BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 22222
[Redacted]	)	
	)	DECISION
Petitioners.	)	
	)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated July 21, 2009. The Notice of Deficiency Determination asserted additional Idaho income tax, penalty, and interest in the total amount of $9,034 for 2006.

There were two issues addressed in the Notice of Deficiency Determination. The primary issue is the proper computation of a net operating loss that was carried forward. Also addressed was a deduction claimed by the petitioners and subsequently denied by the auditor (and subsequently conceded by the petitioners) for the insulation of their residence.

The primary issue is whether a net operating loss carried forward to subsequent years should be reduced by the amount of an Idaho capital gains deduction in an intervening year. In this case net operating losses were incurred in 2003 and 2004 in the total amount of $124,078. These were carried forward to 2006.

In 2005, the petitioners had negative Idaho taxable income without reflecting a net operating loss carryforward. Included in the computation of their Idaho taxable income was a gain in the amount of $101,082 from the sale of property and the related Idaho capital gains deduction in the amount of $60,649. Also included in the computation of the petitioners' Idaho taxable income were net itemized deductions in the total amount of $104,583 and a deduction for their personal exemptions in the amount of $6,400.

The auditor computed the absorption of the net operating loss with regard to the petitioners' 2005 return as follows:

Idaho taxable income	($185,653)
Idaho net operating loss carryforward	124,078
Net itemized deductions	104,583
Personal exemptions	6,400
Idaho capital gains deduction	60,649
Net operating loss absorbed in 2005	$110,057

The net operating loss carried forward to 2005 was $124,078. Therefore, the remaining loss allowable for 2006 was $14,021 ($124,078 - $110,057). This reduction in the amount of the net operating loss carryforward did not benefit the petitioners.

"Net operating loss" is defined in Idaho Code § 63-3021 (2005):

> Net operating loss. -- (a) The term "net operating loss" means the amount by which Idaho taxable income, after making the modifications specified in subsection (b) of this section, is less than zero.
> (b) Add the following amounts:
> (1) The amount of any net operating loss deduction included in Idaho taxable income.
> (2) In the case of a taxpayer other than a corporation:
> (i) Any amount deducted due to losses in excess of gains from sales or exchanges of capital assets; and
> (ii) Any deduction for long-term capital gains provided by this chapter.
> (3) Any deduction allowed under section 151 of the Internal Revenue Code (relating to personal exemption) or any deduction in lieu of any such deduction.
> (4) Any deduction for the standard or itemized deductions provided for in section 63 of the Internal Revenue Code, or section 63-3022(j), Idaho Code, except for any deduction allowable under section 165(c)(3) of the Internal Revenue Code (relating to casualty losses) pertaining to property physically located inside Idaho at the time of the casualty.

Idaho Code § 63-3022 provides the authority for the deduction of net operating losses:

> (c)(1) A net operating loss for any taxable year commencing on and after January 1, 2000, shall be a net operating loss carryback not to exceed a total of one hundred thousand dollars ($100,000) to the two (2) immediately preceding taxable years. Any portion of the net operating loss not subtracted in the two (2) preceding years may be subtracted in the next twenty (20) years succeeding the taxable year in which the loss arises in order until exhausted. The sum of the deductions may not exceed the amount of the net operating loss deduction incurred. At the election of the

> taxpayer, the two (2) year carryback may be foregone and the loss subtracted from income received in taxable years arising in the next twenty (20) years succeeding the taxable year in which the loss arises in order until exhausted. The election shall be made as under section 172(b)(3) of the Internal Revenue Code. An election under this subsection must be in the manner prescribed in the rules of the state tax commission and once made is irrevocable for the year in which it is made. The term "income" as used in this subsection (c) means Idaho taxable income as defined in this chapter as modified by section 63-3021(b)(2), (3) and (4), Idaho Code. (Underlining added.)

The last sentence above is further supported by Income Tax Administrative Rule 201.03.a. which stated:

> Adjustments to income, including modifications pursuant to Section 63-3021, Idaho Code, in a carryback or carryover year shall be made for purposes of determining, how much, if any, of the net operating loss may be carried over to subsequent years.

The petitioners contend that the code sections above provide that they may fully deduct both their net operating loss and their Idaho capital gains deduction. They argue that the net effect of the adjustment made by the auditor is to (among other things) disallow the capital gains deduction due to their net operating loss carryforward. They question whether it was really the legislature's intent to so punish a person (for example by effectively disallowing the capital gains deduction) due to their being unfortunate enough to have incurred a net operating loss.

In 2005, the petitioners' Idaho income tax return reflects a negative taxable income without the application of any of the net operating loss carried forward. Therefore, none was effectively deducted in that year. For 2006, the petitioners' return reflected an Idaho taxable income in the amount of $117,154 without the application of any of the net operating loss carryforward. The Idaho taxable income reflected on the schedule of Individual Income Tax Audit Changes is $106,303. At that point, the auditor determined that the entire net operating loss had been used. So, given this, the petitioners were allowed to effectively deduct (in determining their Idaho taxable income) the amount of $14,021 of their net operating loss carryforwards (out of $124,078).

There is no dispute over the computation of the amounts of the net operating losses produced in 2003 or 2004. The absorption of the losses though is not agreed. It appears that the petitioners' argument is that this result is clearly outside the legislative intent.

Deductions are strictly a matter of legislative grace. INDOPCO, Inc. v. Commissioner, 503 U. S. 79, 84 (1992), New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934). In addressing such an issue, the Idaho Supreme Court held:

> 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.

Idaho State Tax Commission v. Stang, 105 Idaho 800, 802-803; 25 P.3d 113, 115-116 (2001).

The language in Idaho Code § 63-3022 leaves some doubt as to whether the auditor's method to determine the amount of the net operating losses absorbed in 2005 would be correct if the taxpayer has not made an election to forgo the carryback of the net operating loss. We feel that this doubt is removed by Income Tax Administrative Rule 201.03. Accordingly, we find that the auditor correctly computed the amount of the absorption of the net operating loss in 2005. Therefore, the relief sought by the petitioners is denied.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax and interest (computed to May 31, 2010):

YEAR	TAX	INTEREST	TOTAL
2006	$7,233	$1,379	$8,612

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 ___________________ 2010.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ________ day of ___________________ 2010, 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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