

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
) DOCKET NO. 25096
[Redacted],)
)
)
) Petitioners.) DECISION
)
_____)

[Redacted] and [Redacted] (Petitioners) protested the Notice of Deficiency Determination dated April 13, 2012, issued by the Income Tax Audit Bureau of the Idaho State Tax Commission asserting additional income tax, penalty, and interest for taxable years 2000, 2001, 2003 through 2005, and 2007 through 2010, in the total amount of \$86,784. Petitioners disagreed with the determination of their Idaho taxable income using the community property allocation of income between Idaho and Washington, and between Idaho and Texas. The Tax Commission, having reviewed the file, hereby issues its decision.

BACKGROUND

Petitioners filed Idaho part-year/nonresident income tax returns for taxable years 2006 through 2010, reporting only [Redacted] schedule F losses, capital gains and/or losses, interest and dividend income, and in 2010, some wages as Idaho income. Petitioners' only reference to [Redacted] [Redacted] and [Redacted] income for those years was in the proration of their itemized deductions and personal exemptions. The Income Tax Audit Bureau (Bureau) examined Petitioners' 2007 through 2010 Idaho individual income tax returns, looking specifically at the allocation of income pursuant to the community property statutes, the farm losses, Idaho-specific adjustments to [Redacted] taxable income, and Idaho credits.

During the examination, the Bureau found that [Redacted] claimed to be a resident of Idaho for many years. The Bureau researched the Tax Commission's records and found no

Idaho individual income tax returns for Petitioners after taxable year 1999 and before 2006. The Bureau expanded its examination to determine whether Petitioners were required to file Idaho individual income tax returns for the taxable years 2000 through 2005.

The Bureau requested information and documentation from Petitioners, which Petitioners provided. The Bureau reviewed the information and documentation and determined Petitioners were required to file Idaho income tax returns for taxable years 2000, 2001, 2003, 2004, and 2005. The Bureau prepared returns for Petitioners and sent them a Notice of Deficiency Determination. In addition to the deficiency for the non-filed returns, the Bureau determined Petitioners Idaho income tax returns for taxable years 2007 through 2010 did not properly report Petitioners' Idaho taxable income. The Bureau adjusted Petitioners' 2007 through 2010 Idaho income tax returns to properly allocate Petitioners' community income, to include unreported interest income, to disallow the investment tax credit claimed on horses, and to correct the bonus depreciation claimed in taxable years 2008 and 2009. These adjustments to Petitioners' 2007 through 2010 Idaho income tax returns were included as part of the Notice of Deficiency Determination the Bureau sent Petitioners for taxable years 2000, 2001, 2003, 2004, and 2005.

Petitioners protested the Notice of Deficiency Determination. Petitioners stated they protest the entire deficiency, but their protest letter only addressed the community property allocation and the requirement that [Redacted] file Idaho income tax returns for taxable years 2000, 2001, 2003, 2004, and 2005. Petitioners stated the statute of limitations prohibit any deficiency assessments before taxable year 2007. Petitioners stated [Redacted] was not a resident of Idaho from 2000 through 2010. Therefore, [Redacted] salary, based upon his labor in other states, is not reportable to Idaho. Petitioners stated neither [Redacted] nor [Redacted] were

Idaho residents in 2002; they moved to [Redacted] in 2001 and did not leave [Redacted] until 2003.

Petitioners argued various aspects of applying community property laws to the income earned by [Redacted]. The arguments included [Redacted] wages were never earned in Idaho, Idaho law does not apply to [Redacted] because he was not a resident of Idaho, wages earned in [Redacted] are solely managed by that spouse, Idaho court cases state that property acquired outside Idaho by a non-resident is separate property, and the sourcing of [Redacted] wages was not to Idaho (referencing California FTB Publication 1031).

