

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
[Redacted],) DOCKET NO. 23515
)
)
Petitioner.) DECISION
)
_____)

[Redacted] (taxpayer) protested the Notice of Deficiency Determination dated August 31, 2010, asserting income tax, penalty, and interest in the total amount of \$12,628 for taxable year 2005. The taxpayer disagreed that it was required to file an Idaho income tax return and with the computation of the gain on the sale of the Idaho property it sold in 2005. The Tax Commission, having reviewed the file, hereby issues its decision.

BACKGROUND

The Income Tax Audit Bureau (Bureau) received information that showed the taxpayer sold Idaho property in 2005. The Bureau researched the Tax Commission’s records and found that the taxpayer did not file an Idaho income tax return for taxable year 2005. The Bureau sent the taxpayer letters asking it about its requirement to file an Idaho income tax return. The taxpayer did not respond. The Bureau determined the taxpayer was required to file an Idaho income tax return, so it prepared a return based upon the property sale information and sent the taxpayer a Notice of Deficiency Determination.

The taxpayer protested the Bureau’s determination. The taxpayer stated the Tax Commission was late, inaccurate, and unjustifiable in its assertion of tax due to Idaho. The taxpayer stated it has been dissolved and is no longer an active business. The Bureau requested additional information from the taxpayer but did not receive a response. Therefore, the Bureau referred the matter for administrative review. Shortly after the Bureau referred the case for

administrative review, the Bureau received a packet of information from the taxpayer showing how the property sale flowed through to the taxpayer's sole member and how it was reported on the member's federal income tax return.

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 did not respond to the Tax Commission's letter, so the Tax Commission decided the matter based upon the information available.

LAW AND ANALYSIS

Idaho Code section 63-3026A states in part 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 property located in Idaho. Idaho Code section 63-3030 states in part that any corporation, S-corporation, or partnership which transacts business in Idaho or has income attributable to Idaho shall file an Idaho income tax return.

The taxpayer sold property located in Idaho. The selling price of the property was \$109,000. The taxpayer did not provide any documentation to establish its basis in the property, but it did state that approximately \$20,000 was owed on the property when it was sold. The taxpayer did provide the closing statement on the sale of the property, so there was evidence of the closing costs of the sale of the property and a mortgage payoff.

The taxpayer was a [Redacted] created solely for the purposes of protecting its shareholder should anyone get hurt on the Idaho property. Apparently, the only asset of the taxpayer was the Idaho property. The taxpayer stated the only income it generated was the gain on the sale of the property. After the property was sold, the taxpayer was dissolved. The

taxpayer argued that since it was only organized to limit the liability of its shareholder, it was not transacting business as it is defined in Idaho Code section 63-3023.

Idaho Code section 63-3023 states:

Subject only to the limitations of the constitutions of the United States and of the state of Idaho, the term "transacting business" shall include owning or leasing, whether as lessor or lessee, of any property, including real and personal property, located in this state, or engaging in or the transacting of any activity in this state, for the purpose of or resulting in economic or pecuniary gain or profit. (Underlining added.)

It is clear from the statute that owning property in Idaho constitutes transacting business in Idaho and if the sale of the property results in a gain, that gain is attributable to Idaho. Therefore, the Tax Commission finds the taxpayer did have a filing requirement with the state of Idaho.

An LLC is a pass-through entity which flows its taxable income to its members and the members report their respective share of the LLC's income on their income tax returns. In this case, the taxpayer had a single member, [Redacted]. [Redacted] is a nonresident of Idaho and did not file a 2005 Idaho individual income tax return.

Idaho Code section 63-3022L provided, for taxable years before January 1, 2011, that when a nonresident member of an LLC fails to file an Idaho income tax return reporting his share of the LLC's Idaho taxable income, the LLC can be held liable for the tax, at the corporate rate, on the unreported income. Since the taxpayer's member was a nonresident and did not file an Idaho income tax return, the Bureau asserted the tax upon the taxpayer.

The Bureau based its computation of the taxpayer's tax solely upon the sales price of the property. Subsequently, the taxpayer provided documentation showing the costs associated with the sale of the property. The taxpayer also provided a copy of the member's federal income tax return showing his treatment of the property sale. The Tax Commission reviewed the member's

federal reporting and found that it was incorrectly reported and that the gain was understated. The member treated the sale as a receipt of royalties. He started with the amount “cash due to seller” on the closing statement and subtracted some of the costs of the sale. In effect, the member deducted some of the costs of the sale twice.

The taxpayer stated the Idaho property was purchased as a long-term investment, but because of the rapid increase in property values over a short period, the property was sold. Based upon this statement, the Tax Commission decided the mortgage payoff amount was a good approximation of the taxpayer’s basis in the property. Therefore, the Tax Commission calculated the taxpayer’s gain on the sale allowing a basis and the costs of the sale.

CONCLUSION

The taxpayer owned and sold property in Idaho. The taxpayer transacted business in Idaho and was required to file an Idaho income tax return. Since the taxpayer was an LLC, all its income flowed through to its member. However, the taxpayer’s member did not file an Idaho income tax return thus failing to report the taxpayer’s income to Idaho. Therefore, the Tax Commission finds the application of Idaho Code section 63-3022L(3) is appropriate and hereby upholds the imputation of the tax on the taxpayer. The Tax Commission also finds that since the taxpayer did not file an Idaho income tax return, it is liable for the minimum tax required of all LLCs required to file an Idaho income tax return. (*See* Idaho Code section 63-3025A.)

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.

THEREFORE, the Notice of Deficiency Determination dated August 31, 2010, and directed to [Redacted] is MODIFIED according to the provisions of this decision, and as so MODIFIED, is AFFIRMED.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax, penalty, and interest:

| <u>YEAR</u> | <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|------------|----------------|-----------------|--------------|
| 2005 | \$6,347 | \$1,587 | \$2,025 | \$9,959 |

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 _____ 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.
