

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 23712
[Redacted],)	
)	
Petitioners.)	DECISION
_____)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated November 4, 2010, asserting an additional liability for Idaho income tax and interest in the total amount of \$16,518 for 2009.

The only contested issue in this docket is the proper treatment of tax withheld at the entity level on pass-through entities by other states for the purpose of computing the credit for taxes paid another state on the petitioners' Idaho individual income tax return. The petitioners contend that the withholding should be treated as tax imposed by the other state. The auditor held that the proper measure of the tax paid to the other state would be the tax computed upon the individual income tax return filed with the other state. The petitioners did not submit individual income tax returns showing that the petitioners had filed and paid tax to any of the states involved. The petitioners contend that the filing of individual tax returns in the other states was not allowed by the other states and, therefore, the tax withheld should be treated as having been imposed upon the petitioners.

Idaho Code § 63-3029 sets forth the authority for the credit for taxes paid another state. It stated, in part:

Credit for income taxes paid another state. (1) A resident individual shall be allowed a credit against the tax otherwise due under this chapter for the amount of any income tax imposed on the individual, an S corporation, partnership, limited liability company, estate or trust of which the individual is a shareholder, partner, member, or beneficiary (to the extent attributable to the individual as a result of the individual's share of the S corporation's, partnership's, limited liability company's, estate's or trust's taxable income in another state), for the taxable year by another state on

income derived from sources therein while domiciled in Idaho and that is also subject to tax under this chapter.

(2) For purposes of this section:

(a) "State" shall include any state of the United States, the District of Columbia, or any possession or territory of the United States.

(b) Except as provided in subsection (3)(a)(i) of this section, "individual" shall include estates and trusts.

(c) References to "domiciled in" shall mean "a resident of" for purposes of computing the credit for trusts and estates.

(3) (a) Except as provided in subsection (3)(b) of this section:

(i) The credit provided under this section to an individual shall not exceed the proportion of the tax otherwise due under this chapter that the amount of the adjusted gross income of the taxpayer derived from sources in the other state as modified by this chapter bears to the adjusted gross income of the taxpayer as modified by this chapter.

(ii) The credit provided under this section to an estate or trust shall not exceed the proportion of the tax otherwise due under this chapter that the amount of the federal total income of the estate or trust derived from sources in the other state and taxed by that state bears to the federal total income of the estate or trust. "Federal total income of the estate or trust derived from sources in the other state" shall be determined as provided under section 63-3026A, Idaho Code, as if the estate or trust was a nonresident.

(b) When tax is paid to another state on income of an S corporation, partnership, limited liability company, estate or trust, the limitation calculated in subsection (3)(a) of this section with respect to that income shall be based on the proportion that the individual taxpayer's share of the entity's taxable income correctly reported to the other state under the laws of the other state bears to the individual's adjusted gross income. This limitation shall apply whether the tax is paid to the other state by the individual or by the S corporation, partnership, limited liability company, estate or trust.

(c) The credit provided under this section shall further be limited to the tax paid to the other state.

(4) To substantiate the credit allowed under this section, the state tax commission may require a copy of any receipt showing payment of income taxes to the other state or a copy of any return or returns filed with such other state, or both.

(5) No credit allowed under this section shall be applied in calculating tax due under this chapter if the tax upon which the credit is based has been claimed as a deduction, unless the tax is restored to income on the Idaho return. (Underlining added.)

The states involved are [Redacted]. We will discuss the provision of each state's statutes separately.

The petitioners submitted one partnership return to support their claim for \$417 of credit for taxes paid to [Redacted]. Shown on that return,¹ was “Partner Withholding” in the amount of \$417. The auditor, indicating that the petitioners had not established the amount of tax imposed on them by the state of [Redacted], disallowed the credit claimed by the petitioners.

[Redacted] Code § 15-30-3313 stated, in part:

Consent or withholding. (1) A pass-through entity that is required to file an information return as provided in 15-30-3302 and that has a partner, shareholder, member, or other owner who is a nonresident individual, a foreign C. corporation, or a pass-through entity that itself has any partner, shareholder, member, or other owner that is a nonresident individual, foreign C. corporation, or pass-through entity shall, on or before the due date, including extensions, for the information return:

- (a) with respect to any partner, shareholder, member, or other owner who is a nonresident individual:
 - (i) file a composite return;
 - (ii) file an agreement of the individual nonresident to:
 - (A) file a return in accordance with the provisions of 15-30-2602;
 - (B) timely pay all taxes imposed with respect to income of the pass-through entity; and
 - (C) be subject to the personal jurisdiction of the state for the collection of income taxes and related interest, penalties, and fees imposed with respect to the income of the pass-through entity; or
 - (iii) remit an amount equal to the highest marginal tax rate in effect under 15-30-2103 multiplied by the nonresident individual's share of Montana source income reflected on the pass-through entity's information return;

* * *

(2) Any amount paid by a pass-through entity with respect to a nonresident individual pursuant to subsection (1)(a)(iii) must be considered as a payment on the account of the nonresident individual for the income tax imposed on the nonresident individual for the tax year pursuant to 15-30-2104. On or before the due date, including extensions, of the pass-through entity's information return provided in 15-30-3302, the pass-through entity shall furnish to the nonresident individual a record of the amount of tax paid on the individual's behalf. (Underlining and italics added.)

