

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 25427
[Redacted],)	
)	
Petitioners.)	DECISION
_____)	

BACKGROUND

On October 5, 2012, the Audit Division (Audit) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to [Redacted](Petitioners) proposing income tax, penalty, and interest for taxable years 2007 through 2009, in the total amount of \$10,402. On December 5, 2012, the Petitioner filed a timely protest. On March 6, 2013, the file was transferred to the Tax Policy Division for resolution. On March 19, 2013, the Commission sent the taxpayer a letter that explained the methods available for redetermining an NODD. A hearing was not requested and no additional information was provided. The Commission considered the issues with the information available in the file.

ISSUES

1. Whether the Petitioners’ Idaho Net Operating Loss from their wholly-owned Sub Chapter S corporation¹ exceeded their basis in the corporation, and is, therefore, limited and not deductible on their personal income tax returns.

LAW AND DISCUSSION

An S corporation is a corporation that meets certain criteria established by the Internal Revenue Code (IRC) for ownership, etc., and the owners have made an election on their [Redacted] return to claim “S” status. The impact of the election is that the S corporation’s items

¹ A corporation that has elected to be treated as a pass-through entity as defined in Internal Revenue Code section 1361(1).

of income, loss, deductions, and credits flow to the shareholders and are taxed on the shareholder's personal return. The two main reasons for electing S corporation status are to avoid double taxation on distributions and to allow corporate losses to flow through to its owners. There are three shareholder loss limitations. The first limitation is the "Stock and Debt Basis" limitations, followed by the "At Risk" limitations and the "Passive Activity Loss" limitations. Each limitation must be met, in the order presented, before a shareholder is allowed to claim a flow-through loss on their personal tax return. Losses that exceed any of these limitations are suspended and may be allowed if the owner's stock and or debt basis is restored. Losses that were suspended because they exceed the stock and debt basis, upon disposal of the taxpayer's interest in the corporation are lost and cannot be deducted.

The Petitioners have separated since the NODD was issued and the husband has obtained a CPA under a limited Power of Attorney (POA) to represent him on the S corporation issue. On March 19, 2013, the Commission sent a letter to each Petitioner and the POA asking for a response within 30 days of the letter. Only the wife responded and she does not have the business information. The POA responded to a phone message on October 4, 2013. He said he had not received the letter. It was scanned and emailed to him.

These audit adjustments arise from the first limitation. The Petitioners claimed pass-through losses on their 2007 and 2008 Idaho income tax returns. Audit disallowed the pass-through losses because the amount was greater than the stock and debt basis of the Petitioners in the corporation. When Audit disallowed the 2007 and 2008 losses, the Petitioners' Idaho taxable income was still negative, so there was no additional tax assessed for those years. The Petitioners had also claimed a Net Operating Loss (NOL) on their 2009 Idaho income tax

return. The disallowance of the 2007 and 2008 losses results in the NOL carried into 2009 being disallowed.

Internal Revenue Code (IRC) §1366(d) says;

Special rules for losses and deductions.

Cannot exceed shareholder's basis in stock and debt

The aggregate amount of losses and deductions taken into account by a shareholder under subsection (a) for any taxable year shall not exceed the sum of -

(A) the adjusted basis of the shareholder's stock in the S corporation (determined with regard to paragraphs (1) and (2)(A) of section 1367(a) for the taxable year), and
(B) the shareholder's adjusted basis of any indebtedness of the S corporation to the shareholder (determined without regard to any adjustment under paragraph (2) of section 1367(b) for the taxable year).

Internal Revenue Code (IRC) §1367(b)(2)(a) says that once a shareholder's stock basis has been reduced to zero, any excess losses are applied to the shareholder's basis in loans to the corporation.

Audit questioned whether the Petitioners had adequate basis to allow them to claim the losses on their personal income tax returns. The Petitioner provided copies of the S corporation income tax returns for the years 2003 and 2004. Audit calculated the stock and debt basis for the entire history of the corporation based on the information provided. The only response was from the CPA. "The Note Payable (Line 20) on the Balance Sheet reflects the \$50,000 for 2003 and the \$50,000 for 2004 received from family members. No repayment terms were ever stated. You can contact me at the above address and phone if you need anything else."

Neither the Petitioner, nor the POA, provided adequate evidence that the Petitioner himself was liable for the debt. An entry on the balance sheet of a tax return, without supporting documentation, is not sufficient to establish basis and allow losses to be deducted on personal income tax returns.

CONCLUSION

A Notice of Deficiency Determination issued by the Idaho State Tax Commission is presumed to be accurate. Parsons v. Idaho State Tax Com'n, 110 Idaho 572 (Ct. App. 1986). The burden is on the taxpayer to show the deficiency is erroneous. Albertson's, Inc. v. State, Dept. of Revenue, 106 Idaho 810 (1984).

Having presented insufficient information in support of their position, the Petitioners did not meet their burden of proving error on the part of the deficiency determination. Absent information to the contrary, the Commission accepts Audit's calculation of Idaho income tax, penalty, and interest for those years.

THEREFORE, the Notice of Deficiency Determination dated October 5, 2012, and directed to [Redacted] and [Redacted] is hereby AFFIRMED.

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
12/31/07	\$ 0	\$ 0	\$ 0	\$ 0
12/31/08	0	0	0	0
12/31/09	8,232	1,235	1,223	<u>10,690</u>
			BALANCE DUE	<u>\$10,690</u>

Interest is calculated through January 31, 2014, and will continue to accrue at the rate set forth in Idaho Code section 63-3045.

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.
