BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 24583
[Redacted],	)	
	)	
Petitioners.	)	DECISION
	)	

[Redacted] (taxpayers) protest the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated October 7, 2011, asserting additional liability for Idaho income tax and interest in the total amounts of $2,161, $1,846, and $1,716 for taxable years 2008, 2009, and 2010, respectively.

ISSUE

The issue is whether Idaho can impose its income tax on the wages earned by a resident of another state, and if so, how is that tax liability computed?

[Redacted] were married at all times relevant to this decision. Also during all such times, [Redacted] was domiciled in Idaho, and [Redacted] was domiciled in Washington. Taxpayers filed joint tax returns for all years both with the [Redacted] and the Commission.

The returns submitted by the taxpayers for taxable years 2008 through 2010 reported only the income earned by [Redacted]. The auditor adjusted the returns for each taxable year to include the community property portion of the taxpayers' income that was deemed to be includable in Idaho taxable income and adjusted the taxpayers' liability accordingly.

The taxpayers appealed the determination contending that the auditor has not properly computed their liability for the aforementioned years. The taxpayers' appeal states that the Commission erred by including all of [Redacted] earnings plus one-half of

[Redacted] earnings in the calculation of their Idaho income tax liability. The taxpayers have indicated that the computation does not produce a fair result.

LAW & ANALYSIS

The taxpayers have made reference to state and federal publications along with various Idaho Code sections in an attempt to substantiate their position, including, but not limited to, Idaho Code sections 63-3002, 63-3011C, and 63-3011(f).

The taxpayers believe, based on their interpretation of IRS Publication 555, Community Property, that their income should be split 50/50. IRS Publication 555 does discuss reporting half of one's community income on their federal return, but only in instances where the taxpayer files a Married, filing separate return. Generally, as stated in IRS Publication 555, the laws of the state in which you are domiciled govern whether you have community property and community income or separate property and separate income.

Both the state of Idaho and the state of Washington are community property states and both treat earnings as community property and, therefore, community income. Under Idaho law, earnings of a spouse are presumed to be community property. Idaho Code section 32-906(1); Martsch v. Martsch, 103 Idaho 142, 645 P.2d 882 (1982). This is true even if the husband and wife are separated and living apart. Suter v. Suter, 97 Idaho 461, 546 P.2d 1169 (1976) Desfosses v. Desfosses, 120 Idaho 354, 815 P.2d 1094 (Ct. App. 1991). Thus, under Idaho law, only death or a legal divorce will disband the community.

Washington community property law also provides that income earned through the labor of a spouse is presumed to be community income. R.C.W. section 26.16.030; In re Marriage of Hurd, 848 P.2d 185 (Wa.Ct.App. 1993) ("Earnings arising from services performed during marriage are community property."). However, Washington community property law provides

an exception to this general principle where the husband and wife are living separate and apart even though they are not legally divorced. Specifically, R.C.W. section 26.16.140 provides that "[w]hen a husband and wife are living separate and apart, their respective earnings and accumulations shall be the separate property of each." Thus, under Washington law, earnings of a spouse are community property except where the spouses are separated and living apart, in which case, each spouse's earnings are treated as his or her separate property. However, Washington courts have consistently held that in order for R.C.W. section 26.16.140 to apply, the married couple must be living separate and apart as a result of marital discord.

The taxpayers have made it clear that their living arrangement is in no way because of marital discord. In fact, during an informal hearing with [Redacted], he stated that even if it would reduce his tax liability, he would hesitate to file his income tax returns with a Married, filing separate status because in his mind that indicated the marriage was in trouble and the couple was in the process of divorcing. Therefore, based on the community property laws of their respective states of domicile, [Redacted] earnings and [Redacted] earnings would be considered community income.

Since the earnings of both taxpayers are considered community property, the issue now becomes how to determine the taxpayers' Idaho taxable income and Idaho income tax liability.

Idaho Code § 63-3002 states:

> Declaration of intent. -- It is the intent of the legislature by the adoption of this act, insofar as possible to make the provisions of the Idaho act identical to the provisions of the Federal Internal Revenue Code relating to the measurement of taxable income, to the end that the taxable income reported each taxable year by a taxpayer to the internal revenue service shall be the identical sum reported to this state, subject only to modifications contained in the Idaho law; to achieve this result by the application of the various provisions of the Federal Internal Revenue Code relating to the definition of income, exceptions therefrom, deductions (personal and

> otherwise), accounting methods, taxation of trusts, estates, partnerships and corporations, basis and other pertinent provisions to gross income as defined therein, resulting in an amount called "taxable income" in the Internal Revenue Code, and then to impose the provisions of this act thereon to derive a sum called "Idaho taxable income"; to impose a tax on residents of this state measured by Idaho taxable income wherever derived and on the Idaho taxable income of nonresidents which is the result of activity within or derived from sources within this state. All of the foregoing is subject to modifications in Idaho law including, without limitation, modifications applicable to unitary groups of corporations, which include corporations incorporated outside the United States.

