

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 21497
[REDACTED])	
)	DECISION
Petitioners.)	
)	
)	
)	
)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated August 27, 2008, asserting additional liability for Idaho income tax, penalty, and interest in the total amount of \$25,669 for 2004. This was composed of Idaho income tax in the amount of \$17,334, penalty in the amount of \$4,334, and interest in the amount of \$4,001.

The petitioners did not file an Idaho income tax return for 2004. [Redacted] received distributions of income from two Idaho resident trusts. Whether this income is taxable by the state of Idaho is the sole issue in this docket.

The auditor asserted that, since the trusts were Idaho resident trusts, the income from those trusts (the income here in question) was taxable by the state of Idaho pursuant to Idaho Code § 63-3026A(3)(a)(iv). The petitioners contend that Idaho Code § 63-3026A(3)(b) exempts them from taxation by the state of Idaho.

The pertinent provision of law is found in Idaho Code § 63-3026A:

Computing Idaho taxable income of part-year or nonresident individuals, trusts and estates. -- (1) For nonresident individuals, trusts, or estates the term "Idaho taxable income" includes only those components of Idaho taxable income as computed for a resident which are derived from or related to sources within 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.

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(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:

*

(iv) A resident estate or trust;

*

(b) Notwithstanding the provisions of subsection (3)(a) of this section, transactions and investments made, placed or directed by Idaho resident registered broker-dealers and investment advisers or institutions exempt from registration under the Idaho securities act in securities listed with or through the New York Stock Exchange, the American Stock Exchange or any other stock exchange registered with the United States securities and exchange commission and approved by the director of the department of finance which generate dividends, interest, capital gains or similar profits or returns **for nonresidents** not otherwise subject to Idaho income taxation shall not result in the intangible property being deemed to have a situs **outside the domicile of the owner**. (Emphasis added.)

Upon reading Idaho Code 63-3026A(3)(b), it appears that two issues are present. The first is that it appears this portion of the code does not apply to trusts. This exemption is for “nonresidents.” “Nonresident” is defined in Idaho Code § 63-3014:

Nonresident. – The term “nonresident” means any individual who is not a resident or part-year resident.

“Individual” is defined in Idaho Code § 63-3008 as “a natural person.” Therefore, by its terms, the exemption provided in subsection (b) applies only to individuals, and not to trusts.

To this the petitioners respond that the beneficiaries of a trust (as opposed to the trust) own the assets of the trust. They cite no authority for this rationale other than Idaho Code § 63-3026A.

The TRUST AGREEMENT provided states, at Article 6.4:

Spendthrift Provision. No beneficial interest in any Trust created under the terms of this agreement may be voluntarily or involuntarily anticipated, assigned, encumbered, pledged, sold or otherwise transferred, except pursuant to the exercise of the powers granted in this agreement to disclaim, appoint or release. No beneficial interest in any trust created under the terms of this agreement shall be capable of being taken or reached by any attachment, levy, writ or other legal or equitable process to satisfy any claim against or obligation of the person having that interest. No such interest shall be subject to control or interference by any other person. Any violation of this provision shall be invalid and given no effect by any Trustee.

The Bankruptcy Court has addressed the spendthrift trusts as follows:

Under a “pure” spendthrift trust the beneficiary's interest is neither transferable by the beneficiary nor leviable by creditors. The beneficiary cannot control it. The creditors cannot reach it. Once transferred by the Trustee to the beneficiary under the terms of the trust, however, it becomes the legal property of the beneficiary and is transferable by him and leviable by his creditors. See Roy v. Edgar, 11 B.R. 853 (Bkrtcy.N.D.Fla.1981). Here, by virtue of Article FIRST, SECTION 5, the beneficial interest may or may not be leviable by creditors, but it is clearly transferable by the debtor-beneficiary.

In the Matter of Kim I. Rolfe, Debtor, 34 B.R. 159, 161 (1983).

The income here in question is first the income of the trust. The income was reported on the trust returns and only secondarily on the petitioners’ federal income tax return. Presumably, any information returns (e.g. 1099s) from the entities invested in showed the income to be that of the trusts, not that of the beneficiaries.

The Idaho Supreme Court has addressed the construction of the law with regard to the tax statutes as follows:

Where an ambiguity is found in tax statutes, the statutes are generally "strictly construed against the taxing authority and in favor of the taxpayer and ambiguities therein are to be resolved in

favor of the taxpayer." Department of Employment v. Diamond Int'l Corp., 96 Idaho 386, 387, 529 P.2d 782, 783 (1974). If there is ambiguity in a tax statute specifically regarding deductions, however, "the law is to be construed strongly against the taxpayer." Potlatch Corp. v. Idaho State Tax Comm'n., 128 Idaho 387, 389, 913 P.2d 1157, 1159 (1996); see also Manufab, Inc. v. Mississippi State Tax Comm'n., 808 So.2d 947, 949 (Miss.2002) (tax credits and exemptions construed strictly against taxpayer); Bennett v. State Dep't of Assessments and Taxation, 143 Md.App. 356, 795 A.2d 124, 132 (Md.2001) ("It is a firmly established principle of law that exemptions from taxation are not favored, but are strictly construed in favor of the State."); Hermann v. Director of Revenue, 47 S.W.3d 362, 365 (Mo.2001) (en banc), reh'g denied, (June 26, 2001) ("Tax credits and exemptions are construed strictly and narrowly against the taxpayer"); William Lyon Co. v. Franchise Tax Board, 4 Cal.App.4th 267, 5 Cal.Rptr.2d 680, 685 (1992) (same).

Canty v. Idaho State Tax Commission, 138 Idaho 178, 182, 59 P.3d 983, 987 (2002).

The Idaho Supreme Court also addressed the provisions of exemptions from tax as follows:

The Stangs urge this Court to "construe" the Idaho Income Tax Code in a manner that would permit the Stangs to avoid paying Idaho income tax on the \$8,000 distribution. They argue that because the Idaho Income Tax Code does not expressly address this situation, this Court should be free to construe the tax code in a manner that would prevent the Stangs from having to pay taxes to both California and Idaho on the same monies. When construing the provisions of the Idaho Income Tax Code, however, we must enforce the law as written. Potlatch Corp. v. Idaho State Tax Comm'n., 128 Idaho 387, 913 P.2d 1157 (1996). If there is any ambiguity in the law concerning tax deductions, the law is to be construed strongly against the taxpayer. *Id.* This Court has no authority to rewrite the tax code. Bogner v. State Dep't of Revenue and Taxation, 107 Idaho 854, 693 P.2d 1056 (1984). Any exemption from taxation must be created or conferred in clear and plain language and cannot be made out by inference or implication. Herndon v. West, 87 Idaho 335, 393 P.2d 35 (1964). This Court does not have the authority to create deductions, exemptions, or tax credits. If the provisions of the tax code are socially or economically unsound, the power to correct it is legislative, not judicial. *Id.*

The Commission finds that the argument set forth by the petitioners does not persuade us that the assets of the spendthrift trusts here in question were the property of the beneficiaries. The petitioners have set forth no other argument to support their position. Accordingly, the Notice of Deficiency Determination dated August 21, 2007, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER the petitioners to pay the following tax, penalty, and interest (calculated to October 31, 2009):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2004	\$17,334	\$4,334	\$4,932	\$26,600

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

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

DATED this _____ day of _____, 2009.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____, 2009, 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]

Receipt No.