

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 23752
[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 24, 2010, asserting an additional liability for Idaho income tax and interest in the total amount of \$198,118, \$749, and \$38 for 2007, 2008, and 2009, respectively.

The petitioners were, during all times pertinent to this matter, nonresidents of Idaho. The petitioners held stock in an S corporation that transacted business in Idaho. In 2007, the petitioners sold their stock in the S corporation on an installment basis. They did not report any portion of the gain from the sale of the stock on their 2007 Idaho nonresident income tax return. The petitioners did not file Idaho income tax returns for 2008 or 2009.

The auditor determined that a portion of the gain from the sale of the stock should have been included in the computation of Idaho taxable income. Further, the auditor determined that the petitioners should have recaptured a portion of the Idaho investment tax credit in 2007. The auditor also asserted penalties. The substantial understatement penalty (10 percent) was asserted for 2007 and the delinquency penalty (25 percent) was asserted for both 2008 and 2009.

The petitioners protested the NODD stating, in part:

On one hand, Idaho is “looking through” the sale of stock and treating it as the sale of tangible assets rather than as the intangible sale of stock. On the other hand, when it comes to the capital gains deduction (Idaho Code Sec 63-3022H) for those same assets, the state appears to reverse its position and not to consider them to be qualified property but instead as stock. Taken as a whole, these positions are inconsistent. Moreover, while the Sec. 63-3022H does not include

stock, it does encompass capital gains from tangible personal property used in a revenue-producing activity in Idaho. Given that we are subject to investment tax credit recapture on our sale of stock, that sale of stock obviously is treated elsewhere in the Code as relating to tangible personal property.

The representative for the petitioners states that the Commission has treated the sourcing of the gain or loss from the sale of stock by nonresidents in an inconsistent manner. They cite the Commission's decisions in Docket Nos. 15253 and 17455 and that the Commission denied the nonresident taxpayers losses from the sale of S corporation stock in those decisions and yet assert a deficiency against their clients to tax the gain from the sale of S corporation stock.

Idaho Code § 63-3026A provides the authority for the sourcing of income for individuals to Idaho. Idaho Code § 63-3026A stated [2007], in part, the following:

- (3) For the purposes of subsections (1) and (2) of this section:
- (a) Income shall be considered derived from or relating to sources within Idaho when such income is attributable to or resulting from:
- (i) Any business, trade, profession or occupation conducted or carried on in this state, including the distributive share of partnership income and deductions, and the pro rata share of S corporation income and deductions;
  - (ii) The ownership or disposition of any interest in real or tangible personal property located in this state;
  - (iii) The ownership or disposition of any interest in intangible personal property only to the extent that such property is employed in a business, trade, profession or occupation conducted or carried on in this state. Provided however, that interest income from an installment sale of real or tangible personal property shall constitute income from sources within this state to the extent that the property sold was located within this state. Provided further, that interest income received by a partner or shareholder of a partnership or S corporation from such partnership or S corporation shall constitute income from sources within this state to the extent that the partnership or S corporation is transacting business within this state;
  - (iv) A resident estate or trust;
  - (v) A nonresident estate or trust to the extent the income and deductions of the nonresident estate or trust were derived from or related to sources within this state;
  - (vi) The conduct of pari-mutuel wagering, charitable gaming or any other form of gambling taking place within this state, except as expressly limited in section 67-7439, Idaho Code;
  - (vii) Gains or losses realized from the sale or other disposition of a partnership interest or stock in an S corporation to the extent of the

partnership's or S corporation's Idaho apportionment factor in the taxable year immediately preceding the year of sale. (Underlining added.)

The portion of Idaho Code § 63-3026A that was underlined above was added by 2005 legislation with an effective date of January 1, 2005. The decision in Docket No. 15253 addressed tax years of 1997 and 1998. The decision in Docket No. 17455 addressed a tax liability for the year 2000. While the effect of the Commission's decisions in Dockets 15253 and 17455 are different from the law as applied by the auditor in this matter, in each of the cases the current statute was followed by the auditors.

The intent and meaning of the applicable portion of Idaho Code § 63-3026A appears clear. The petitioners have not cited authority to support a contrary finding. Accordingly, the Commission finds that the gain from the sale of the stock in question is taxable as asserted by the auditor.

The auditor also asserted that \$4,345 of investment tax credit claimed by the petitioners should be recaptured in 2007 due to the sale of the petitioners' stock. The petitioners set out theoretical objections to the imposition of the recapture, but set forth no specific authority precluding this adjustment. The petitioners have not asserted either that the facts the auditor relied upon are in error or that the authority relied upon by the auditor is not applicable. Accordingly, this adjustment is also affirmed.

The auditor asserted the substantial understatement penalty for 2007 and the delinquency penalty for both taxable years 2008 and 2009. Idaho Code § 63-3046 stated [2007], in part:

(c) (1) In the event the return required by this chapter is not filed on or before the due date (including extensions) of the return, there may be collected a penalty of five percent (5%) of the tax due on such returns for each month elapsing after the due date (including extensions) of such returns until the return is filed.

\* \* \*

(d) (1) If there is a substantial understatement of tax for any taxable year, there shall be added to the tax an amount equal to ten percent (10%) of the amount of any underpayment attributable to such understatement.

(2) For purposes of this subsection, there is a substantial understatement of tax for any taxable year if the amount of the understatement for the taxable year exceeds the greater of:

- (i) Ten percent (10%) of the tax required to be shown on the return for the taxable year, or
- (ii) Five thousand dollars (\$5,000).

\* \* \*

(4) For purposes of paragraph (d)(2) of this section, the term “understatement” means the excess of:

- (i) The amount of tax required to be shown on the return for the taxable year, over
- (ii) The amount of the tax imposed which is shown on the return.

(5) The amount of the understatement under paragraph (4) shall be reduced by that portion of the understatement which is attributable to:

- (i) The tax treatment of any item by the taxpayer if there is or was substantial authority for such treatment, or
- (ii) Any item with respect to which the relevant facts affecting the item’s tax treatment are adequately disclosed in the return or in a statement attached to the return.

\* \* \*

(g) Total penalties imposed under subsections (a), (c) and (d) of this section and under section 63-3033, Idaho Code, shall not exceed twenty-five percent (25%) of the tax due on the return.

The petitioners have not asserted either that the reporting of the sale of the stock in question was fully disclosed in the Idaho income tax return or that there was substantial authority for their position. Accordingly, the substantial understatement penalty is affirmed as it was asserted by the auditor for 2007.

The petitioners did not file Idaho income tax returns for either 2008 or 2009. The Commission finds that they were required to file the returns in question. Accordingly, the delinquency penalty asserted by the auditor for 2008 and 2009 is appropriate.

THEREFORE, the Notice of Deficiency Determination dated November 24, 2010, is hereby APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax, penalty, and interest (computed to February 15, 2012):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2007	\$158,150	\$15,815	\$28,842	\$202,807
2008	560	140	73	773
2009	27	10	2	<u>39</u>
			TOTAL	<u>\$203,619</u>
			LESS PAYMENT	(70,330)
			TOTAL DUE	<u>\$133,289</u>

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

\_\_\_\_\_  
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.

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