

Financial Technician – Desk Audit Manual

6/2/2016

The purpose of the Financial Technician Desk Audit position is to review individual income tax returns for single item issues that are relatively straightforward (Examples: real property nonfilers, short filer, CP2000, Idaho health insurance premium (HIP) deduction, Idaho long-term care insurance premium deduction, Schedule A medical expenses, and Idaho itemized deductions – state tax addback). This position may also perform limited reviews of Idaho pass-through entity (PTE) returns (100% apportionment factor) to verify PTE withholding or composite filing for nonresident members. The Financial Technician is only responsible for the specific issues they are assigned to review; unlike a Tax Auditor who is responsible for all material issues on the Idaho and federal income tax returns. The review may entail sending a couple of letters and/or conducting phone conversations to obtain the needed information, and then issuing a Notice of Deficiency Determination (NODD) or No Change letter to conclude the review.

Scope of Work

The Financial Technician's work is limited to the single issue selected for review, and any sub-issue directly related to the item under review. Examples of related sub-issues include:

- Real property nonfiler – federal Schedule E rental income reported
- Short Filer – Idaho social security deduction, credit for taxes paid to other states, or Idaho itemized deduction & exemption amounts resulting from a change in residency status
- HIP & long-term care insurance premiums deduction – Schedule A medical expenses
- PTE composite filing – permanent building fund tax
- CP2000 – See CP2000 Procedures Manual for more information

The Financial Technician may discover other audit issues during the review that are not directly related to the assigned single issue. In these instances, the Financial Technician will refer the case to their manager for potential reassignment to a member of the audit staff. Examples of issues to be referred to the manager include:

- Short Filer – When a domicile audit is warranted.
- Retirement benefits deduction
- Schedule A unreimbursed employee expenses
- PTE returns with an apportionment factor less than 100% or where the apportionment factor or business income/deductions have potential audit issues.

- PTE withholding or composite filing – 10 or more nonresident members or it is not clear which ones are using composite filing or filing individual returns.
- PTE withholding or composite filing – Nonresident did not report all Idaho source income on their Idaho nonresident income tax return.
- PTE withholding or composite filing – Nonresident is a member in multiple PTEs operating in Idaho or has other non-PTE Idaho source income.
- Idaho Fiduciary Income Tax Returns (trusts and estates)

[Information redacted pursuant to Idaho Code § 74-109(4)]

When reviewing leads for potential cases, our goal is to identify taxpayers whose returns appear to be in error. In making this determination we need to review both the Idaho and federal returns, information in the GenTax Data Warehouse, and potentially returns of other related taxpayers.

For additional information see [Intrastate Income Tax Audit Manual Section 500](#), Audit Coverage Policy.

[Information redacted pursuant to Idaho Code §§ 74-109(4) and 74-107(15)]

The following are specific guidelines and examples of audit explanations for some of the issues worked by Financial Technicians.

Real Property Nonfiler

[Information redacted pursuant to Idaho Code §§ 74-109(4) and 74-107(15)]

When a real estate transaction takes place in Idaho, a Form 1099-S is generated by the title company for the year in which that piece of real property sold. Copies of these 1099s are then sent to the Tax Commission.

[Information redacted pursuant to Idaho Code § 74-107(15)]

Letters

Before sending the first letter, we always run an Accurint report (if we have not already done so) to get the most current address for the taxpayer. You must update the address in GenTax so our first and second letters use this new address.

A 'First Letter' is generated informing the recipient that there is no tax return filed for the year the real property transaction transpired and that the state of Idaho is requesting that an explanation be sent or a return filed for that particular year. The taxpayer is given **20 days** to respond to the First Letter. Most initial responses to this First Letter range from utter shock to efficient compliance.

The recipient of the letter may call in, write a letter, or send in his/her requested tax return. Any form of communication is acted upon. If no communication transpires within the date of the letter, a second letter is sent out giving **15 days** to respond. If no response is received, the Financial Technician needs to contact the county where the property was sold to see what information regarding a basis is available (A CRM note should be made indicating who we contacted and what information was obtained if any). Then a provisional NODD is processed by the Financial Technician and sent out.

The following steps are performed to create and print the first and second letters in GenTax.

[Information redacted pursuant to Idaho Code § 74-107(15)]

All other letters sent to the taxpayer are created outside of GenTax.

