

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 39078
[Redacted],	)	
	)	
Petitioners.	)	DECISION
_____	)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated July 29, 2014, asserting additional liability for Idaho income tax and interest in the total amounts of \$1,665, \$3,588, and \$3,492 for taxable years 2011, 2012, and 2013 respectively.

**ISSUE**

The issue is whether Idaho can impose its income tax on the wages earned by a resident of another state, and if so, how is that tax liability computed?

[Redacted] were married at all times relevant to this decision. Also during all such times, [Redacted] was domiciled in Idaho and [Redacted] was domiciled in [Redacted]. Petitioners filed joint tax returns for all years, both with the [Redacted] and the Commission.

The Married, filing joint tax returns submitted by the petitioners for taxable years 2011 through 2013 reported only the income earned by [Redacted]. Subsequent to being contacted by the auditor concerning community property and the potential adjustments to their returns, the petitioners submitted amended returns, changing from a Married, filing joint filing status to Married, filing separate. The reason for the change was that, “to obtain relief from community property income one cannot file a joint return.” Because taxpayers are not permitted to change from a filing status of Married, filing joint, to Married, filing separate after the due date of the return, the auditor adjusted the returns for each taxable year to include the community

property portion of the petitioners' income that was deemed to be includable in Idaho taxable income, and adjusted the petitioners' liability accordingly.

The petitioners appealed the determination, contending that the adjustments made by the auditor to include half of [Redacted] income in the calculation of the petitioners' Idaho taxable income, are completely unfair. The petitioners' appeal letter also acknowledges that they cannot file amended returns after the due date to change their filing status to Married, filing separate, but if it were allowed, the petitioners would meet all of the requirements to have their state income taxes be separate under IRC section 66(a) or (b).

### **LAW & ANALYSIS**

Both the state of Idaho and the state of [Redacted] are community property states and both treat earnings as community property and, therefore, community income. Under Idaho law, earnings of a spouse are presumed to be community property. Idaho Code section 32-906(1); Martsch v. Martsch, 103 Idaho 142, 645 P.2d 882 (1982). This is true 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). Thus, under Idaho law, only death or a legal divorce will disband the community.

[Redacted] community property law also provides that income earned through the labor of a spouse is presumed to be community income. R.C.W. section 26.16.030; In re Marriage of Hurd, 848 P.2d 185 (Wa.Ct.App. 1993) ("Earnings arising from services performed during marriage are community property."). 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.

IRC section 66-Treatment of Community Income states in relevant part:

(a) Treatment of community income where spouses live apart:

If—

- (1) 2 individuals are married to each other at any time during a calendar year;
- (2) such individuals—
  - (A) live apart at all times during the calendar year, and
  - (B) do not file a joint return under section 6013 with each other for a taxable year beginning or ending in the calendar year;
- (3) one or both of such individuals have earned income for the calendar year which is community income; and
- (4) no portion of such earned income is transferred (directly or indirectly) between such individuals before the close of the calendar year, then, for purposes of this title, any community income of such individuals for the calendar year shall be treated in accordance with the rules provided by section 879 (a).

(b) Secretary may disregard community property laws where spouse not notified of community income

The Secretary may disallow the benefits of any community property law to any taxpayer with respect to any income if such taxpayer acted as if solely entitled to such income and failed to notify the taxpayer's spouse before the due date (including extensions) for filing the return for the taxable year in which the income was derived of the nature and amount of such income.

The petitioners may very well meet some of the criteria described in IRC Section 66. However, the code section is clear in regards to the filing status of taxpayers seeking to qualify for relief from community property. Such individuals must, "live apart at all times during the calendar year," and "not file a joint return under section 6013 with each other for a taxable year beginning or ending in the calendar year" ....

IRC section 6013-Joint return of income tax by husband and wife, states in relevant part:

(a) **Joint returns:** A husband and wife may make a single return jointly of income taxes....

In the present case, the petitioners made the election to file a joint return. The petitioners have, at no time, indicated that their living arrangement was because of marital discord. Therefore, based on the community property laws of their respective states of domicile, [Redacted] earnings and [Redacted] earnings would be considered community income.

