

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 22463
[Redacted])	
Petitioner.)	DECISION
)	
)	

On January 26, 2010, the Idaho State Tax Commission’s (Commission) Income Tax Audit Bureau (ITA) issued a Notice of Deficiency Determination (NODD) to [Redacted] (petitioner) proposing additional income tax and interest for taxable years 2006 and 2007 in the total amount of \$4,083.

The petitioner filed a timely petition for redetermination. The petitioner was informed of its appeal rights. The Idaho Code section 63-3045(2) hearing was held on July 20, 2010. The Commission, having reviewed the file, hereby issues its decision.

I. Issues

ISSUE 1 – The petitioner disagrees with the ITA’s assertion that under Idaho Code section 63-3022L the petitioner is required to pay the tax on income not reported to Idaho by two of its members. The petitioner argues that to require the petitioner to pay the tax is a violation of the [Redacted] Due Process Clause and the [Redacted] Equal Protection Clause.

ISSUE 2 – The petitioner disagrees with the ITA’s exclusion, as part of their Idaho Code section 63-3022L calculation of certain deductions reported on [Redacted], as well as the ITA’s failure to take into consideration the member’s standard deduction, personal exemptions, credits, and any other offsets that would have been available to the member had the member filed an Idaho individual income tax return.

II. Findings

The Commission will not delve into the petitioner's Due Process or Equal Protection arguments since the Commission does not have the authority to declare an act of the Idaho Legislature unconstitutional. Wanke v. Ziebarth Const. Co., 69 Idaho 64, 75, 202 P.2d 384, 391 (1949). Instead, the Commission will focus on whether or not the ITA properly applied the Idaho statutes and rules in determining that the petitioner owed the Idaho income tax at-issue and whether or not the ITA was correct in not allowing certain deductions in its calculation. It is the Commission's finding that the ITA's imposition of Idaho Code section 63-3022L tax, as shown in the NODD dated January 26, 2010, was proper and that the ITA was correct in excluding certain deductions from its calculation.

III. In General

The petitioner is a limited liability company (LLC) that files as a partnership. Under Idaho law, a limited liability company that is classified as a partnership pursuant to the Internal Revenue Code shall be treated as a partnership for purposes of the Idaho Income Tax Act. Idaho Code section 63-3006A.¹ For taxable years 2006 and 2007, the partnership reported that 100 percent of its income was from Idaho activity.

During 2006 and 2007, the LLC's partnership return reported that it had seven and nine members, respectively. For taxable year 2006, member number 6 did not file an Idaho income tax return to report his share of the LLC's income to Idaho. For taxable year 2007, member number 9 did not file an Idaho income tax return to report his share of the LLC's income to Idaho.

¹ References to the Idaho Code or Rules refer to the Idaho Code or Income Tax Administrative Rules in effect for the years at issue unless otherwise stated.

The ITA in its NODD asserted that the LLC owed tax on the unreported Idaho income in accordance with Idaho Code section 63-3022L. Interest was included in the NODD in accordance with Idaho Code section 63-3045. The ITA did not assert any penalty.

More specifically, the ITA calculated the amount of tax owed by the petitioner as follows:

Table - 1	Taxable Year 2006	Taxable Year 2007
Ordinary income	\$2,797	\$68
Guaranteed payments	37,751	4,816
Taxable amount	40,548	4,884
Tax rate	7.60%	7.60%
Idaho tax	3,082	371
Permanent Building Fund	10	10
Total tax due	<u>\$3,092</u>	<u>\$381</u>

The ITA did not allow, as part of the Idaho Code section 63-3022L tax calculation, the following separately stated expenses that were being passed through to the two members that had failed to file the required Idaho income tax return:

Table - 2	Taxable Year 2006	Taxable Year 2007
Disability Insurance	\$784	\$286
Life insurance	171	114
Total	<u>\$955</u>	<u>\$400</u>

In the petitioner's petition for redetermination, the petitioner does not provide any authority for inclusion of the expenses in the Idaho Code section 63-3022L tax calculation, rather, the petitioner focused its protest upon the assertion of the [Redacted] Due Process Clause and the [Redacted] Equal Protection Clause as a defense against the application of Idaho Code section 63-3022L to the petitioner. As previously mentioned, the Commission will not delve into

the constitutional arguments raised by the petitioner and, instead, will concentrate on the application of Idaho Code section 63-3022L and the calculation therein of the amount of tax due, if any.

