



of the Idaho capital gain deduction “is limited to the amount of the capital gain net income from all property included in federal taxable income.” Idaho Code § 63-3022H (2001).<sup>1</sup> Thus, Mr. and Mrs. [Redacted] overstated the amount of the allowable Idaho capital gain deduction by failing to apply the limitation set out in Idaho Code § 63-3022H(2). (For ease of reference, we will hereinafter refer to the limitation as the “capital gain net income limitation.”).

The taxpayers’ 2001 and 2002 Idaho nonresident individual income tax returns were selected for audit. A Notice of Deficiency Determination was then issued that reduced the Idaho capital gain deduction to the amount allowed after applying the capital gain net income limitation. Mr. and Mrs. [Redacted] then filed this administrative protest.

The taxpayers raise two arguments in this protest. First, they argue that the Tax Commission is misreading the capital gain net income limitation. Second, they argue that even if the Commission is correctly interpreting the capital gain net income limitation, the statutory limitation violates the Privileges and Immunities Clause of the U.S. Constitution.

## **OPINION**

### **A. Statutory Construction.**

In their letter of protest, Mr. and Mrs. [Redacted] contend that the Tax Commission’s audit staff has misread the capital gain net income limitation set out in Idaho Code § 63-3022H(2). The gist of the taxpayers’ statutory construction argument is that: (1) there was no capital gain net income limitation prior to 1995; (2) the 1995 amendment that created the limitation was presented to the Idaho Legislature as a revenue neutral proposal that was not intended to impact Idaho taxpayers or to increase or decrease the tax base; and, therefore, (3) the specific language of Idaho Code § 63-3022H(2) cannot be read literally but, rather, must be read

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<sup>1</sup> The term “capital gain net income” is defined in Internal Revenue Code § 1222(9) as “the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges.”

in a manner consistent with the treatment afforded Idaho taxpayers prior to the 1995 amendment. In the end, the taxpayers assert that the phrase “included in federal taxable income” must be read to mean “included in Idaho taxable income.” To emphasize this point, it is helpful to view the relevant statutory language as written and as Mr. and Mrs. [Redacted] assert it should be interpreted.

- As written:

**63-3022H. Deduction of capital gains.** – (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. . . .

Idaho Code § 63-3022H (Supp. 2001) (underline added for emphasis).<sup>2</sup>

- As interpreted by the taxpayers:

**63-3022H. Deduction of capital gains.** – (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 Idaho taxable income. . . .

(Underline added for emphasis).

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<sup>2</sup> As in effect for the 2001 taxable year. The statute was amended effective January 1, 2002. See 2002 Idaho Sess. Laws, Ch. 35, § 2, p. 68. Among other changes, the 2002 legislation deleted the word “federal” from the limitation set out in Idaho Code § 63-3022H(2). Thus, for the 2002 taxable year the Idaho capital gain deduction was limited to “the amount of the capital gain net income from all property included in taxable income.” *Id.* The term “taxable income” is defined in Idaho Code § 63-3011B as “federal taxable income as determined under the Internal Revenue Code.” Therefore, for purposes of this administrative protest, the 2002 amendment does not affect our analysis. Rather, as relevant in this protest, the 2002 amendment merely deleted a redundant word.

Under the taxpayers' proposed interpretation, they would be entitled to the full Idaho capital gain deduction during the years at issue because the capital gain net income from all property included in their Idaho taxable income was equal to the amount of the net capital gain from the sale or exchange of qualified property. In other words, by not considering the "non-Idaho source" gains and losses reported by Mr. and Mrs. [Redacted] on their federal income tax return, they would be entitled to the full Idaho capital gain deduction.