Since the earnings of both petitioners are considered community property, the issue now becomes how to determine the petitioners' Idaho taxable income and Idaho income tax liability.

Idaho Code § 63-3002 states:

Declaration of intent. -- It is the intent of the legislature by the adoption of this act, insofar as possible to make the provisions of the Idaho act identical to the provisions of the Federal Internal Revenue Code relating to the measurement of taxable income, to the end that the taxable income reported each taxable year by a taxpayer to the internal revenue service shall be the identical sum reported to this state, subject only to modifications contained in the Idaho law; to achieve this result by the application of the various provisions of the Federal Internal Revenue Code relating to the definition of income, exceptions therefrom, deductions (personal and otherwise), accounting methods, taxation of trusts, estates, partnerships and corporations, basis and other pertinent provisions to gross income as defined therein, resulting in an amount called "taxable income" in the Internal Revenue Code, and then to impose the provisions of this act thereon to derive a sum called "Idaho taxable income"; to impose a tax on residents of this state measured by Idaho taxable income wherever derived and on the Idaho taxable income of nonresidents which is the result of activity within or derived from sources within this state. All of the foregoing is subject to modifications in Idaho law including, without limitation, modifications applicable to unitary groups of corporations, which include corporations incorporated outside the United States.

Idaho taxable income is defined in Idaho Code section 63-3011(C) as "taxable income as modified to the Idaho adjustments specifically provided in this chapter."

The petitioners and the Commission disagree whether the state of Idaho can impose tax on half of [Redacted] wages earned in the state of [Redacted], along with all of [Redacted] wages earned in the state of Idaho.

The petitioners' appeal letter states more than once, that the inclusion of [Redacted] income in Idaho taxable income is not fair. She does not live in Idaho, use Idaho resources, and the inclusion of her income unjustly increases the amount of income [Redacted] must pay Idaho taxes on. The question of whether the State may tax income earned outside of its borders was addressed by the Supreme Court in Herdon v. West, 87 Idaho 335, 393 P.2d 35 (1964). In that case, the taxpayer was a resident of Idaho and was also a general partner in an Oklahoma business from which she derived income. The taxpayer argued that the State's attempt to tax her Oklahoma income violated her rights under the Fourteenth Amendment to the United States Constitution. The Supreme Court stated that:

The Supreme Court of the United States has made it clear that a state has the power to tax in relation to a resident's income derived from sources outside the State and that there is nothing in the Federal Constitution to prevent the exercise of such power. The rationale for allowing a state to compute a tax on income earned elsewhere is based on the premise that inhabitants are supplied many services by their state of residence and should contribute toward the support of the state, no matter where their income is earned. (citations omitted)

As for the fairness of the law, the law is, perhaps not perfect. No tax law yet devised has been entirely fair and just to all in its practical workings. Chicago, M.,ST.P. & P.R.CO v. HEDGES et al., and four other cases. Nos. 511E-514E, 517E. (1933).

### **CONCLUSION**

The petitioners were both domiciled in community property states during taxable years 2011 through 2013, and filed their tax returns for all years with a filing status of Married, filing joint. There are certain exceptions within [Redacted] code and within the state of [Redacted] community property laws that may allow certain taxpayers to treat their earnings as separate income. However, those exceptions are not present in this case. Therefore, the Commission concludes that the community property laws should govern the ownership of the income in

question. Accordingly, the Commission finds that the auditor's inclusion of one-half of [Redacted] income and all of [Redacted] income is the proper determination of Idaho taxable income.

THEREFORE, the NODD dated July 29, 2014, and directed to [Redacted] is hereby AFFIRMED and MADE FINAL.

IT IS ORDERED that the petitioners pay the following amount of tax and interest:

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2011	\$1,528	\$204	\$1,732
2012	3,407	318	3,725
2013	3,423	213	<u>3,636</u>
		TOTAL DUE	<u>\$9,093</u>

Interest is calculated through October 26, 2015.

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 \_\_\_\_\_ 2015.

IDAHO STATE TAX COMMISSION

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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.

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