

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 1-567-215-616
[REDACTED],)	
)	
Petitioners.)	DECISION
_____)	

[Redacted] (Petitioners) protested the Notice of Deficiency Determination dated February 4, 2015, issued by the Income Tax Audit Bureau of the Idaho State Tax Commission asserting additional income taxes, penalties, and interest for taxable years 2011, 2012, and 2013, in the total amount of \$3,566. Petitioners disagreed with the determination that their Idaho taxable income includes a community property allocation of income from California, and with the amount of their allowed employee business expenses. The Tax Commission having reviewed the file hereby issues its decision.

BACKGROUND

Petitioners filed Idaho part-year/nonresident income tax returns for taxable years 2011, 2012, and 2103, reporting only [Redacted] wages as Idaho income. Petitioners’ only reference to [Redacted] California income for those years was in the proration of their itemized deductions and personal exemptions. The Income Tax Audit Bureau (Bureau) selected Petitioners’ 2011 through 2013 Idaho individual income tax returns for examination; looking specifically at the allocation of income pursuant to the community property statutes and the employee business expenses claimed on schedule A.

The Bureau requested information and documentation from Petitioners, which Petitioners provided. The Bureau reviewed the information and documentation provided and determined Petitioners did not properly report all the income taxable by Idaho. The Bureau adjusted Petitioners’ 2011, 2012, and 2013 Idaho income tax returns to properly allocate Petitioners’

community income to Idaho. In addition, the Bureau's review of Petitioners' employee business expenses found that Petitioners overstated their allowable employee business expenses. The Bureau corrected Petitioners' 2011 through 2013 Idaho income tax returns and sent them a Notice of Deficiency Determination.

Petitioners protested the Notice of Deficiency Determination. Petitioners disagreed that [Redacted] California income was community income because they have been separated since August 2006, and lived in two different states. Petitioners also disagreed with the Bureau's determination of [Redacted] employee business expenses. Petitioners stated [Redacted] employee business expenses were audited by the [Redacted] and the state of Idaho should accept the results of that audit. Petitioners felt like they were unfairly taken advantage of.

The Bureau reviewed Petitioners' arguments, acknowledged Petitioners' protest, and worked with Petitioners to try and resolve their differences. The Bureau and Petitioners did come to an agreement regarding Petitioners' employee business expenses, but were unable to resolve the community property issue. Because Petitioners and the Bureau were at an impasse, the Bureau 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 held on August 27, 2015. During the hearing Petitioners stated again that they disagreed with the community property allocation of income to Idaho, but they were now in agreement with the modified adjustment to their employee business expenses.

Petitioners stated [Redacted] moved to California in 2010 and has not been back to Idaho since [Redacted] move. Petitioners stated they used a well-known tax preparation software that

told them they needed to file as married filing joint. Petitioners stated they had separate bank accounts; although the account used by [Redacted] was their previous joint account. Petitioners stated that when they separated in 2006, [Redacted] continued to take care of the finances because [Redacted] was unfamiliar with them. Petitioners stated they shared some common bills and a credit card account. Petitioners stated they each paid their own share of the bills and there was no commingling of income. Petitioners stated [Redacted] money was [Redacted] and [Redacted] money was [Redacted]. Petitioners stated they divorced in October 2014 only after [Redacted] was convinced that it was best for both of them. Petitioners stated [Redacted] knew their marriage had ended well before he moved to California, and [Redacted] had no intention to continue the marriage. Petitioners stated that after their divorce they no longer shared or had common bills.

Since Petitioners came to an agreement with the Bureau regarding their employee business expenses, the Petitioners 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 California. [Redacted] income was sourced from California and [Redacted] income was sourced from Idaho. Petitioners filed part-year/non-resident Idaho individual income tax returns reporting only the Idaho source income as taxable by Idaho.

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. In the case of community property, 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).

Idaho and California are community property states. Both consider wages as community property and therefore community income. *See* Idaho Code section 32-906 and California Family Code section 760. 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 California; however, California does have an exception to this general principle where the husband and wife are living separate and apart even though they are not legally divorced. Specifically, California Family Code section 771 provides that “The earnings and accumulations of a spouse . . . while living separate and apart from the other spouse, are the separate property of the spouse.” Thus, under California 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.

California courts have consistently held that the term “living separate and apart” is determined by the facts and circumstances of each case, and that at least one of the parties has the subjective intent to end the marital relationship. *In re Marriage of Davis*, 61 Cal. 4th 846 (2015); *In re Marriage of Baragry*, 73 Cal. App. 3d 444 (1977). The fact that a couple is living apart is not, by itself, sufficient to give rise to separate property, there must be intent which is objectively evidenced by words or conduct reflecting that there is a complete and final break in the marriage relationship. *In re Marriage of Davis*, Id.

In the case at hand, Petitioners stated they lived separate and apart beginning in

August 2006. Even before [Redacted] moved to California in 2010, Petitioners stated [Redacted] knew their marriage was over and [Redacted] intended to end the marriage.

The presumption is that all property acquired during coverture is community property; however, when the source of property can be established as separate property, the effect of such presumption is overcome and the property retains its character as separate property. Stahl v. Stahl, 91 Idaho 794, 430 P.2d 685. Therefore, because [Redacted] was domiciled in California and California considers his income as separate property, [Redacted] income retains its character as separate property and is not subject to community property allocation.

CONCLUSION

Petitioners were domiciled at all times in community property states where their earnings are generally considered community income. As such, half of [Redacted] earnings are attributable to [Redacted] and half of [Redacted] earnings are attributable to [Redacted]. However, because California treats the accumulations and earnings of a spouse living separate and apart as separate property and Petitioners were separated at all times during the years in question, [Redacted] income was [Redacted] separate property and not subject to the community property allocation to [Redacted]. Therefore, the Tax Commission finds Petitioners' Idaho taxable income does not include [Redacted] income.

Aside from the community property issue, Petitioners and the Bureau agreed on the amount of allowable employee business expenses. The Tax Commission recognizes the efforts of the Petitioners and the Bureau, and hereby upholds the modified adjustment to Petitioners' employee business expenses.

THEREFORE, the Notice of Deficiency Determination dated February 4, 2015, and directed to [Redacted] is hereby AFFIRMED as modified by this decision.

IT IS ORDERED that Petitioners pay the following taxes, penalties, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2011	\$458	\$23	\$68	\$ 549
2012	394	20	44	458
2013	0	0	0	<u>0</u>
			TOTAL DUE	<u>\$1,007</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 _____ 2016.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2016, 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.