We reject the taxpayers' proposed interpretation of the statute. The Tax Commission is required to enforce the tax laws of this state as written. Idaho State Tax Com'n v. Stang, 135 Idaho 800, 802, 25 P.3d 113, 115 (2001); Bogner v. State Dept. of Revenue & Tax., 107 Idaho 854, 856, 693 P.2d 1056, 1058 (1984). Where the express language of a statute is clear and unambiguous, "the clear expressed intent of the legislature must be given effect and there is no occasion for construction." Worley Highway Dist. v. Kootenia Cty., 98 Idaho 925, 928, 576 P.2d 206, 209 (1978) (*quoting* State v. Riley, 83 Idaho 346, 349, 362 P.2d 1075, 1076 - 1077 (1961)). *See also* State v. Berntsen, 68 Idaho 539, 547, 200 P.2d 1007, 1011 (1948) ("Where the language of a legislative enactment is clear, then the court cannot speculate upon the intention of the legislature, but must accept the interpretation of the act as it appears therein."). While the taxpayers have asserted that the legislative history relating to Idaho Code § 63-3022H(2) supports their interpretation of the capital gain net income limitation, the bottom line is that the statutory language is clear on its face. The limitation applies to "the capital gain net income from all property included in federal taxable income." The Commission's audit staff correctly applied the limitation as written. Because the statute is clear and unambiguous, there is no need to consult the legislative history cited by the taxpayers in their letter of protest.

But even if we were to conclude that the statutory language is ambiguous and open to interpretation, the legislative history cited by the taxpayers does not necessarily support their proposed interpretation of the statute. The capital gain net income limitation was added as part of a 1995 amendment to the Idaho capital gain deduction. *See* 1995 Idaho Sess. Laws, Ch. 83, §3, p. 244. The Statement of Purpose relating to that legislation does not refer to the capital gain net income limitation but, instead, refers to some of the other amendments to the capital gain deduction that were part of the same act. *See* 1995 Statement of Purpose of House Bill 131. More specifically, the Statement of Purpose provides in relevant part as follows:

This bill makes technical corrections to the Idaho Income Tax Act. The corrections are to add clarity and eliminate ambiguity. The bill: . . .

. . . .

Clarifies the Idaho long-term capital gain deduction for tangible personal property used by a “revenue producing enterprise.” It clarifies treatment of gains by shareholders of S corporations, partners of partnerships, and beneficiaries of estates and trusts.

*Id.* The Statement of Purpose goes on to provide that the bill will have “[n]o fiscal effect.” From this relatively sparse legislative history, the taxpayers conclude that the 1995 amendment to the Idaho capital gain deduction statute was not intended to make any substantive change in the law but, rather, was in the nature of “general housekeeping.” Letter of protest, p. 6.<sup>3</sup> Thus, according to the taxpayers, the statute should be read and interpreted the same both before and after the 1995 amendment.

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<sup>3</sup> The taxpayers also cite to legislative history relating to a different amendment made to Idaho Code § 63-3022H during the 1995 legislative session. *See* letter of protest pp. 5 - 6 (referring to the legislative history of 1995 Idaho Sess. Laws, Ch. 111, p. 347). However, that amendment did not relate to the capital gain net income limitation and only made a very minor modification to Idaho Code § 63-3022H(1). *See* 1995 Idaho Sess. Laws, Ch. 111, § 15, p. 359. We do not find the legislative history relating to this minor modification to the Idaho capital gain deduction to be germane to the issue raised in this administrative protest.

Because the Statement of Purpose to 1995 House Bill 131 does not specifically refer to the capital gain net income limitation, we are not convinced that the Bill was intended to have no substantive effect on the calculation of the capital gain deduction. In a general sense, the proposed Bill was intended “to add clarity and eliminate ambiguity.” Adding clarity and eliminating ambiguity does not necessarily equate to making no substantive change in the calculation of the deduction. Furthermore, the fact that the Bill was anticipated to have no fiscal effect does not convince us that the capital gain net income limitation was intended to have no substantive effect on the calculation of the deduction. At best, the relevant legislative history is ambiguous as to the intent and purpose of the inclusion of the newly codified capital gain net income limitation. Ambiguous legislative history is simply not sufficient to override the express and unambiguous language used in the statute itself. *C.f.*, Big Sky Paramedics, LLC v. Sagle Fire Dist., 140 Idaho 435, 437 - 438, 95 P.3d 53, 55 - 56 (2004) (Eismann, J., concurring) (“Statements made by persons supporting legislation cannot modify the plain language of the legislation. Their expressed reasons for supporting the legislation are irrelevant when interpreting the wording used in the legislation.”).

Because the statute is clear on its face, and because the taxpayers have been unable to point to any relevant legislative history that clearly indicates that the statute should be interpreted in a manner other than as expressly written, we reject the taxpayers’ statutory construction argument. During the years at issue the Idaho capital gain deduction was “limited to the amount of the capital gain net income from all property included in federal taxable income.” Idaho Code § 63-3022H(2) (Supp. 2001). The audit staff correctly applied that limitation when it made the audit adjustments that are the subject matter of this administrative protest. Therefore, absent a

constitutional defect in the statute, the audit adjustments must be upheld. We now turn to the taxpayers' constitutional argument.

