

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
[Redacted],) DOCKET NO. 24223
)
)
Petitioners.) DECISION
)
_____)

[Redacted] (taxpayers) protested the Notice of Deficiency Determination dated July 13, 2011, asserting income tax, penalty, and interest for taxable year 2008 in the total amount of \$5,469. The taxpayers disagreed with the adjustment disallowing the Idaho capital gains deduction claimed on their amended 2008 Idaho individual income tax return. The Tax Commission, having reviewed the file, hereby issues its decision.

BACKGROUND

The taxpayers are members of four Idaho limited liability companies (LLCs). In 2008, one of the LLCs sold a small office building resulting in a pass-through gain for the taxpayers. Initially, the taxpayers filed their Idaho income tax return reporting the gain with no capital gains deduction. The taxpayers subsequently amended their 2008 Idaho income tax return to claim the Idaho capital gains deduction.

The Income Tax Audit Bureau (Bureau) reviewed the taxpayers’ amended return, requested information from the taxpayers, reviewed the information the taxpayers provided, and determined the Idaho capital gains deduction was limited to zero because the taxpayer’s [Redacted] income tax return reported a capital loss rather than capital gain net income. The Bureau adjusted the taxpayers’ return and sent them a Notice of Deficiency Determination.

The taxpayers protested the Bureau’s determination stating that the inclusion of gains and losses from non-qualifying property is in direct conflict with the Idaho law allowing the capital

gains deduction. The taxpayers stated the instructions to the Idaho capital gains deduction form clearly state that the gains from the sale of stocks and other intangibles do not qualify. Therefore, the calculation of the limitation for the Idaho capital gains deduction should not include gains and losses from the sale of stocks and other intangibles.

The Bureau and the taxpayers continued discussing the issue and the Bureau modified its determination as it related to the addition of penalty and interest. The Bureau eliminated the penalty and recalculated the interest to correspond with the date the taxpayers received the refund of tax claimed on their amended Idaho income tax return. Even though these were some of the changes requested by the taxpayers, they still asked that the Tax Commission review the capital gains deduction. Therefore, the Bureau referred the matter for administrative review.

The Tax Commission reviewed the matter and sent the taxpayers a letter discussing the options available for redetermining a protested Notice of Deficiency Determination. The taxpayers responded with a letter that further explained their position and referenced the material sent to the Bureau. The taxpayers also stated they would be available to answer any questions the Tax Commission might have.

The Tax Commission read through all the information the taxpayers provided and offered the taxpayers the opportunity to provide further information for consideration. The taxpayers did not provide anything further; they only asked that they receive an explanation of the Tax Commission's decision. Therefore, the Tax Commission having considered everything presented, issues its decision on the matter.

LAW AND ANALYSIS

Idaho Code section 63-3022H states, in pertinent part:

DEDUCTION OF CAPITAL GAINS. (1) If an individual taxpayer reports capital gain net income in determining taxable income, eighty percent (80%) in taxable

year 2001 and sixty percent (60%) in taxable years thereafter of the capital gain net income from the sale or exchange of qualified property shall be a deduction in determining Idaho taxable income.

(2) The deduction provided in this section is limited to the amount of the capital gain net income from all property included in taxable income. Gains treated as ordinary income by the Internal Revenue Code do not qualify for the deduction allowed in this section. The deduction otherwise allowable under this section shall be reduced by the amount of any federal capital gains deduction relating to such property, but not below zero.

(3) Property held by an estate, trust, S corporation, partnership, limited liability company or an individual is "qualified property" under this section if the property had an Idaho situs at the time of sale and is:

(a) Real property held at least twelve (12) months;

(b) Tangible personal property used in Idaho for at least twelve (12) months by a revenue-producing enterprise;

(c) Cattle or horses held for breeding, draft, dairy or sporting purposes for at least twenty-four (24) months if more than one-half (1/2) of the taxpayer's gross income (as defined in section 61(a) of the Internal Revenue Code) for the taxable year is from farming or ranching operations in Idaho;

(d) Breeding livestock other than cattle or horses held at least twelve (12) months if more than one-half (1/2) of the taxpayer's gross income (as defined in section 61(a) of the Internal Revenue Code) for the taxable year is from farming or ranching operations in Idaho;

(e) Timber grown in Idaho and held at least twenty-four (24) months; . . .

