

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 24219
[Redacted],)	
)	
Petitioners.)	DECISION
_____)	

The petitioners protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated July 28, 2011. The Notice of Deficiency Determination asserted additional liabilities for Idaho income tax and interest in the total amount of \$4,828 for 2010.

For 2009, the petitioners claimed an ordinary loss from the default on a note through which they loaned money to a real estate development firm. The auditor disallowed the ordinary loss indicating that the loss was a capital loss and that the taxpayers were only allowed to claim \$3,000 of such loss against ordinary income in any given year. To settle the deficiency for 2009, the auditor reclassified the loss as a theft loss, thereby allowing the loss to eliminate the petitioners' Idaho taxable income for 2009. On the basis of this reclassification, the petitioners withdrew their objection to the 2009 adjustment on April 7, 2011.

On April 8, 2011, the petitioners filed an amended 2010 Idaho income tax return claiming a net operating loss carried forward from the same loss. This return requested a refund in the amount of \$4,828. This refund was not issued to the petitioners.

The net operating loss deduction claimed on the petitioners' 2010 amended return was denied with the explanation that, "theft losses, including Ponzi losses, are excluded from the calculation of the Idaho net operating loss." The petitioners appealed stating that they disagreed with the denial of the refund. They cited no authority for their position.

The question before us is governed by Idaho Code § 63-3021 which stated, in pertinent part:

Net Operating Loss. (a) The term "net operating loss" means the amount by which Idaho taxable income, after making the modifications specified in subsection (b) of this section, is less than zero (0).

(b) Add the following amounts:

(1) The amount of any net operating loss deduction included in Idaho taxable income.

(2) In the case of a taxpayer other than a corporation:

(i) Any amount deducted due to losses in excess of gains from sales or exchanges of capital assets; and

(ii) Any deduction for long-term capital gains provided by this chapter.

(3) Any deduction allowed under section 151 of the Internal Revenue Code (relating to personal exemption) or any deduction in lieu of any such deduction.

(4) Any deduction for the standard or itemized deductions provided for in section 63 of the Internal Revenue Code, or section 63-3022(j), Idaho Code, except for any deduction allowable under section 165(c)(3) of the Internal Revenue Code (relating to casualty losses) pertaining to property physically located inside Idaho at the time of the casualty. (Underlining added.)

The loss allowed in the settlement of the 2009 liability was an itemized deduction.

Therefore, unless this deduction is allowable under Internal Revenue Code (IRC) § 165(c)(3), it is to be excluded from the computation of the net operating loss. IRC § 165 states, in part:

Losses.

(a) General rule.

There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) Amount of deduction. For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

(c) Limitation on losses of individuals. In the case of an individual, the deduction under subsection (a) shall be limited to

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

(3) except as provided in subsection (h), losses of property not connected with a trade or business or a transaction entered into for profit, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.

The inclusion of those losses addressed by IRC § 165(c)(3), but not those addressed by IRC § 165(c)(1) (relating to business losses) or IRC § 165(c)(2) (relating to transactions entered into for profit) in the computation of the Idaho net operating loss, favors the losses from personal losses over losses from business endeavors or transactions entered into for profit. The loss in question in this docket would fall under IRC § 165(c)(2) and therefore would not be includable in the computation of an Idaho net operating loss pursuant to Idaho Code § 63-3021.

The second reason that the auditor is correct is due to the nature of the item from which the loss has arisen. The property must have been “physically located inside Idaho at the time of the casualty.” The investment is an intangible. The U.S. Supreme Court has held that “intangible property is not physical matter which can be located on a map.” Delaware v. New York, 507 U.S. 490, 498 (1993); Texas v. New Jersey, 379 U.S. 674, 677 (1965). If it cannot be located on a map, it follows that it cannot be “physically located inside Idaho at the time of the casualty.”

The result reached herein may seem illogical or may not seem to be socially or economically sound. Such an argument was addressed by the Idaho Supreme Court as follows:

The Stangs urge this Court to "construe" the Idaho Income Tax Code in a manner that would permit the Stangs to avoid paying Idaho income tax on the \$8,000 distribution. They argue that because the Idaho Income Tax Code does not expressly address this situation, this Court should be free to construe the tax code in a manner that would prevent the Stangs from having to pay taxes to both California and Idaho on the same monies. When construing the provisions of the Idaho Income Tax Code, however, we must enforce the law as written. Potlatch Corp. v. Idaho State Tax Comm'n, 128 Idaho 387, 913 P.2d 1157 (1996). If there is any ambiguity in the law concerning tax deductions, the law is to be construed strongly against the taxpayer. *Id.* This Court has no authority to rewrite the tax

code. Bogner v. State Dep't of Revenue and Taxation, 107 Idaho 854, 693 P.2d 1056 (1984). Any exemption from taxation must be created or conferred in clear and plain language and cannot be made out by inference or implication. Herndon v. West, 87 Idaho 335, 393 P.2d 35 (1964). This Court does not have the authority to create deductions, exemptions, or tax credits. If the provisions of the tax code are socially or economically unsound, the power to correct it is legislative, not judicial. Id.

Idaho State Tax Commission v. Stang, 135 Idaho 800, 802-803 (2001).

The Notice of Deficiency Determination stated that [the petitioners] “owe the following Individual Income Tax plus penalty and interest . . .” and sets out that the petitioners owed \$4,828. The Commission finds that the amount stated as owed was the amount requested by the petitioners in their amended 2010 return. This refund was not paid. Therefore, no further amount is due from the petitioners.

THEREFORE, the Notice of Deficiency Determination dated July 28, 2011, is hereby MODIFIED, and AS SO MODIFIED is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners are not due a refund due to the filing of their amended 2010 Idaho income tax return dated April 8, 2011.

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.