**B. Privileges and Immunities Clause.**

The taxpayers assert that, if the audit staff's interpretation of the capital gain net income limitation is upheld, the statutory limitation would result in a violation of the Privileges and Immunities Clause. Letter of protest, pp. 6 - 7. We disagree.

The Privileges and Immunities Clause provides that "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens of the several States." U.S. Const., Art. IV, § 2. The U.S. Supreme Court has interpreted the Privileges and Immunities Clause to prohibit States from discriminating against nonresident individuals absent a substantial reason for the discriminatory treatment. Historically, the Privileges and Immunities Clause has not been a very effective mechanism for attacking state tax laws. According to the Supreme Court, "as a practical matter, the Privileges and Immunities Clause affords no assurance of precise equality in taxation between residents and nonresidents of a particular State. Some differences may be inherent in any taxing scheme, given that, '[l]ike many other constitutional provisions, the privileges and immunities clause is not an absolute,' and that '[a]bsolute equality is impracticable in taxation.'" Lunding v. New York Tax Appeals Tribunal, 522 U.S. 287, 297, 118 S.Ct. 766, 774 (1998) (quoting Toomer v. Witsell, 334 U.S. 385, 396, 68 S.Ct. 1156, 1162 (1948), and Maxwell v. Bugbee, 250 U.S. 525, 543, 40 S.Ct. 2, 7 (1919)). However, the Privileges and Immunities Clause will invalidate a state tax law that discriminates against nonresidents "where there is no substantial reason for the discrimination beyond the mere fact that they are citizens of other States." Toomer v. Witsell, 334 U.S. 385, 396, 68 S.Ct. 1156, 1162 (1948). See also State v. Berntsen, 68 Idaho 539, 200 P.2d 1007 (1948) (invalidating an

Idaho tax law on Privileges and Immunities Clause grounds where the tax statute specifically denied married nonresidents with dependent children an exemption that was provided to similarly situated residents.).

The first step in a Privileges and Immunities Clause analysis is to show that the state law in question discriminates against a nonresident of the state. If the person challenging the state law is able to make that initial showing of discrimination, the state must defend its statute by showing that (1) there is a substantial reason for the discriminatory treatment; and (2) the discrimination practiced against nonresidents bears a substantial relationship to the state's objective. Supreme Court of N.H. v. Piper, 470 U.S. 274, 284, 105 S.Ct. 1272, 1278 (1985).

In the present protest, the taxpayers have not convinced us that the capital gain net income limitation discriminates against nonresidents. Absent that initial showing of discrimination, there can be no violation of the Privileges and Immunity Clause.

On its face, the capital gain net income limitation applies the same to both residents and nonresidents of this state. If, for example, a taxpayer had a \$10 gain from the sale of qualifying Idaho real property and a \$7 loss from the sale of stock (which does not qualify for the Idaho capital gain deduction), he would have capital gain net income of \$3. If the taxpayer happened to be a resident of Idaho, his Idaho capital gain deduction would be limited to \$3, which is the capital gain net income from all property included in federal taxable income. Likewise, if the taxpayer was a nonresident of Idaho, his Idaho capital gain deduction would be limited to \$3. In either case, the amount of the Idaho capital gain deduction is the same. The difference in the ultimate Idaho income tax owed by the hypothetical resident and nonresident lies in the fact that the Idaho resident gets to claim the \$7 loss from the sale of stock in computing his Idaho taxable income while the nonresident does not. Therefore, for Idaho income tax purposes, the

nonresident must include the \$10 gain from the sale of the Idaho real property as Idaho source income (just like the Idaho resident), is allowed an Idaho capital gain deduction of \$3 (just like the Idaho resident), but is not able to offset his Idaho taxable income with the non-Idaho source capital loss from the sale of the stock.

