses reported on their federal return but only capital gains on their Idaho return. The taxpayers stated that changes in the language of Idaho Code section 63-3022H demonstrate that the nonresident situation was considered and remedied since the statute was first written.

The Tax Commission sent the taxpayers a letter giving them two methods for having the Notice of Deficiency Determination redetermined. The taxpayers' representative requested a telephone hearing. During the hearing, the taxpayers' representative stated that IDAPA 35.01.01.170.01 states that the net capital gain income had to be included in Idaho taxable income. From this he theorized that the deduction, computed on the capital gain included in Idaho taxable income, should be limited by what was included in Idaho taxable income not federal taxable income. The representative stated that the statute (Idaho Code section 63-3022H) was changed in later years to stating that the deduction was limited to the net capital gain income included in "taxable income." The change was the dropping of the word "federal" from taxable income. He stated this change was to recognize the disparity in cases like this where the amount of federal capital gain is offset by losses not reportable to Idaho. The representative said he believed Rule 170.01 clarified the intent of the statute. If the gain was included in Idaho taxable income, the deduction should only be limited by what was included in Idaho taxable income.

Idaho Code section 63-3022H stated, in pertinent part,

(1) If an individual taxpayer reports a net capital gain in determining taxable income, eighty percent (80%) in taxable year 2001 and sixty percent (60%) in taxable years thereafter of the net capital gain from the sale or exchange of qualified property shall be a deduction in determining taxable income.

(2) The deduction provided in this section is limited to the amount of the capital gain net income from all property included in federal taxable income. Gains treated as ordinary income by the Internal Revenue Code do not qualify for the deduction allowed in this section. The deduction otherwise allowable under this section shall be reduced by the amount of any federal capital gains deduction relating to such property, but not below zero.

The Bureau adjusted the taxpayers' 2001 return because their federal return reported a net capital gain of only \$1,459. The taxpayers' Idaho income tax return reported a gain of \$37,292 as the only Idaho source income of the taxpayers. The taxpayers then claimed the 80% capital gains deduction on the full amount of the gain. The Bureau adjusted the taxpayers' return because the gain reported on the taxpayers' federal return limited the deduction to the amount reported on their federal return.

Idaho Code section 63-3022H states that, if an individual has reported in taxable income a net capital gain, 80% of the net capital gain from the sale of qualifying property shall be a deduction in determining taxable income. Taxable income is defined in Idaho Code section 63-3011B as federal taxable income as determined under the Internal Revenue Code (IRC). IRC section 1222(11) defines net capital gain as the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for such year.

On the taxpayers' 2001 federal return, they reported long-term capital losses as well as the long-term capital gain from the sale of their Idaho property. The net result was a long-term capital gain. The taxpayers also reported a net short-term capital loss. The net short-term capital loss was less than the net long-term capital gain so the taxpayers realized a net capital gain.

The Idaho Code allows a capital gain deduction if a net capital gain is included in taxable income. The taxpayers had a net capital gain used in determining taxable income, so a capital gains deduction was available to them. However, the Idaho Code limits the amount of the capital

gains deduction in subsection (2) of section 63-3022H. The limitation is: the amount of the deduction cannot exceed the capital gain net income from all property included in federal taxable income. IRC section 1222(9) defines capital gain net income as the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges. The taxpayers had both capital gains and capital losses. After combining the gains and losses, the taxpayers had capital gain net income of \$1,459. Therefore, according to Idaho Code section 63-3022H(2), the taxpayers' capital gains deduction is limited to \$1,459.

The taxpayers argued the change in the language of Idaho Code section 63-3022H is an indication that the Idaho legislature recognized the disparity between resident individuals and nonresident individuals. The taxpayers stated it represents the intent of the legislature and should be applied in this case. The Tax Commission agrees that the change in the language clarified the intent and purpose of the statute. However, the change in the language does nothing to rectify the so-called disparity between residents and nonresidents. The taxpayers seem to think the language change changes the way nonresidents are treated. The Tax Commission does not agree. Nonresidents, as well as residents, are still limited to the amount of capital gain net income from all property included in federal taxable income.

WHEREFORE, the Notice of Deficiency Determination dated April 2, 2004, is hereby 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>
2001	\$1,187	\$187	\$1,374

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

An explanation of taxpayers' right to appeal this decision is enclosed.

DATED this ____ day of _____, 2004.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE BY MAIL

I hereby certify that I have on this ____ day of _____, 2004, served a copy of the within and foregoing DECISION by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted]
[REDACTED]

[Redacted]