NODD Explanation Page Examples:

Individual

This office sent you a letter dated **DATE OF 1ST LTR**, requesting information about the sale of Idaho real property. Correspondence was again sent on **DATE OF 2ND LTR**, and **DATE OF 3RD LTR(if applicable)**.

We have not received the requested information regarding the sale of Idaho real property. This refusal to comply constitutes conduct that defeats the Idaho State Tax Commission's tax enforcement duties. As a result, we are issuing this deficiency determination to protect the interests of the state of Idaho.

(Note : Use appropriate explanation for item 2a based on facts of case)

2a. Sales Proceeds

Idaho Code section 63-3026A and Income Tax Administrative Rule 264 state that gains from the ownership or disposition of real or tangible personal property located in Idaho is Idaho source income. Since you have not documented the net gain, we have based our determination on the information available to this office.

2a. Net Gain

Idaho Code section 63-3026A and Income Tax Administrative Rule 264 state that gains from the ownership or disposition of real or tangible personal property located in Idaho is Idaho source income. Since you have not documented the net gain, we have based our determination on the information available to this office. We used **(NAME OF COUNTY)** county's assessed value at the time of purchase in determining your gain.

| | |
|----------------------------|------------------|
| Gross Proceeds | \$XXX,XXX |
| Assessed Value at purchase | \$XXX,XXX |
| Gain | \$XXX,XXX |

3. Personal Exemptions

Idaho Code section 63-3026A allows for a proration of the personal exemptions allowed on your federal return.

4. Standard/Itemized Deductions

Idaho Code section 63-3026A allows for a proration of the **standard deduction or itemized deductions** as reported on your federal return. **(Note: Indicate if we used standard or itemized above)**

10. Permanent Building Fund Tax

Idaho Code section 63-3082 states that every person required to file an income tax return shall pay a tax of ten dollars (\$10).

17. Penalties

Idaho Code section 63-3046(c) states that in the event the return required by this chapter is not filed, or the return is filed but the tax thereon is not paid, there may be collected a penalty of five percent (5%) of the tax due on such returns for each month elapsing after the due date of such returns until such penalty amounts to twenty-five percent (25%) of the tax due.

Business

This office sent you a letter dated **DATE OF 1ST LTR**, requesting information about the sale of Idaho real property. Correspondence was again sent on **DATE OF 2ND LTR**, and **DATE OF 3RD LTR(if applicable)**.

We have not received the requested information regarding the sale of Idaho real property. This refusal to comply constitutes conduct that defeats the Idaho State Tax Commission's tax enforcement duties. As a result, we are issuing this deficiency determination to protect the interests of the state of Idaho.

(Note : Use appropriate explanation for item 2a based on facts of case)

2a. Sales Proceeds

Idaho Code section 63-3030, states in part that returns with respect to taxes measured by income shall be made by every partnership and S corporation which transacts business in this state. Section 63-3023, Idaho Code, states in part that the term "transacting business" shall include owning or leasing, whether as lessor or lessee, of any property, including real and personal property, located in this state, or engaging in or the transacting of any activity in this state, for the purpose of or resulting in economic or pecuniary gain or profit. Since you have not documented the net gain, we have based our determination on the information available to this office.

2a. Net Gain

Idaho Code section 63-3030, states in part that returns with respect to taxes measured by income shall be made by every partnership and S corporation which transacts business in this state. Section 63-3023, Idaho Code, states in part that the term "transacting business" shall include owning or leasing, whether as lessor or lessee, of any property, including real and personal property, located in this state, or engaging in or the transacting of any activity in this state, for the purpose of or resulting in economic or pecuniary gain or profit. Since you have not documented the net gain, we have based our determination on the information available to this office. We used (NAME OF COUNTY) county's assessed value at the time of purchase in determining your gain.

| | |
|----------------------------|------------------|
| Gross Proceeds | \$XXX,XXX |
| Assessed Value at purchase | <u>\$XXX,XXX</u> |
| Gain | \$XXX,XXX |

4. Apportionment Factor

Idaho Code section 63-3027 requires taxpayers having income from business activity both within and without Idaho to allocate and apportion such net income as provided in this section. Since the net apportionable income on line 3 is from the sale of Idaho property, an Idaho apportionment percentage of 100% has been used to calculate your Idaho tax liability.

