

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 23322
[Redacted],	)	
	)	
Petitioners.	)	DECISION
_____	)	

[Redacted] (taxpayers) protested the Notice of Deficiency Determination dated August 11, 2010, asserting income tax, penalty, and interest in the total amount of \$39,897 for taxable year 2006. The taxpayers protested the gain determined on the sale of Idaho property. The Tax Commission, having reviewed the file, hereby issues its decision.

**BACKGROUND**

The Income Tax Audit Bureau (Bureau) received information that showed the taxpayers sold real property in Idaho in 2006. The Bureau researched the Tax Commission's records and found the taxpayers did not file an Idaho individual income tax return for taxable year 2006. The Bureau sent the taxpayers letters asking them about the sale of the Idaho property and their requirement to file an Idaho income tax return. The taxpayers contacted the Bureau and stated the property sold qualified for the exclusion found in Internal Revenue Code (IRC) section 121. The taxpayers stated the property qualified under the ownership/use test which states that if a taxpayer owns and uses the property for a full twenty-four months during the 5-year period ending on the date of the sale or exchange, the property can qualify for the exclusion.

The Bureau continued corresponding with the taxpayers and asked that the taxpayers provide documentation or evidence that the property was their primary residence. And if the Idaho property was their primary residence, that the taxpayers file Idaho resident income tax returns for the years the property was their primary residence. The taxpayers did not agree with the Bureau's

analysis. The taxpayers provided a copy of their 2006 [Redacted] income tax return and maintained their position that they met the ownership and use requirement.

The Bureau determined the taxpayers did not meet the requirements of IRC section 121, so it prepared a return for the taxpayers and sent them a Notice of Deficiency Determination. The taxpayers protested the Bureau's determination stating they were not required to file Idaho income tax returns because they were not Idaho residents. Furthermore, they believe the property qualified as their principal residence and the gain on the sale is excluded per IRC section 121. The Bureau acknowledged the taxpayers' protest, and after the Bureau determined it and the taxpayers were at an impasse, the matter was referred for administrative review.

The Tax Commission sent the taxpayers a letter giving them two options for having the Notice of Deficiency Determination redetermined. The taxpayers requested a telephone hearing which was held on January 11, 2011. The taxpayers provided copies of utility bills to establish that they occupied the property for at least two years of the five preceding years before the sale of the property. The taxpayers' primary argument was that since they used the property for an aggregate of two years during the five-year period before the sale, the property qualified as their primary residence and, therefore, the gain is excludable. The taxpayers also argued that if they were required to file Idaho part-year resident returns, there would be no tax consequences because they did not earn any income while living in Idaho.

### **LAW AND ANALYSIS**

IRC section 121 provides for the exclusion from income the gain from the sale of a principal residence. It states in pertinent part:

Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

The taxpayers argued their Idaho property met the qualifications for the exclusion because they owned and used the property as their principal residence for more than two years within the five-year period before the sale of the property. The Tax Commission reviewed the information the taxpayers provided and agrees that the taxpayers owned and used the property for the required time. The issue is whether the Idaho property was the taxpayers' principal residence during the years in question.

Treasury Regulation section 1.121-1(b)(2) defines principal residence as:

In the case of a taxpayer using more than one property as a residence, whether property is used by the taxpayer as the taxpayer's principal residence depends upon all the facts and circumstances. If a taxpayer alternates between 2 properties, using each as a residence for successive periods of time, the property that the taxpayer uses a majority of the time during the year ordinarily will be considered the taxpayer's principal residence.

The Treasury Regulation provides examples to illustrate the provisions of Treasury Regulation section 1.121-1(b). The Tax Commission believes Example 1 is on point for this case. It states:

Taxpayer A owns 2 residences, one in New York and one in Florida. From 1999 through 2004, he lives in the New York residence for 7 months and the Florida residence for 5 months of each year. In the absence of facts and circumstances indicating otherwise, the New York residence is A's principal residence. A would be eligible for the section 121 exclusion of gain from the sale or exchange of the New York residence, but not the Florida residence.

The taxpayers stated they lived in the Idaho property on a yearly basis from May to October. The rest of the year, the taxpayers lived in their home in [Redacted]. [Redacted] is where [Redacted] base of operations was for his employment. [Redacted] is also where the taxpayers stated they were domiciled. Based upon the taxpayers' statements, it appears their situation was exactly the same as Taxpayer A in Example 1.

The taxpayers stated they would like the Tax Commission to consider their situation as similar to Example 2.

Taxpayer B owns 2 residences, one in Virginia and one in Maine. During 1999 and 2000, she lives in the Virginia residence. During 2001 and 2002, she lives in the Maine residence. During 2003, she lives in the Virginia residence. B's principal residence during 1999, 2000, and 2003 is the Virginia residence. B's principal residence during 2001 and 2002 is the Maine residence. B would be eligible for the 121 exclusion of gain from the sale or exchange of either residence (but not both) during 2003.

The Tax Commission does not see Example 2 as similar to the taxpayers' situation. In Example 2, Taxpayer B lived the entire year in either her [Redacted] residence or her [Redacted] residence. The taxpayers in this case did not live an entire year in either their Idaho or [Redacted] residences. The taxpayers would like the Tax Commission to look at the time they spent in Idaho and [Redacted] in the aggregate and then apply Example 2. Example 2 is specific in that Taxpayer B lived the full years in one or the other residences, it does not consider the aggregate time based upon months. The aggregate time based on months is Example 1.

Idaho Code section 63-3026A(3)(ii) states that income shall be considered derived from or relating to sources within Idaho when such income is attributable to or resulting from the ownership or disposition of any interest in real or tangible personal property located in Idaho. Idaho Code section 63-3030 sets the filing requirement thresholds for part-year resident individuals. The threshold for tax year 2006 was \$2,500 from all sources while a resident of Idaho and from Idaho sources while a nonresident of Idaho.

The information available shows the taxpayers had a gain on the sale of their Idaho property of \$175,296. Therefore, if the gain is not excludable, the taxpayers were required to file an Idaho individual income tax return for taxable year 2006.

## CONCLUSION

Based upon the facts, the taxpayers lived in the Idaho house for only five months of the year and they had a residence in [Redacted] where they lived seven months of the year, the Tax Commission finds the Idaho residence was not the principal residence of the taxpayers. Therefore, the gain on the sale of the Idaho residence is not excludable as provided in IRC section 121. And since the taxpayers were present in Idaho for more than 90 days, their presence in Idaho is considered to be for other than temporary or transitory purposes and are therefore deemed part-year residents of Idaho.

The return the Bureau prepared for the taxpayers was based upon the sales price of the Idaho property. The Tax Commission hereby modifies that return to reflect the taxpayers' gain on the sale of the Idaho property, the Idaho capital gains deduction, prorated self-employment and IRA deductions, a prorated standard deduction, prorated exemptions, and a prorated Idaho grocery credit.

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

THEREFORE, the Notice of Deficiency Determination dated August 11, 2010, and directed to [Redacted] is AFFIRMED AS MODIFIED by this decision.

IT IS ORDERED that the taxpayers pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2006	\$4,550	\$1,138	\$1,123	\$6,811

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

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2011.

IDAHO STATE TAX COMMISSION

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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.