Idaho Code section 63-3011B defines taxable income:

The term "taxable income" means federal taxable income as determined under the Internal Revenue Code.

Internal Revenue Code (IRC) section 1222(9) defines capital gain net income:

The term "capital gain net income" means the excess of the gains from sales or exchanges of capital assets over the losses from such sales or exchanges.

The taxpayers argued that their 2008 losses from stock transactions should not be considered in the determination of the limitation placed on the Idaho capital gains deduction. Their argument is based on language found in the instructions to Idaho Form CG which states, **"NOTE: Gains from the sale of stocks and other intangibles do not qualify."** and "Losses from property not eligible for this deduction do not reduce gains from eligible property." The taxpayers believe this language "clearly states that stock transactions are not to be considered in

determining the 60% Idaho gain deduction.” They stated that only qualifying property is to be considered.

As stated in Idaho Code section 63-3022H, only certain capital assets qualify for the Idaho capital gains deduction. The statute specifically lists the capital assets that qualify. Stocks and other intangibles are not included in the list. The taxpayers believe that because stocks and other intangibles are mentioned in the instructions, stocks and other intangibles are excluded from all considerations in determining the Idaho capital gains deduction. This reasoning is not supported by the statute.

The statute initially states that the taxpayer must have capital gain net income in the determination of taxable income. Since taxable income is defined as federal taxable income, gains and losses from stock transactions must be included. Furthermore, capital gain net income is the excess of the gains on the sale or exchange of capital assets over the losses of capital assets, which includes stock transactions. Therefore, by statute stocks and other intangibles do have a part in the determination of the Idaho capital gains deduction.

The language in the instructions is there as a reminder that even though the underlying assets of a stock sale or sale of an interest in a partnership may be qualified property, the sale of the stock or partnership interest is not the sale of qualified property. The language is not intended to single out stock and other intangible transactions to exclude them from the computation of capital gain net income.

Capital gain net income requires the netting of all gains and losses from the sale or exchange of all capital assets. (IRC section 1222(9).) However, Income Tax Administrative Rule 170.04 and .05 instructs that netting gains and losses from qualifying and non-qualifying property is first done within their respective classes before the capital gain deduction is

determined and then between the two classes after the capital gain deduction is determined. Thus, the statute and the rule allow the maximum deduction for capital gains from Idaho sources.

The Idaho Code places a limit on the amount of the capital gains deduction. In subsection (2) of section 63-3022H, the deduction is “limited to the amount of capital gain net income from ALL property included in federal taxable income.” (Emphasis added.) In this case, the taxpayers had no capital gain net income. Therefore, according to Idaho Code section 63-3022H(2), the taxpayers’ capital gains deduction is limited to zero.

The taxpayers argued that the stock transactions should not be included in the determination of capital gain net income. However, as pointed out earlier, the federal statute makes no provision for excluding stock transactions or any other gains or losses on the sale of capital assets in the determination of capital gain net income.

CONCLUSION

The taxpayers realized a flow-through gain on the sale of real property located in Idaho in 2008. The property sold was qualifying real property for purposes of the Idaho capital gains deduction. The taxpayers had other gains and losses from sources that were not taxable by Idaho. The taxpayers reported a net capital loss on their 2008 [Redacted] income tax return. The taxpayers did not have capital gain net income in their [Redacted] taxable income.

Since the Idaho capital gain deduction is limited to the amount of capital gain net income included in [Redacted] taxable income and the taxpayers had no capital gain net income, the taxpayers’ Idaho capital gain deduction is zero. Therefore, the Tax Commission agrees with the Bureau’s determination of disallowing the Idaho capital gains deduction.

The Bureau initially added penalty and interest to the taxpayers' tax but subsequently eliminated the penalty and reduced the interest. The Tax Commission reviewed the changes the Bureau made to the penalty and interest and found them appropriate.

THEREFORE, the Notice of Deficiency Determination dated July 13, 2011, and directed to [Redacted] is AFFIRMED AS MODIFIED by this decision.

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

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2008	\$4,700	\$390	\$5,090
		LESS PAYMENT	<u>5,090</u>
		BALANCE DUE	<u>\$ 0</u>

Since the taxpayers have paid the tax and interest, no DEMAND for payment is required or needed.

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

DATED this _____ day of _____ 2012.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2012, 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.
