BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 20803
[REDACTED],	)	
	)	DECISION
Petitioner.	)	
	)	

On November 28, 2007, the staff of the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayer) proposing income tax, penalty, and interest for the taxable years 2003 and 2004 in the total amount of $150,105.

On December 13, 2007, the taxpayer filed a timely appeal and petition for redetermination. The taxpayer did not request a hearing but did provide additional information for the Tax Commission to consider. The Tax Commission, having reviewed the file, hereby issues its decision.

The Income Tax Audit Bureau (Bureau) received information that showed the taxpayer sold Idaho property in 2003 and 2004. The Bureau researched the Tax Commission's records and found that the taxpayer did not file Idaho individual income tax returns for those years. Idaho Code section 63-3026A states, in part, that income is considered derived from an Idaho source when the income is attributable to or resulting from the ownership or disposition of any interest in real or tangible personal property located in Idaho. The Bureau sent the taxpayer letters asking him about his requirement to file Idaho individual income tax returns. The taxpayer did not respond. The Bureau determined the taxpayer was required to file Idaho income tax returns, so it prepared returns based upon the property sales information and sent the taxpayer a Notice of Deficiency Determination.

The taxpayer protested the Bureau's determination. The taxpayer stated he had no idea how the Tax Commission came to the conclusion that he had Idaho income since he has never worked in Idaho. He stated he suspected the Tax Commission attributed the sales of property owned [Redacted], of which he was a partner, as his income. The taxpayer stated the sales proceeds were not income. The proceeds paid off bank loans and other creditors associated with the properties. The taxpayer stated the reason the properties were sold was because they were constantly losing money. The taxpayer provided copies of his federal and California income tax returns as proof that he received no income from the sales of the properties.

The Bureau reviewed the information the taxpayer provided as well as other information in the Tax Commission's records and determined the property sales were not reported on the taxpayer's federal returns nor were they reported on any other return. Consequently, the Bureau acknowledged the taxpayer's protest and referred the matter for administrative review.

The Tax Commission reviewed the matter and sent the taxpayer a letter discussing the methods available for redetermining a protested Notice of Deficiency Determination. The taxpayer stated again that no income was generated in the state of Idaho. He said that before he could provide any further information, he needed to know what documentation the Tax Commission was relying on that determined his taxable income.

The Tax Commission provided the taxpayer with the information that was used to determine his Idaho taxable income. The taxpayer replied that the Tax Commission only accounted for the selling price of the properties; it did not allow for the purchase, construction, and selling costs of the properties. The taxpayer stated he did not have any of the records associated with the properties. The taxpayer stated [Redacted] that his investment resulted in a significant loss. [Redacted]. He stated the [Redacted] income [Redacted] paid the mortgage

[Redacted]; everything else was paid by him. Consequently, when the [Redacted] were sold, all proceeds went to paying off the mortgages and other expenses. The taxpayer stated his former partner handled all the paperwork, and when they parted, it was not on good terms. Furthermore, the taxpayer did not know where his former partner was, so he could not get any information on the properties. The taxpayer stated he would try to get copies of the closing statements from the title companies to show some of the costs associated with the properties.

The taxpayer did get copies of the closing statements for six of the eight properties sold. The taxpayer also found a document that summarized some of the other costs incurred in developing the properties. The taxpayer stated this information should clearly show that no money was made on the sales of the properties in Idaho.

The taxpayer [Redacted] held the property as rental property. [Redacted] 100 percent of its business activities in the state of Idaho. The taxpayer was a 50 percent partner [Redacted] and apparently its financing partner. [Redacted]. Since[Redacted], all its income and/or loss were passed through to its partners. [Redacted] the taxpayer should have been filing Idaho individual income tax returns beginning with the first year of his involvement [Redacted]. However, according to the Tax Commission's records, the taxpayer has not filed any income tax returns with the state of Idaho.

The taxpayer stated his partners [Redacted] quitclaimed the properties to him after the decision was made to sell [Redacted]. It was handled this way because the partners knew that any proceeds from the sales would be allocated to the taxpayer because of his capital investment. Since the taxpayer received the properties [Redacted], his basis in the properties was the same as [Redacted] in the properties. However, [Redacted] basis in the properties is unknown since a depreciation schedule was not provided with the income tax return [Redacted] filed with the state of Idaho. The only information available is the mortgage payoff amounts on the properties and the estimated cost to build [Redacted] provided in the taxpayer's summary of property costs. The Tax Commission knows the loan payoff amount does not cover the complete cost incurred to construct [Redacted]; however, it is the only documented information that establishes a cost [Redacted]. Therefore, the Tax Commission finds that using the mortgage payoff amounts is a reasonable approximation of the taxpayer's basis in the improvements made to the land.

