

from [Redacted] showing a loss for the year. [Redacted] owns some property that is leased to [Redacted], a [Redacted] in [Redacted].

LAW AND ANALYSIS

First issue: Whether the ITC from pass-through entities is allowable.

The ITC from pass-through entities was allowed. See the related Docket No. 26127 for the details.

Second issue: Whether the Petitioners' investment in [Redacted] which was reported as a non-passive activity was, in fact, a passive activity.

The loss reported from [Redacted] is categorized as a passive loss on the Petitioners' [Redacted] return. The loss is from renting real estate and is passive by law, IRC 469(C)(2). Passive losses are not allowed to offset non-passive income, but have to be carried over until there is enough passive income to utilize the losses. Audit disallowed the loss from [Redacted] saying that there was insufficient passive income to offset the losses. In the protest, the POA asserted that two of the other pass-through investments reported on their [Redacted] Schedule E were mislabeled as non-passive. The POA claims that the Petitioners' investments in [Redacted] should have been treated as passive income. The Petitioners are 85 percent owners in [Redacted]. The other 15 percent owner is the day to day manager, who fully bought out the Petitioners in 2012. The Petitioner has a full-time job with [Redacted] in [Redacted], Idaho. [Redacted] is in [Redacted] over 500 miles away.

The Petitioners claim that they did not materially participate in the [Redacted] activity and, therefore, the income from that activity should be treated as passive, thus allowing the [Redacted] loss to offset it. The Petitioners are the majority owners, but there is no evidence that they act in any capacity beyond that of an investor. It is well established in Idaho law that a

taxpayer claiming a deduction, exemption, or credit bears the burden of establishing his or its entitlement to the same, both as to law and fact. Further, statutes allowing deductions and exemptions are “construed strongly against the taxpayer.” Potlatch Corp. v. Idaho State Tax Com’n, 128 Idaho 387 (1996), *citing* Hecla Mining Co. v. Idaho Tax Com’n, 108 Idaho 147, 151, 697 P.2d 1161, 1165 (1985).

Part of the passive activity regulations deals with combining certain activities together if they are essentially part of the same activity. In the present case, [Redacted] owns and rents the property to [Redacted]. The Petitioners are the majority owners in [Redacted] and 50 percent owners in [Redacted].

1.469-4 (d) **Limitation on grouping certain activities.** The grouping of activities under this section is subject to the following limitations:

(1) Grouping rental activities with other trade or business activities—(i) Rule. A rental activity may not be grouped with a trade or business activity unless the activities being grouped together constitute an appropriate economic unit under paragraph (c) of this section and—

(A) The rental activity is insubstantial in relation to the trade or business activity;

(B) The trade or business activity is insubstantial in relation to the rental activity; or

(C) Each owner of the trade or business activity has the same proportionate ownership interest in the rental activity, in which case the portion of the rental activity that involves the rental of items of property for use in the trade or business activity may be grouped with the trade or business activity.

The election to treat the two investments as one activity has to be done in advance and once characterized, the Petitioners cannot change the status after the fact in order to get a better answer.

“To make an election, a taxpayer must clearly notify the Commissioner of the taxpayer’s intent to do so.” See *Kosonen v. Commissioner*, T.C. Memo 2000-107 [TC Memo 2000- 107] (2000). Because the Krukowskis did not elect to treat the rental activities as a single activity on their 1994 Income Tax Return, they cannot now claim that the activities should be grouped as a single activity for purposes of this dispute.

Third issue: Whether the statute of limitations would restrict the audit from addressing the passive/non-passive issue.

Idaho Code section 63-3068(j) Statute of Limitations: Notwithstanding any other provisions of this section, a notice of deficiency, related to items on the return of any pass-through entity, as defined in this section, which other taxpayers are required by law to report, shall be issued to such other taxpayers within the later of three (3) years from the due date of the other taxpayers' return, without regard to extensions, three (3) years from the date the other taxpayers' returns were filed, or three (3) years from the date of filing of the pass-through entity's return. If the pass-through entity files an amended return, notices of deficiency may be issued to the other taxpayers within three (3) years from the date the amended return for the pass-through entity was filed with the state tax commission.

CONCLUSION

1. Whether the ITC from pass-through entities is allowable. Docket No. 26127 found that \$8,958 of the pass-through ITC was allowable. Combined with the \$1,277 of carryover credit reported, the total allowed is \$10,235. This reduces the NODD ITC adjustment from \$11,781 to \$1,546.

2. Whether the Petitioners' investment in [Redacted] which was reported as a non-passive activity, was, in fact, a passive activity.

Based on the Petitioners' original claim that the investment activity in [Redacted] was non-passive and the prohibition on characterizing passive and non-passive income, the Commission upholds the audit on this issue.

3. Whether the statute of limitations would restrict the audit from addressing the passive/non-passive issue.

Idaho Code section 63-3068(j) keeps the statute of limitations open for any effected K-1 recipient when a pass-through entity files an amended return. The filing of the amended return by [Redacted] extended the statute of limitations for the issue of the passive loss reported on the

Petitioners' Idaho income tax return. The Commission finds that the NODD adjustment to the Petitioners' passive loss claim was correct.

The tax effect of the passive loss adjustment is \$4,212 and the ITC adjustment is \$1,546. The refund request is reduced from \$26,390 to \$20,632.

THEREFORE, the NODD dated September 25, 2013, and directed to [Redacted] and [Redacted] is hereby AFFIRMED as MODIFIED.

| <u>YEAR</u> | <u>REFUND CLAIMED</u> | <u>REFUND ALLOWED</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|-----------------------|-----------------------|-----------------|--------------|
| 12/31/09 | (\$26,390) | (\$20,632) | (\$4,312) | (\$24,944) |

Interest is calculated through July 31, 2015, and will continue to accrue at the rate set forth in Idaho Code section 63-3045.

An explanation of the Petitioners' right to appeal this decision is enclosed.

DATED this _____ day of _____ 2015.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2015, 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.