It seems clear from the information in the file that the withholding provided for in [Redacted] Code § 15-30-3313(1)(a)(iii) was the course of action chosen by the pass-through

¹ [Redacted] Form PR-1, Schedule III, Section B, Column G

entity. Further, it seems clear from [Redacted] Code § 15-30-3313(2) that the intent of the statute was that the amount withheld would be available as a credit when the nonresident owner filed their nonresident [Redacted] return. The instructions for the [Redacted] return stated, in part:

Column G – Partner Withhold. Enter the amount of backup withholding for each partner. For a nonresident individual and a second tier pass-through entity, the amount withheld is 6.9% of the of the [Redacted] source income.

* * *

Payments made by the partnership on the partner's behalf are reported to the partner on the [Redacted] Schedule K-1 or Form PT-WH. This payment will be included as [Redacted] income tax withheld on the partner's [Redacted] individual tax return (Form 2), corporation income tax return (Form 2), corporation income tax return (Form CIT-4), partnership return (Form PR-1) or S corporation return (Form CLT-4S) as follows:

[Redacted] Form 2 – line 56
[Redacted] Form CLT-4 – line 11e
[Redacted] Form PR-1 – line 25d
[Redacted] Form CLT-4S – line 24d

The Commission finds that neither the [Redacted] code nor the [Redacted] instructions leave any significant doubt but that the amount here at issue could have been claimed as withholding on the [Redacted] individual return (Form 2) as a credit against the tax *imposed* on the Idaho (nonresident) partner.

The petitioners held interests in two partnerships and one S corporation which were transacting business in [Redacted] during 2009. The petitioners claimed a credit for taxes paid to the state of [Redacted] in the amount of \$15,334. Again, the auditor stated that, since the petitioners did not submit a copy of a [Redacted] individual income tax return for 2009, the petitioners had not established the amount of tax imposed upon them by the state of [Redacted] and denied the entire credit claimed by the petitioners.

From the [Redacted] statutes, we find that they refer to partners in partnerships and shareholders in S corporations as “pass-through entity taxpayers.”² From the [Redacted] instructions for the filing of a partnership return, we find the following:

Pass-through entity taxpayers may take a credit for the amount of tax paid by the partnership on their behalf. To claim the credit, the partner must file a [Redacted] income tax return for the taxable year. A pass-through entity taxpayer subject to withholding by the pass-through entity and who has no other [Redacted] source income may elect to forego the credit and not file a [Redacted] income tax return. However, pass-through entity taxpayers with income or loss from other [Redacted] sources must file a [Redacted] income tax return.

We find similar language in the instructions for the filing of the TC-20S, the form for the filing of an S corporation income tax return. Accordingly, we find not only was the filing of the [Redacted] individual allowed, but also that since the petitioners had income from more than one [Redacted] source, they were required to have filed an individual income tax return with the state of [Redacted].

The petitioners also held an 11.91 percent interest in a limited liability company transacting business in [Redacted]. The entity filed a composite return with the state of [Redacted] and paid tax in the amount of \$3,543. The petitioners claimed a credit in the amount of \$666 with regard to this payment by the pass-through entity. The petitioners did not explain how they arrived at the \$666 amount. The auditor allowed \$479³ with regard to the \$3,543 paid to [Redacted] on the composite return filed on behalf of all of the nonresident members who collectively held an 88.09 percent interest in the entity.

Because tax credits and deductions are a matter of legislative grace, taxpayers bear the burden of proving entitlement to the credits they claim on their returns. *See* INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 84, 112 S.Ct. 1039, 1042-43 (1992).

² [Redacted] code § 59-10-1402(10).

³ \$3,543 x (11.91/88.09).

The reason for a credit for taxes paid to another state is to minimize the duplication of tax on the same income. The methodology promoted by the petitioners would lead to illogical results. If a taxpayer will have no liability to the other state after having filed his individual income tax return, but had substantial withholding, the method urged by the petitioners would grant a credit on the Idaho return, even though there was no liability to the other state. If an Idaho resident taxpayer had interests in two pass-through entities in another state, one of which passes through \$100,000 of gain and the other \$100,000 of loss, the methodology urged by the petitioners would grant the taxpayer a credit on the Idaho return even though there would ultimately be no taxable income sourced to the other state and no liability to that state.

THEREFORE, the Notice of Deficiency Determination dated November 4, 2010, is hereby APPROVED, AFFIRMED, and MADE FINAL.

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

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2009	\$15,938	\$1,231	\$17,169

(computed to January 15, 2012):

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 _____ 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.
