

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 24573
[Redacted],)	
)	
Petitioners.)	DECISION
_____)	

[Redacted] (Petitioners) protested the Notice of Deficiency Determination dated October 14, 2011, issued by the Income Tax Audit Bureau of the Idaho State Tax Commission asserting additional tax and interest for taxable years 2008, 2009, and 2010 in the total amount of \$7,572. Petitioners disagreed with the determination of Idaho taxable income using the community property allocation of income between Idaho and [Redacted]. The Tax Commission, having reviewed the file, hereby issues its decision.

BACKGROUND

Petitioners filed Idaho part-year/nonresident income tax returns for 2008, 2009, and 2010, reporting only [Redacted] income, a capital loss, rental income/loss, and some interest income as Idaho income. Petitioners' referenced [Redacted] income only in the proration of their standard deduction and personal exemptions. The Income Tax Audit Bureau (Bureau) examined Petitioners' 2008, 2009, and 2010 Idaho individual income tax returns looking specifically at the allocation of income pursuant to the community property statutes.

Petitioners are domiciled in two separate community property states. Petitioners derived their income from two primary sources. [Redacted] income is a [Redacted] and [Redacted] income is from her ongoing [Redacted] employment. [Redacted] is a resident of Idaho, and [Redacted] is a resident of [Redacted]. The Bureau determined Petitioners' 2008, 2009, and 2010 Idaho individual income tax returns did not accurately report Idaho source income and the

community property split of community income. The Bureau issued a Notice of Deficiency Determination which allocated half of [Redacted] income and all of [Redacted] income as Idaho taxable income.

Petitioners protested and subsequently filed amended Idaho individual income tax returns reporting half of [Redacted] income and half of [Redacted] income as Idaho taxable income. The Bureau reviewed Petitioners' amended income tax returns and referred the matter for administrative review.

The Tax Commission reviewed the matter, and sent Petitioners a letter that discussed the methods available for redetermining a protested Notice of Deficiency Determination. Petitioners contacted the Tax Commission and restated their position that a community property split of income should be exactly that, half of the community income attributed to each spouse. As a result, half of the community income is allocated to Idaho and half to [Redacted]. Petitioners implied the source of the income, Idaho or [Redacted], should have no bearing on the taxability of the income. Petitioners stated the amended Idaho tax returns they submitted are the correct determination of their Idaho taxable income for the taxable years 2008, 2009, and 2010.

LAW AND ANALYSIS

The issue in this case is the determination of the community property income to be reported to the state of Idaho for income tax purposes. [Redacted] lives in [Redacted], Idaho, and receives the majority of his income from a [Redacted] pension. [Redacted] lives in [Redacted] and works for the [Redacted]. Idaho and [Redacted] are community property states. Both consider wages as community property and therefore community income. *See* Idaho Code section 32-906 and Revised Code of [Redacted] (R.C.W.) section 26.16.030. This is true in Idaho 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). It is likewise true in [Redacted]; however, [Redacted]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 [Redacted]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, [Redacted] 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 fact that a couple is living apart is not, by itself, sufficient to give rise to the separate property treatment of R.C.W. section 26.16.140. Regardless, Petitioners did not argue marital discord; their decision to live apart appears to be based upon the exigencies of [Redacted] career.

Idaho Code section 63-3002 states the purpose of the Idaho income tax act is to impose a tax on residents of the state of Idaho measured by income wherever derived, and on the income of nonresidents derived from activity or sources within Idaho. Therefore, for community property purposes, generally Idaho taxable income consists of all the income from Idaho sources plus one-half the income of the nonresident spouse living in the other community property state. *See* Parker v. Idaho State Tax Com’n, 148 Idaho 842 (2010). However, in this case [Redacted] income is retirement income from a [Redacted] pension.

Retirement income of this type (qualified plans) receives special treatment as provided by federal law. Title 4, Section 114, United States Code exempts qualified retirement plan distributions from state taxation if the recipient is a non-resident of the state attempting to collect. 4 U.S.C. section 114(a) states “No State may impose an income tax on any retirement income of an individual who is

not a resident or domiciliary of such State (as determined under the laws of such State).” 4 U.S.C. section 114(b)(1)(G) further states that government plans, defined by Internal Revenue Code section 414(d), are included in the state exemption. Internal Revenue Code section 414(d) states that government plans include all those established and maintained for the employees of the United States of America. Because [Redacted] pensions are qualified retirement plans under 4 U.S.C. section 114(b)(1)(G), [Redacted] pension meets the requirements of 4 U.S.C. section 114(a) and is therefore exempt from tax if received by a non-resident of the taxing state.

Since Idaho is a community property state, [Redacted] pension is attributed equally to [Redacted]. And, because [Redacted] is not a resident of the state of Idaho, 4 U.S.C. section 114(a) exempts her portion of the pension from Idaho taxation. Therefore, [Redacted] community property interest in the pension cannot be recognized as taxable income by the state of Idaho. Only [Redacted] half interest in the pension and his half interest in [Redacted] income can be recognized as Idaho taxable income.

The Tax Commission reviewed the amended returns Petitioners submitted and found they better represented Petitioners’ Idaho community property income. However, the Tax Commission did find it necessary to make corrections to Petitioners’ rental losses and health insurance deductions to bring Petitioners’ amended returns into full compliance with the community property statutes.

CONCLUSION

Petitioners were domiciled at all times in community property states where their earnings were considered community income. However, because [Redacted] is a resident of [Redacted], the half of the retirement income attributable to her is exempt from Idaho taxation, even though it is considered Idaho source income. As a result, the amended Idaho income tax returns

submitted by Petitioners, with corrections, reflect the proper division of Petitioners' community income and therefore Petitioners' Idaho taxable income.

THEREFORE, the Notice of Deficiency Determination dated October 14, 2011, and directed to [Redacted] is hereby AFFIRMED AS MODIFIED by this decision.

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

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2008	\$ 807	\$148	\$ 955
2009	907	121	1,028
2010	1,042	91	<u>1,133</u>
		TOTAL DUE	<u>\$3,116</u>

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 _____ 2013.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2013, 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.