The Tax Commission also reviewed the information provided on [Redacted] Idaho income tax return, specifically the balance sheet. [Redacted] listed depreciable assets and land on its balance sheet. The amount given for land closely approximates the amount the taxpayer stated was paid for the land. The Tax Commission used this information, along with the development costs summary the taxpayer provided, to determine the taxpayer's basis in the land. The Tax Commission used the combined basis of the land and the improvements to determine the taxpayer's gain or loss on the sales.

The Tax Commission found that the taxpayer's determination of gain or loss on the properties was not the same as the determination of gain or loss for tax purposes. The taxpayer talked about including such costs as interest, taxes, and repairs; costs that were likely expensed on [Redacted] income tax returns. Whether or not these costs were expensed, interest and taxes are not included in the gain/loss determination, and most repairs are not capital in nature and are not included in the computation of gain or loss.

Furthermore, the taxpayer did not take into account the depreciation that was claimed during the years of service. A taxpayer's basis [Redacted] is always reduced by the depreciation allowed or allowable, and if an accelerated depreciation method was used, the depreciation may need to be recaptured as ordinary income.

The Tax Commission's computation of the gain or loss on the sale of the duplexes resulted in a gain of $300,040. The majority of the gain came from the reduced basis for depreciation deductions. Even though a portion of the gain was likely depreciation recapture, and therefore ordinary income, the Tax Commission decided to treat the entire gain as a capital gain income. Therefore, the taxpayer's reportable gain on the sales [Redacted] to Idaho was $300,040.

In addition to the sales of the duplexes, the taxpayer sold three other Idaho properties during 2003 and 2004. Of these three properties, the taxpayer provided only one closing statement to document the costs of one of the properties. The taxpayer also only spoke of this one property in his correspondence to the Tax Commission. [Redacted]. Based upon the information the Tax Commission could glean from [Redacted] income tax return and information the taxpayer provided, the Tax Commission determined the taxpayer sustained a loss on the sale of this property.

The second property, [Redacted], was also sold in 2004. Very little information was available on this piece of property. However, in keeping with the methodology the Tax Commission employed in determining gain or loss on the sales of the properties, the Tax Commission determined the taxpayer sustained a loss on this property.

The final piece of property, [Redacted], was sold in 2003. The taxpayer did not provide any information on this property. However, the Tax Commission was able to obtain information [Redacted] that helped establish a reasonable basis in the property. The Tax Commission found that the taxpayer owned this property at least from 1997 to 2003. Even though the taxpayer did not provide the necessary information to substantiate his basis in this property, the Tax Commission finds that the County Assessor's assessed value of the property in 1997 is a close approximation of the taxpayer's basis. Therefore, the Tax Commission computed the taxpayer's gain using the assessed value for 1997; however, since the taxpayer provided no information on the sale of this property, no selling costs were included. See Burnet v. Houston, 283 U.S. 223, 51 S.Ct. 413 (1931).

The properties sold in 2003 produced a total gain for the taxpayer of $412,459, thus creating a filing requirement for 2003. However, the properties sold in 2004 produced a loss for the taxpayer in the amount of $15,359. Absent any other income from Idaho sources in 2004, the taxpayer was not required to file an individual income tax return for 2004. Therefore, the Tax Commission hereby cancels the Notice of Deficiency Determination for the 2004 tax year.

Idaho Code section 63-3022H provides for a capital gains deduction on certain property. The Tax Commission found that the properties the taxpayer sold qualified for the Idaho capital gains deduction. Therefore, the Tax Commission allowed a deduction to the taxpayer's 2003 adjusted income for the amount of the Idaho capital gains deduction.

The taxpayer also incurred a passive loss in 2002 that apparently could not be utilized in 2002. Since this information is available to the Tax Commission, the Tax Commission included a passive loss carryover from 2002 on the 2003 return prepared for the taxpayer.

The Bureau added interest and penalty to the taxpayer's Idaho tax deficiency. The Tax Commission reviewed those additions and found them appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046.

WHEREFORE, the Notice of Deficiency Determination dated November 28, 2007, is hereby MODIFIED, in accordance with the provisions of this decision and, as so modified, is APPROVED, AFFIRMED, and MADE FINAL.

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

YEAR	TAX	PENALTY	INTEREST	TOTAL
2003	$6,501	$1,625	$1,893	$10,019

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 ___________________, 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.

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