

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 20455
[REDACTED],)	
)	DECISION
Petitioner.)	
_____)	

On August 15, 2007, the Revenue Operations Division (Division) of the Idaho State Tax Commission issued a Notice of Deficiency Determination (NODD) to [Redacted] proposing denial of a \$172 refund and additional Idaho individual income tax and interest in the total amount of \$272.14 for tax year 2006.

The petitioner filed a timely protest and petition for redetermination. He submitted no documents for examination and did not request an informal conference. The Tax Commission has reviewed the file and hereby issues its decision.

The petitioner filed a timely 2006 Idaho part-year resident individual income tax return. The petitioner attached a note explaining that he was on active duty with the military until he retired in October 2006. At that time he moved back to Idaho, his state of residence.

He said the difference in the income reported in his federal and state returns was because of an IRA distribution. He said that, as an Idaho resident on active duty [Redacted], his military pay was not taxed by Idaho. He explained that he contributed a portion of that pay into a U.S. government Thrift Savings Plan (TSP) that was rolled into an IRA. When he retired in 2006, the traditional IRA was rolled into a Roth IRA. Federal income taxes were required to be paid on the funds that were rolled into the Roth IRA. The petitioner said he prepared a federal Form 8606, Nondeductible IRAs, for the portion of the funds going to the Roth IRA for Idaho income tax only.

Because the petitioner was considered an Idaho resident during the entire 2006 tax year, the Division changed the petitioner's Idaho tax form from a part-year resident form to a resident form. In addition, the Division sent the petitioner a NODD that denied the petitioner the \$172 refund shown in the part-year resident return and notified him of \$271 of tax and \$1.14 of interest as shown in the resident return. The petitioner contested the change.

The Division acknowledged the petitioner's protest and referred the matter for administrative review. In response to a letter advising the petitioner of his rights regarding his appeal, the petitioner sent a letter stating his position. He said he did not require a hearing and he had no additional statements or documents to submit beyond his original 2006 tax return and his letter of disagreement.

He reiterated his position:

It is my contention that deferred (for tax purposes) military pay earned while on active duty with the US Air Force while a resident of Idaho stationed outside the state of Idaho is still exempt from Idaho state taxes when the military pay is no longer deferred.

In my case the deferred (for tax purposes) military pay was placed into a traditional IRA and subsequently withdrawn. The Idaho tax code clearly states this pay is tax exempt. The code does not specify the exemption has to be taken in the year the income was earned.

Idaho Code section 63-3002 states it is the intent of the Idaho Legislature to impose a tax on the residents of this state measured by their income from whatever source derived. Although on active duty with the military during 2006, the petitioner was a resident of Idaho. He does not contest this fact. Therefore, according to Idaho Code section 63-3002, the petitioner should have reported all his income for the year to Idaho. However, the return the petitioner filed with Idaho was a part-year resident return. He reported a different amount for IRA distributions in his Idaho return than he reported in his federal return.

The petitioner explained that the IRA from which he received a distribution was funded with his military pay while he was stationed outside of Idaho. He contends that because his military wages were Idaho tax exempt his TSP contributions should continue to be Idaho tax exempt when they are withdrawn now and in the future.

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. 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. Therefore, the amount of the distribution from the petitioner's traditional IRA reported for federal purposes is also reportable to Idaho.

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 Stang, the taxpayers contributed to an IRA while they resided in another state and received no 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.

The Court stated in Idaho State Tax Comm'n v. 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.

The petitioner summed up his position: "In short I contend you are asking me to pay taxes on tax exempt income by claiming that income became deferred income when it was put into a TSP, which I believe was not the intent or the 'spirit' of the Idaho tax code."

When the petitioner contributed his military compensation to a TSP that later became a traditional IRA, receipt of that income was deferred until he received it as a distribution (no longer military compensation) in a later year. When funds in the IRA are distributed, the distribution is a taxable event in the year of the distribution.

Idaho has no specific exemption or deduction for modifying taxable income when a traditional IRA is converted to a Roth IRA regardless of how it was funded. The Tax Commission must enforce the law as written and disallow the deduction claimed by the taxpayer. Potlatch Corp. v. Idaho State Tax Comm'n, 128 Idaho 387, 913 P.2d 1157 (1996).

The Tax Commission upholds the Division's determination that the petitioner's conversion of his traditional IRA to a Roth IRA is a distribution of an IRA and reportable to Idaho.

WHEREFORE, the Notice of Deficiency Determination dated August 15, 2007, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pays the following tax and interest for 2006:

<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
\$271	\$9	\$280

Interest is computed through October 15, 2007.

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.

DATED this _____ day of _____, 2007.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2007, 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]

Receipt No.