8. Idaho Taxable Income

Idaho Code section 63-3022L(3) If no election is made and an officer, director, shareholder, partner, member, or beneficiary of a corporation, partnership, trust or estate transacting business in Idaho fails to file an income tax return reporting all or any part of the items described in subsection (2) of this section or fails to pay any tax due thereon, such corporation partnership, trust or estate shall be liable for tax on such items at the rate applicable to corporations.

10. Permanent Building Fund Tax

Idaho Income Tax Administrative Rule 855.02 Pass-Through Entities. The permanent building fund tax does not apply to partnerships, estates, trusts or S corporations if all the income of the entity is distributed to or otherwise reported on the income tax return of another taxpayer.

A pass-through entity reporting and paying the tax of a nonresident partner, shareholder, or beneficiary is subject to the permanent building fund tax for each nonresident who is required to file an Idaho income tax return.

18. Penalties

Idaho Code section 63-3046(c) states that in the event the return required by this chapter is not filed, or the return is filed but the tax thereon is not paid, there may be collected a penalty of five percent (5%) of the tax due on such returns for each month

elapsing after the due date of such returns until such penalty amounts to twenty-five percent (25%) of the tax due.

Trust

This office sent you a letter dated **DATE OF 1ST LTR**, requesting information about the sale of Idaho real property. Correspondence was again sent on **DATE OF 2ND LTR**, and **DATE OF 3RD LTR(if applicable)**.

We have not received the requested information regarding the sale of Idaho real property. This refusal to comply constitutes conduct that defeats the Idaho State Tax Commission's tax enforcement duties. As a result, we are issuing this deficiency determination to protect the interests of the state of Idaho.

(Note : Use appropriate explanation for item 2a based on facts of case)

2a. Sales Proceeds

Idaho Code section 63-3030, states in part that returns with respect to taxes measured by income shall be made by every resident trust required to file a federal return and having gross income of one hundred dollars (\$100) or more and every non-resident trust required to file a federal return having gross income from Idaho sources of one hundred dollars (\$100) or more. Since you have not documented the net gain, we have based our determination on the information available to this office.

2a. Net Gain

Idaho Code section 63-3030, states in part that returns with respect to taxes measured by income shall be made by every resident trust required to file a federal return and having gross income of one hundred dollars (\$100) or more and every non-resident trust required to file a federal return having gross income from Idaho sources of one hundred dollars (\$100) or more. Since you have not documented the net gain, we have based our determination on the information available to this office. We used **(NAME OF COUNTY)** county's assessed value at the time of purchase in determining your gain.

| | |
|----------------------------|-------------------------|
| Gross Proceeds | \$XXX,XXX |
| Assessed Value at purchase | <u>\$XXX,XXX</u> |
| Gain | \$XXX,XXX |

6. Tax on Undistributed Taxable Income

Idaho Code section 63-3024 states a tax is measured by Idaho taxable income as defined in this chapter is hereby imposed upon every trust.

15a. Permanent Building Fund Tax

Idaho Income Tax Administrative Rule 855.01 In General. The permanent building fund tax is an excise tax of ten dollars (\$10) reportable on each income tax return required to be filed unless specifically exempt.

20. Penalties

Idaho Code section 63-3046(c) states that in the event the return required by this chapter is not filed, or the return is filed but the tax thereon is not paid, there may be collected a penalty of five percent (5%) of the tax due on such returns for each month elapsing after the due date of such returns until such penalty amounts to twenty-five percent (25%) of the tax due.

Short Filer

See [Intrastate Income Tax Audit Manual Section 18300](#) for a discussion of the Short Filer Project.

NODD Explanation Page Examples:

Idaho Resident – Unreported Income

Adjustment to AGI Reported to Idaho

Idaho Code section 63-3002 provides that the taxable income reported each year to the Internal Revenue Service (IRS) must be the same amount reported to Idaho, subject only to the modifications contained in the Idaho law. As a result, an Idaho resident must report all income earned or received that is reported to the IRS, regardless of the source of the income.