The Bureau reviewed Petitioners' arguments, acknowledged Petitioners' protest, and referred the matter for administrative review. The Tax Commission reviewed the matter and sent Petitioners a letter stating the options available for redetermining a protested Notice of Deficiency Determination. Petitioners requested a telephone hearing, which was scheduled for March 7, 2013, however, just prior to the scheduled time for the hearing Petitioners' representative contacted the Tax Commission, unsure of his capacity as a representative, since [Redacted] had died in October 2012. The Tax Commission decided to postpone the hearing to allow [Redacted] and Petitioners' representative time to sort out the representative's representation of Petitioners. Several months later, the Tax Commission contacted Petitioners' representative and scheduled another telephone hearing.

During the hearing, community property was discussed and a couple of court case citing's were exchanged. The Tax Commission stated it was not contesting the resident status of either [Redacted] or [Redacted]. The other minor issues were also not contested by Petitioners, i.e. investment tax credit on horses and bonus depreciation. The parties agreed the only remaining issue was the determination and allocation of the community property income.

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. Petitioners were domiciled in two separate community property states during the years in question; Idaho and [Redacted], and Idaho and [Redacted]. Petitioners derived their income primarily from [Redacted] employment. [Redacted] operated a [Redacted] and [Redacted], which was not profitable. Petitioners did not file income tax returns for taxable years 2000 through 2005. Petitioners filed part-year/non-resident returns for taxable years 2006 through 2010, reporting [Redacted] income/loss. [Redacted] claimed to be a resident of Idaho for all the years in question except 2002. She was a part-year resident in 2001 and 2003. [Redacted] was a resident of [Redacted], [Redacted], and [Redacted]. The Tax Commission is not contesting [Redacted] residency.

Idaho, [Redacted], and [Redacted] are community property states. All three consider wages as community property and therefore community income. See Idaho Code section 32-906, Revised Code of [Redacted] section 26.16.030, and [Redacted] Family Code section 3.001. 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, [Redacted] 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 [Redacted] 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 [Redacted] 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. [Redacted] law, on the other hand, is the same as Idaho law unless the spouses are permanently separated and a petition has been filed stating the facts that make it desirable for the petitioning spouse to have full control of the community property described or defined in the petition. See [Redacted] Family Code section 3.301. No such petition was presented by Petitioners. Therefore, [Redacted] earnings in [Redacted] and [Redacted] are community property.

The Bureau determined Petitioners' 2007, 2008, 2009, and 2010 Idaho individual income tax returns did not accurately report the community property split of community income. The Bureau's determination allocated half of [Redacted] [Redacted] and [Redacted] income and all of [Redacted] income/loss as Idaho taxable income.

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 non-resident spouse living in the other community property state. See Parker v. Idaho State Tax Com'n, 148 Idaho 842 (2010).

Since [Redacted] and [Redacted] are community property states, [Redacted] income is attributed equally to [Redacted] and [Redacted]. And, because [Redacted] was a resident of Idaho, her half of the community income from [Redacted] and [Redacted] is reportable to Idaho and becomes part of Petitioners' Idaho taxable income.

CONCLUSION

Other than taxable year 2002, Petitioners were domiciled at all times in community property states where their earnings were considered community income. As such, half of [Redacted] earnings are attributable to [Redacted] and half of [Redacted] earnings or losses are attributable to [Redacted]. All other community income (interest, dividends, capital gains and losses, etc.) is also divided equally between Petitioners. The Bureau's division of Petitioners' income is in accordance with the applicable laws governing community property. Therefore, the Tax Commission finds that the Bureau's inclusion of one-half of [Redacted] income and all of [Redacted] income is the correct determination of Petitioners' Idaho taxable income.

THEREFORE, the Notice of Deficiency Determination dated April 13, 2012, and directed to [Redacted] and [Redacted] is hereby AFFIRMED.

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

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2000	\$ 4,398	\$1,100	\$3,570	\$ 9,068
2001	190	48	139	377
2003	2,013	503	1,083	3,599
2004	6,720	1,680	3,213	11,613
2005	10,627	2,657	4,440	17,724
2007	12,548	1,882	3,588	18,018
2008	4,798	720	1,061	6,579
2009	10,807	1,621	1,848	14,276
2010	8,193	1,229	1,015	<u>10,437</u>
			TOTAL DUE	<u>\$91,691</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 _____ 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.