IV. Law and Analysis

63-3022L. Individuals who are officers, directors, shareholders, partners or members of a corporation or partnership or beneficiaries of a trust or estate.

(1) Individuals who are . . . partners or members . . . of a . . . partnership transacting business in Idaho . . . with income taxable in Idaho may elect to have Idaho tax relating to income described in subsection (2) of this section reported and paid by the . . . partnership. . . . Income subject to the election in this subsection shall be taxed at the rate applicable to corporations. The election shall be made on the return of the . . . partnership . . . from which the income is received. The election in this section is not available to an individual who has Idaho taxable income in addition to income described in subsection (2) of this section.

(2) The election in subsection (1) of this section applies to:

(a) Wages, salary and other compensation paid by the . . . partnership . . . to such . . . partners, members . . . to the extent the compensation is Idaho taxable income of the individual to whom it is paid; and

(b) The share of any income, loss, deduction or credit of an . . . partnership . . . required to be included on such . . . partner's, member's . . . Idaho return . . .

(3) If no election is made and an . . . partner, member, . . . of a . . . partnership . . . transacting business in Idaho fails to file an Idaho income tax return reporting all or any part of the items described in subsection (2) of this section or fails to pay any tax due thereon, such . . . partnership . . . shall be liable for tax on such items at the rate applicable to corporations. . . .

Under Idaho Code section 63-3022L(3), it clearly states that if no election is made and the member fails to file an Idaho income tax return reporting the income identified in Idaho Code section 63-3022L(2), the petitioner is liable for tax on such income at the rate applicable to corporations. Given no evidence that either of the non-filing members had income subject to Idaho taxation in addition to the income from the petitioner, the ITA was correct in asserting that the petitioner was responsible for the tax in accordance with Idaho Code section 63-3022L.

Idaho Income Tax Administrative Rule 291.04 and 05 for taxable year 2007 provided the following guidance regarding the deductions to be included within the calculation of the Idaho Code section 63-3022L tax as follows:

04. Deductions That Are Subject to Limitations or Elections by Individuals. A pass-through entity is not allowed to deduct items that are subject to limitations or elections at the individual level. Examples of such items include the Section 179 deduction, research and experimental expenses, mining exploration and development costs, pre-productive period expenses, and passive activity losses. Individuals may not bypass limitations on deductions by electing to have the pass-through entity pay the tax. (3-30-07)

05. Deductions That Are Not Allowed to S Corporations and Partnerships. (3-30-07)

a. Capital Loss. As provided in Section 63-3022(i), Idaho Code, S corporations and partnerships are not allowed to carry over or carry back any capital loss provided for in Section 1212, Internal Revenue Code. (3-30-07)

b. Net Operating Loss. As provided in Section 63-3022(i), Idaho Code, S corporations and partnerships are not allowed to carry over or carry back any net operating loss provided for in Section 63-3022(c), Idaho Code. (3-30-07)

c. Nonbusiness Deductions. Deductions are not allowed for nonbusiness expenses of an individual, such as those claimed as itemized deductions, charitable contributions, or personal exemptions. (3-30-07)

However, in 2010, the Commission issued a temporary rule modifying Idaho Income Tax Administrative Rule 291.04 and 05 as follows:

04. Deductions. Entities paying the tax under Section 63-3022L, Idaho Code, are not entitled to claim the following deductions on behalf of an individual. (7-1-10)T

a. Capital Loss. As provided in Section 63-3022(i), Idaho Code, S corporations and partnerships are not allowed to carry over or carry back any capital loss provided for in Section 1212, Internal Revenue Code. (3-30-07)

b. Net Operating Loss. As provided in Section 63-3022(i), Idaho Code, S corporations and partnerships are not allowed to carry over or carry back any net operating loss provided for in Section 63-3022(c), Idaho Code. (3-30-07)

c. Idaho Capital Gains Deduction. As provided in Section 63-3022H, Idaho Code, the Idaho capital gains deduction may only be claimed by individual taxpayers on an individual income tax return. (7-1-10)T

d. Informational Items. Amounts provided to owners of pass-through entities and beneficiaries of trusts and estates on the federal Schedule K-1 that are informational only may not be used as a deduction in computing the taxable income reportable under Section 63-3022L, Idaho Code. Informational items include the domestic production activities information and net earnings from self-employment. (7-1-10)T

e. Items Not Deductible Under the Internal Revenue Code. A deduction is not allowed for items disallowed under the Internal Revenue Code. For example, a deduction is not allowed for items disallowed as a deduction in Sections 162(c) and 262 through 280E, Internal Revenue Code, unless specifically allowed by Idaho law. Items allowed by Idaho law include expenses related to tax-exempt income under Section 265, Internal Revenue Code, which are allowed to be deducted as a result of Section 63-3022M, Idaho Code. (7-1-10)T

f. Items Not Reported as a Pass-Through Deduction. Amounts not reported from the pass-through entity to the pass-through owner are not allowed as a deduction under Section 63-3022L, Idaho Code. These include: (7-1-10)T

i. The standard deduction; (7-1-10)T

ii. Personal exemptions; (7-1-10)T

iii. Itemized deductions that result from activity of the pass-through owner. For example, a deduction is not allowed for charitable contributions made personally by the pass-through owner, but is allowed for the pass-through owner's share of charitable contributions made by the pass-through entity. (7-1-10)T

05. Double Deductions Disallowed. A pass-through owner may not deduct amounts that previously have been deducted by a pass-through entity paying the tax on his behalf. If the pass-through owner files an Idaho individual income tax return reporting federal taxable income that includes amounts previously deducted by a pass-through entity on his behalf, the pass-through owner must add back the duplicated deduction amounts in computing his Idaho taxable income on his individual income tax return. (7-1-10)T

As currently written, Idaho Income Tax Administrative Rule 291.04.f. explicitly prohibits the inclusion of the standard deduction or personal exemptions in the calculation of the Idaho Code section 63-3022L tax.

As for the deductions shown in Table 2 for disability insurance and life insurance premiums, these deductions appear to be nondeductible personal expenditures and are therefore excluded from the calculation of the Idaho Code section 63-3022L tax in accordance with Idaho Income Tax Administrative Rule 291.04.e. See Treas. Reg. sec. 1.262-1(b)(1); Treas. Reg. sec. 1-264-1; and IRS Rev. Rul. 68-212, 1968-1 CB 91.

V. Conclusion

As of the date of this decision, the petitioner has not provided information that would resolve this case in the petitioner's favor. It is the petitioner's burden of proving error on the part of the deficiency determination. Albertson's, Inc. v. State Dept. of Revenue, 106 Idaho 810, 814, (1984); Parsons v. Idaho State Tax Comm'n, 110 Idaho 572, 574 (Ct. App. 1986). Since the petitioner has not met this burden of proof of showing that the NODD prepared by the ITA is incorrect, the Commission upholds the ITA's determination as shown in the NODD.

WHEREFORE, the Notice of Deficiency Determination dated January 26, 2010, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following tax and interest:

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2006	\$3,092	\$679	\$3,771
2007	381	48	<u>429</u>
		TOTAL DUE	<u>\$4,200</u>

Interest has been updated and is calculated through December 31, 2010, and will continue to accrue at the rate set forth in Idaho Code section 63-3045.

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 _____ 2011.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2011, 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.