

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 18965
[REDACTED],	)	
	)	DECISION
Petitioners.	)	
_____	)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated April 25, 2005. The Notice of Deficiency Determination asserted additional liabilities for Idaho income tax, penalties, and interest in the total amounts of \$53,135 and \$68,992 for 2000 and 2001, respectively.

The petitioners were Idaho residents during 2000 and part-year residents in 2001. [Redacted] was president of [Redacted] which operated at the [Redacted] and was a shareholder in [Redacted], an S corporation. Both the petitioners and [Redacted] were audited for 2000 and 2001. Only the audit of [Redacted] is before us.

The auditor made several adjustments to the petitioners' returns. They are:

1. The auditor reclassified amounts paid for tax planning,
2. The auditor added back the petitioners' proportionate share of state income tax paid by [Redacted],
3. The auditor determined that for 2001 the petitioners had not properly determined the amount of their Idaho source income,
4. Itemized deductions were redetermined,
5. For 2001, the auditor denied [Redacted] in the amount of \$29,452, and
6. Credit for tax paid to other states was reduced by \$35,226 and \$16,136 for 2000 and 2001, respectively.

The petitioners concede items 2 and 5 above. Therefore, these issues will not be discussed further in this decision.

#### FEES FOR TAX PLANNING

The auditor reclassified fees paid for the petitioners' tax planning from that of a business expense to being an investment expense. The petitioners had deducted the costs on Schedule E. The auditor determined that the expense should be treated as an itemized deduction subject to the 2 percent of adjusted gross income limitation, citing Treasury Reg. § 1.67-1T(a)(iii) as authority for his position.

The petitioners were invited to submit authority for their position that the expenses should be treated as business expenses and not be subject to the 2 percent floor. They have submitted no such authority. The Commission finds that the auditor's determination is correct and hereby affirms the auditor's position.

#### IDAHO SOURCE INCOME

For 2001, the auditor determined that the petitioners did not report all of the income that should have been classified as Idaho source income. The petitioners held an interest in [Redacted] throughout the year. Mr. [Redacted] also received wages from both [Redacted] and [Redacted]. The petitioners reported income based on the percentage of the year that they were residents of the state of Idaho. The auditor determined that there was also income from an Idaho source during the time the petitioners were nonresidents of Idaho. After the Notice of Deficiency Determination was issued, the petitioners verified that the wages the petitioners objected to having been deemed to be from an Idaho source were from a source in another state. Therefore, in the auditor's modified report, he appropriately removed this amount from the computation of Idaho source income.

The auditor also determined that certain interest expense claimed as Idaho source by the petitioners was not properly attributable to Idaho. He cited Idaho Code § 63-3026A(3)(iii) as authority for his position regarding the interest expense. Idaho Code § 63-3026A(3)(iii) stated:

(2) For part-year resident individuals, trusts or estates the term "Idaho taxable income" includes the total of: (a) Idaho taxable income as computed for a resident for the portion of the tax period during which a taxpayer is domiciled in or is residing in Idaho, plus (b) those components of Idaho taxable income which are derived from or related to sources within Idaho for that portion of the tax period during which a taxpayer is not domiciled in and is not residing in Idaho. This is to be computed without the deductions for either the standard deduction or itemized deductions or personal exemptions except as provided in subsection (4) of this section.

(3) For the purposes of subsections (1) and (2) of this section:

(a) Income shall be considered derived from or relating to sources within Idaho when such income is attributable to or resulting from:

(i) Any business, trade, profession or occupation conducted or carried on in this state, including the distributive share of partnership income and deductions, and the pro rata share of S corporation income and deductions;

(ii) The ownership or disposition of any interest in real or tangible personal property located in this state;

(iii) The ownership or disposition of any interest in intangible personal property only to the extent that such property is employed in a business, trade, profession or occupation conducted or carried on in this state. Provided however, that interest income from an installment sale of real or tangible personal property shall constitute income from sources within this state to the extent that the property sold was located within this state. Provided further, that interest income received by a partner or shareholder of a partnership or S corporation from such partnership or S corporation shall constitute income from sources within this state to the extent that the partnership or S corporation is transacting business within this state;

This interest was on a debt incurred for the purpose of buying stock in [Redacted]. The interest expense was paid after the petitioners changed their domicile from Idaho to [Redacted].

The petitioners argued that the interest expense should be allowed in the same percentage that the income from the corporation was taxed in Idaho. The petitioners did not provide authority for their argument. Upon reviewing the facts and the applicable law, the Commission finds that the underlying asset (the stock) would need to have been "employed in a business, trade, profession or

occupation conducted or carried on in this state.” There has been no showing that the stock was so employed. Therefore, the auditor’s position with regard to this issue must be affirmed.

#### ITEMIZED DEDUCTIONS

The itemized deductions were adjusted both in the computation of the original deficiency and in the auditor’s modified deficiency. The petitioners made no objection to these computations.

#### TAX PAID TO OTHER STATES

This adjustment needs to be modified for two reasons. First, the petitioners provided additional information which justified a reduction of these adjustments and second, there was a legislative change which affects the computation of this credit.

As was stated above, the auditor reduced the claimed credit for tax paid to other states by \$35,226 and \$16,136 for 2000 and 2001, respectively. The petitioners submitted additional documentation causing these adjustments to be reduced to \$16,108 and \$9,922 for 2000 and 2001, respectively.

During the pendency of this appeal, the Idaho Legislature, in 2007, passed House Bill 240 which further modified the computation of the credit allowable. This modification reduces the adjustments from \$16,108 and \$9,922 for 2000 and 2001, respectively, to \$14,018 and \$9,466 for 2000 and 2001, respectively .

#### AUDIT OF BGI

The petitioners raise one issue that was not addressed by the auditor. [Redacted] was previously audited by the staff of the Commission. It was determined that additional income was taxable by Idaho. Even though [Redacted] was an S corporation, it agreed to pay the liability at the entity level rather than have the income flow through to the shareholders. The amounts were computed. Notices of Deficiency were issued. No appeal was filed. The amounts were paid.

In computing the amounts due at the entity level, amounts were subtracted to reflect the amounts of income reported by the shareholders of the S corporation. These amounts (\$100,075 for 2000 and \$545,070 for 2001) came directly from the Idaho income tax returns filed by [Redacted]. The petitioners now argue (apparently correctly) that the amounts were too low. It appears that at least a portion of the error made was in determining the amount of income reported to Idaho by the petitioners. The petitioners now argue that the alleged error in determining the amounts due (and paid) at the entity level should produce a benefit (either a deduction or a credit) which would be usable in determining the amount taxable to the petitioners.

The relief that the petitioners seek is essentially a credit for tax paid to Idaho. While the Idaho Code contains a provision for a credit for tax paid to another state, there is no similar provision for a credit for tax paid to Idaho. Notices of Deficiency were issued at the entity level. There was a time provided by statute (63 days) in which an appeal of the Notices of Deficiency could have been filed at the entity level and such a defense would have been entertained. That time expired without an appeal having been filed. If the entity agreed to a liability that was incorrect and subsequently sought to collect it from the petitioners, then the petitioners' grievance lies with the entity, not with the Commission.

WHEREFORE, the Notice of Deficiency Determination dated April 25, 2005, is hereby MODIFIED, and as so modified, is APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax, penalty, and interest (computed to July 31, 2008):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2000	\$16,992	\$2,549	\$ 7,949	\$27,490
2001	44,557	6,684	17,408	<u>68,649</u>
				<u>\$96,139</u>

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

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2008.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_, 2008, 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.

\_\_\_\_\_