

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

| | | |
|---------------------------------|---|------------------|
| In the Matter of the Protest of |) | |
| |) | DOCKET NO. 24710 |
| [Redacted], |) | |
| |) | |
| Petitioners. |) | DECISION |
| _____ |) | |

BACKGROUND

On November 15, 2011, the Audit Division (Audit) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to [Redacted] and [Redacted] (Petitioners) proposing income tax, penalty, and interest for taxable year 2009, in the total amount of \$877. The Petitioners submitted a Power of Attorney form naming [Redacted] as their representative (POA). On January 17, 2012, the POA filed a timely protest. On November 27, 2012, the file was transferred to the Tax Policy Division for resolution. On February 6, 2013, the Commission sent the taxpayer a letter that explained the methods available for redetermining an NODD.

ISSUES

1. Whether the [Redacted] ([Redacted]) was a qualified investment partnership in 2009¹, making the income distribution nontaxable to the partners.
2. Whether the apportionment percentage reported on the Petitioners' 2009 K-1 from the [Redacted] was incorrect.

LAW AND DISCUSSION

The Petitioners filed a 2009 nonresident Idaho individual income tax return (Form 43) on October 15, 2010. Audit sent a letter requesting additional documentation to verify the income reported on Form 43. Specifically, the Petitioners' income distribution from the [Redacted] was

¹ Idaho Code §63-3026A(3)(c) and Income Tax Administrative Rule 275.

not included on their original Idaho Form 43. Also, the original partnership return showed an apportionment percentage of 100%, even though a small amount of the property held for investment was not located in Idaho.

Idaho Income Tax Administration Rule 620.03. Multistate Partnerships. If a partnership operates in more than one state, its income shall be apportioned and allocated on the partnership return as if the partnership were a corporation. The allocation and apportionment rules of Section 63-3027, Idaho Code, and related rules apply to the partnership.

63-3027. Computing Idaho taxable income of multistate or unitary corporations. The Idaho taxable income of any multistate or unitary corporation transacting business both within and without this state shall be computed in accordance with the rules set forth in this section:

(a) As used in this section, unless the context otherwise requires:

(1) “Business income” means income arising from transactions and activity in the regular course of the taxpayer’s trade or business and includes income from the acquisition, management, or disposition of tangible and intangible property when such acquisition, management, or disposition constitutes integral or necessary parts of the taxpayer’s trade or business operations. Gains or losses and dividend and interest income from stock and securities of any foreign or domestic corporation shall be presumed to be income from intangible property, the acquisition, management, or disposition of which constitutes an integral part of the taxpayer’s trade or business; such presumption may only be overcome by clear and convincing evidence to the contrary. Underline added.

Rule 620.03 requires that the [Redacted] use Idaho Code § 63-3027 for purposes of apportionment and allocation. § 63-3027 says that the acquisition, management, or disposition of tangible and intangible property is business income when that constitutes integral or necessary parts of the taxpayer’s trade or business operations. The [Redacted] was formed to purchase and manage various real estate and other investments.

Rule 570.03. Net Gains. If gains and losses on the sale of liquid assets are not excluded from the sales factor by other provisions of this rule, such gains or losses shall be treated as provided in Subsection 570.03 of this rule. This subsection does not provide rules relating to the treatment of other receipts produced from holding or managing such assets. If a taxpayer holds liquid assets in connection with one (1) or more treasury functions of the taxpayer, and the liquid assets produce business income when sold, exchanged or otherwise disposed, the overall net gain from those transactions for each treasury function

for the tax period is included in the sales factor. For purposes of Subsection 570.03 of this rule, each treasury function shall be considered separately.

The basic apportionment factor² is calculated using the sum of the ratios of Idaho property, payroll, and sales (doubled) and then divided by 4.

| | | | | | |
|-------------------|---|------------------|---|-----|----------------|
| Idaho property | + | Idaho payroll | + | 2 x | Idaho sales |
| ----- | | ----- | | | ----- |
| Total property | | Total payroll | | | Total sales |
| ----- | | | | | |
| 4 | | | | | |

During the audit process, the POA provided an amended Form 42 for the [Redacted] that calculated the Idaho apportionment factor at 31.4929 percent. The POA also provided an amended Idaho schedule K-1 for the Petitioners. The difference in the Petitioners' return and the method used by Audit was that on the Petitioners' return, the income from intangible assets was not sourced to Idaho, the commercial domicile of the partnership. Also, the Petitioners' Form 42 used the gross receipts from sales of stock instead of net gain from the sale of intangible assets³. Rule 570.03 requires that sales of intangible assets be reported using the net gain in the sales factor and not the gross receipts.

Audit reviewed the information provided and recalculated the Idaho apportionment factor to 98.3541 percent instead of 100 percent. That reduced the Petitioners' distributive share of the [Redacted] income from \$27,992 down to \$27,531. When the recalculated income was included in the Form 43 (individual nonresident return) calculation, the Idaho percentage increased from 31.69 percent to 62.77 percent.