The U.S. Supreme Court has long-ago held that a state is not required to allow nonresidents to deduct losses generated from property or activity that is not from “sources” within the taxing state. Shaffer v. Carter, 522 U.S. 37, 40 S.Ct. 221 (1920). More recently, in Lunding v. New York Tax Appeals Tribunal, the Supreme Court reiterated this principle:

In *Shaffer v. Carter*, the Court upheld Oklahoma’s denial of deductions for out-of-state losses to nonresidents who were subject to Oklahoma’s tax on in-state income. The Court explained:

“The difference . . . is only such as arises naturally from the extent of the jurisdiction of the State in the two classes of cases, and cannot be regarded as an unfriendly or unreasonable discrimination. As to residents, it may, and does, exert its taxing power over their income from all sources, whether within or without the State, and it accords to them a corresponding privilege of deducting their losses, wherever these accrue. As to nonresidents, the jurisdiction extends only to their property owned within the State and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources. Hence there is no obligation to accord to them a deduction by reason of losses elsewhere incurred.”

Lunding v. New York, 522 U.S. at 299, 118 S.Ct. at 775 (*quoting Shaffer v. Carter*, 252 U.S. at 57, 40 S.Ct. at 227.).

In the present protest, the taxpayers make the following Privileges and Immunities Clause argument:

[T]he purpose of the privileges and immunities clause of the United States Constitution is to “assure to the citizens of any one state the same treatment accorded to its own citizens and residents by a State Legislature.” *State v. Berntsen*, 68 Idaho 539, 541, 200 P.2d 1007 (1948). However, by interpreting and applying Idaho Code § 63-3022H in the

manner proposed [by the audit staff], nonresidents of Idaho will be treated in a grossly disparate manner from their resident counterparts.

For example, assume that an Idaho resident sells Idaho real property for a gain, while in the same year disposing of Washington real property at a loss equal to such gain. This Idaho resident will not be subject to tax in Idaho on the gain flowing from the sale of his Idaho real property, **because the offsetting Washington loss will also be reported on said resident's Idaho income tax return thereby resulting in net Idaho income of zero.** Now suppose instead, that a Washington resident sells Idaho real property at a gain, while in the same taxable year disposing of Washington real property at a loss equal to such gain. The Washington resident will be forced to recognize Idaho gain in the year in question, **because the Washington resident is not allowed to report non-Idaho source capital losses on his Idaho income tax return.** However, the Washington resident will also not be allowed to avail himself of the Idaho capital gains deduction, because for purposes of determining his federal capital gain net income, the capital loss sustained in Washington will cause him to report capital gain net income on his federal income tax return of zero. Thus, a nonresident of Idaho will be denied the benefit of the deduction and forced to pay Idaho income tax, while under the same facts an Idaho resident would not be required to pay Idaho income tax.

Letter of protest, p. 7 (bolding added for emphasis).

Note that under the hypothetical set out above, both the Idaho resident and the Washington resident get exactly the same Idaho capital gain deduction (zero). The difference in tax treatment is the result of the fact that Idaho does not allow the nonresident to report his capital loss from the sale of Washington property, thereby preventing the Washington resident from offsetting the gain recognized on the sale of Idaho property. As pointed out above, the U.S. Supreme Court has stated on more than one occasion that it is not a violation of the Privileges and Immunities Clause to deny a nonresident a deduction for losses that are not connected to “sources” within the taxing state. Thus, the hypothetical provided by the taxpayers does not establish that the state of Idaho is **unconstitutionally** discriminating between residents and nonresidents. More importantly, the hypothetical presented by the taxpayers does not indicate

that there is any discrimination at all with respect to the Idaho capital gain deduction. Under the taxpayers' hypothetical, the amount of the Idaho capital gain deduction is the same if the taxpayer is a resident of Idaho or a resident of [Redacted].

The taxpayers' entire Privileges and Immunities Clause argument is built on faulty logic. Unless and until the taxpayers can show some actual discrimination against nonresidents relating to the capital gain net income limitation, their Privileges and Immunities Clause argument fails.

**ORDER**

WHEREFORE, the Notice of Deficiency Determination dated October 27, 2004, is hereby APPROVED, AFFIRMED AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following taxes, penalties, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2001	\$ 1,886	\$ -0-	\$ 357	\$ 2,243
2002	27,979	-0-	3,508	<u>31,487</u>
			TOTAL DUE	<u>\$ 33,730</u>

Interest is calculated through June 30, 2005, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6)(b) until paid.

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

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

DATED this \_\_\_\_\_ day of June, 2005.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of June, 2005, 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]  
[Redacted]

Receipt No.

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