Idaho taxable income is defined in Idaho Code section 63-3011(C) as "taxable income as modified to the Idaho adjustments specifically provided in this chapter."

Idaho Code section 63-3022 Adjustments to Taxable Income states "the additions and subtractions set forth in this section, and in sections 63-3022A through 63-3022Q, Idaho code, are to be applied to extent allowed in computing taxable income…"

Idaho Code section 63-3022(f) states "subtract the amount of any income received or accrued during the taxable year which is exempt from taxation by this state, under the provisions of any other law of this state or a law of the United States, if not previously subtracted in arriving at taxable income."

The taxpayers cited Idaho Code section 63-3022(f) as one of their arguments for not including [Redacted] earnings in taxable income because the income was not Idaho source. The fact that [Redacted] income was earned in Washington does not, in and of itself, make it exempt from taxation by Idaho under Idaho Code section 63-3022(f).

The taxpayers and the Commission disagree whether the state of Idaho can impose tax on half of [Redacted] wages earned in the state of Washington, along with all of [Redacted] wages earned in the state of Idaho. The taxpayers cited a brochure published by the Commission entitled, <u>RESIDENCY STATUS AND IDAHO SOURCE INCOME HOW RESIDENCY AFFECTS YOUR IDAHO INCOME TAX</u>, along with

publications and instructions that they believe provide the authority that [Redacted] income is overstated.

There are several problems with affording the Commission's publication the force and effect of law. First, determination of the tax laws is the responsibility of the legislative branch of government. The brochure cited by the taxpayers was composed by the staff of the Commission and is not subject to review by the legislative branch of the government. Accordingly, affording the brochure the force and effect of law would constitute the executive branch of the government changing the law as determined by the legislative branch. The Commission finds that the brochure does not have the force and effect of law.

Secondly, the instructive brochures and other informal advice rendered by the staff of the Commission are not intended to be an exhaustive treatment of the law. The tax laws are very voluminous. If the informal advice made available by the Commission was to be held to a standard of being an exhaustive treatment of the law, then the offering of such would, in all probability, be impracticable. The brochures, the instructions for the completion of the tax forms, and the taxpayer assistance made available, are intended to be a brief treatment of the issues which are intended to provide answers to many taxpayers while not being an exhaustive or perfect treatment of any tax matter.

The taxpayers' appeal letter requests an explanation of the fairness of taxing 76 percent of the community income and why the state of Idaho thinks that it is fair and just to tax income derived outside of the state of Idaho. The question of whether the state may tax income earned outside of its borders was addressed by the Supreme Court in Herdon v. West, 87 Idaho 335, 393 P.2d 35 (1964). In that case, the taxpayer was a resident of Idaho and was also a general partner in an Oklahoma business from which she derived income. The taxpayer argued that the state's attempt to tax her

[Redacted] income violated her rights under the Fourteenth Amendment of the United States Constitution. The Supreme Court stated that:

> The Supreme Court of the United States has made it clear that a state has the power to tax in relation to a resident's income derived from sources outside the State and that there is nothing in the Federal Constitution to prevent the exercise of such power. The rationale for allowing a state to compute a tax on income earned elsewhere is based on the premise that inhabitants are supplied many services by their state of residence and should contribute toward the support of the state, no matter where their income is earned. (citations omitted)

As for the fairness of the law, the law is perhaps not perfect. No tax law yet devised has been entirely fair and just to all in its practical workings. Chicago, M.,ST.P. & P.R.CO v. HEDGES et al., *and four other cases. Nos. 511E-514E, 517E. (1933).*

CONCLUSION

The taxpayers were both domiciled in community property states during taxable years 2008 through 2010 and filed their tax returns for all years with a filing status of Married, filing joint. There are certain exceptions within federal code and within the state of Washington community property laws that may allow certain taxpayers to treat their earnings as separate income. However, those exceptions are not present in this case. Therefore, the Commission concludes that the community property laws should govern the ownership of the income in question. Accordingly, the Commission finds that the auditor's inclusion of one-half of [Redacted] income and all of [Redacted] income is the proper determination of Idaho taxable income.

THEREFORE, the NODD dated October 7, 2011, and directed to [Redacted], is hereby AFFIRMED and MADE FINAL.

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

YEAR	TAX	INTEREST	TOTAL
2008	$1,922	$287	$2,209
2009	1,718	171	1,889
2010	1,670	87	1,757
		TOTAL DUE	$5,855

Interest is calculated through August 3, 2012.

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 _____ 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.

_____