² Idaho Code §63-3027(p).

³ Idaho Income Tax Administrative Rule 570.03

The Form 42 details of the sales factor as filed are:

| | <u>Everywhere</u> | <u>Idaho</u> |
|-----------------------------------|-------------------|-----------------|
| Dividends | \$ 12,332 | \$12,332 |
| Gross receipts from sale of stock | 408,225 | 0 |
| Gross rents | 32,700 | 32,700 |
| Interest | 9,996 | 8,160 |
| Other income | <u>10</u> | <u>10</u> |
| | <u>\$463,263</u> | <u>\$53,202</u> |

This resulted in a sales factor (doubled) of 22.97 percent and an overall factor of 31.69 percent.

Form 42 details as corrected:

| | <u>Everywhere</u> | <u>Idaho</u> |
|-----------------------------|-------------------|------------------|
| Dividends | \$ 12,332 | \$ 12,332 |
| Net gain from sale of stock | 230,861 | 230,861 |
| Gross rents | 32,700 | 32,700 |
| Interest | 9,996 | 8,948 |
| Other income | <u>4,138</u> | <u>4,138</u> |
| | <u>\$291,834</u> | <u>\$288,979</u> |

This resulted in a sales factor (doubled) of 99.02 percent and an overall factor of 98.35 percent.

Idaho Code § 63-3026A(3)(c):

“Nonresident individuals shall not be taxable on investment income from a qualified investment partnership. For purposes of this paragraph, a “qualified investment partnership” means a partnership, as defined in section 63-3006B, Idaho Code, that derives at least ninety percent (90%) of its gross income from investments that produce income that would not be taxable to a nonresident individual if the investment were held by that individual.” Underline added.

RULE 275. Investment Income From Qualified Investment Partnerships

Section 63-3026A(3)(C), Idaho Code. (4-11-06)

01. In General. (4-11-06)

a. For taxable years beginning on or after January 1, 2007, an Idaho nonresident individual will not be taxed on investment income from a qualified investment partnership. See Rule 250 of these rules for information on when pass-through income from a partnership is deemed to have been received. (4-2-08)

b. The exemption from tax on investment income from a qualified investment partnership shall not apply to gains or losses derived from the sale of a nonresident individual’s interest in a qualified investment partnership. The source of these gains and losses is to be governed by section 63-3026A(3)(a)(vii), Idaho Code, and as discussed in Rule 266 of these rules. The source of investment

income that is not from a qualified investment partnership shall be determined as provided in Rule 263 of these rules.(4-2-08)

02. Qualified Investment Partnership. An entity shall be a qualified investment partnership only if it meets both of the following criteria: (4-2-08)

a. The entity is classified as a partnership for federal income tax purposes, but is not a publicly traded partnership taxed as a corporation under Section 63-3006, Idaho Code. (4-2-08)

b. The gross income from investments of the entity must be derived at least ninety percent (90%) from investments that when held by a nonresident individual directly, would not produce income subject to the Idaho income tax. See Rules 263 and 266 of these rules.

CONCLUSION

First Issue: The question of whether a partnership is a “Qualified Investment Partnership” must be answered each year for each partner. This portion of the statute only applies to nonresident taxpayers. The relative size of various types of income can change constantly, therefore the only way to judge whether a particular partnership is qualified is at the end of each year.

Whether a particular type or item of income is taxable to a nonresident, is different than whether that type of income is sourced to Idaho for purposes of the apportionment factor. For example, dividends from publicly traded stock would be sourced to Idaho, the commercial domicile of the partnership, but those same dividends would not be taxable by Idaho in the hands of a nonresident.

Based on the information in the partnership return, the total gross receipts of the [Redacted], during taxable year 2009, were \$291,834. Of that amount, \$36,838, or approximately 12.62 percent, was rental income from Idaho property that would be taxable if it were earned directly in the hands of a nonresident taxpayer. The remaining 87.38 percent of the gross receipts would not be taxable to a resident of another state if those were received directly by the individual. Since the gross receipts of the partnership that would be nontaxable to a

nonresident did not exceed 90 percent, the [Redacted] did not qualify as a “Qualified Investment Partnership”.

Second Issue: The Petitioners used the gross proceeds from the sale of stock for calculating the apportionment factor. Also, since the commercial domicile of the [Redacted] is in Idaho, the revenue from the intangibles should be sourced to Idaho for the sales numerator of the factor. Audit was correct in the recalculation the apportionment factor.

THEREFORE, the Notice of Deficiency Determination dated November 15, 2011, corrected on September 9, 2013, and directed to [Redacted] and [Redacted] is hereby AFFIRMED.

| <u>YEAR</u> | <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|------------|----------------|-----------------|---------------|
| 12/31/09 | \$ 748 | \$ 37 | \$ 112 | <u>\$ 897</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 _____ 2014.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2014, 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.