Information received from the IRS indicates that the adjusted gross income (AGI) reported on your federal return filed with the IRS is not the same as the AGI reported on your Idaho Individual Income Tax Return. The difference, as shown below, has been added to compute your 20XX Idaho taxable income.

| | |
|--|---------------|
| Federal Form 1040 AGI reported to the IRS | \$ XX,XXX |
| AGI reported on the Idaho Form 40 | <u>XX,XXX</u> |
| Adjustment to AGI reported on the Idaho return | \$ XX,XXX |

Grocery Credit [delete if not needed]

Idaho Code section 63-3024A provides that any resident individual who is required to file and who has filed an Idaho income tax return is allowed a credit for each personal exemption. The amount of credit depends on the taxpayer's Idaho taxable income. The credit rate is reduced by \$20 when taxable income exceeds \$1,000.

Due to audit adjustments, your Idaho taxable income exceeds \$1,000. We have therefore reduced the grocery credit by \$20 for each exemption claimed.

Permanent Building Fund Tax [delete if not needed]

Idaho Code section 63-3082 provides that every person required to file an income tax return must pay a tax of ten dollars. This tax is in the nature of an excise tax upon the receipt of the income that requires the filing of such return.

Due to audit adjustments, you now meet the filing requirement. Therefore, we have assessed the permanent building fund tax.

Part-Year Resident or Non-Resident – Filed on Wrong Form, Idaho Adjusted Income is Correct.

2.a. Summary of Adjustments

The amount on line 2.a. of the 042 is the net adjustment as determined on the Summary of Adjustments schedule. The net adjustment is computed as a result of the following adjustments:

(Part-Year Resident or Non-Resident) Adjustment

You filed your Idaho return on Form 40, Idaho Individual Income Tax Return, as a full-year Idaho resident. (The documentation you provided or information available) shows that you were actually a (part-year resident or non-resident), and therefore, you should have filed on Idaho Form 43. An adjustment has been made to change your filing status from a resident to a (part-year resident or non-resident).

7 and 8. Idaho Percentage of Personal Deductions

Idaho Code section 63-3026A(4) allows a (part-year resident or non-resident) to deduct the Idaho percentage of either the standard deduction or itemized deductions (other than state and local income or sales taxes) and the exemptions allowable for federal income tax purposes. The Idaho percentage is the proportion that Idaho adjusted income bears to total adjusted income.

Grocery Credit Adjustment [delete if non-resident]

Idaho Code section 63-3024A allows a part-year resident a prorated grocery credit based on the number of months domiciled in Idaho during the taxable year. Idaho Income Tax Administrative Rule 771.02 provides that a fraction of a month exceeding 15 days is treated as a full month. If the credit exceeds a part-year resident's tax liability, the individual is not entitled to a refund.

As a part-year resident, your grocery credit is limited by the number of months you were domiciled in Idaho. As a result, your credit has been reduced as follows:

| | |
|-------------------------------------|--------------|
| XX Months Domiciled in Idaho | XX |
| Multiplied by Monthly Credit Amount | <u>\$XXX</u> |

| | |
|--|-------|
| Idaho Grocery Credit Allowed – Per Audit | \$XXX |
| Less: Idaho Grocery Credit Claimed | (XXX) |
| Idaho Grocery Credit Adjustment | \$XXX |

Part-Year Resident or Non-Resident – Filed on Wrong Form, Idaho Adjusted Income is Wrong.

2.a. Summary of Adjustments

The amount on line 2.a. of the 042 is the net adjustment as determined on the Summary of Adjustments schedule. The net adjustment is computed as a result of the following adjustments:

Idaho Source Income Adjustment [Delete if not needed]

Idaho Code section 63-3002 provides that the taxable income reported each year to the Internal Revenue Service (IRS) must be the same amount reported to Idaho, subject only to the modifications contained in the Idaho law. It further provides that an Idaho resident is required to report all income regardless of source while an Idaho nonresident is required to report all income from an Idaho source.

Idaho Income Tax Administrative Rule 250.01 states that all income earned or received from sources within Idaho is subject to Idaho income taxation. *[Cite any other necessary sections in 63-3026A or rules 260 – 275]*

Your return has been adjusted to include the XXXX income from Idaho sources.

Adjustments to Idaho Adjusted Gross Income [Delete if not needed]

Idaho Income Tax Administrative Rule 252.XX states [Cite necessary subsection]

As a result of changes to your Idaho source income, the deduction for XXXXXXXX has been adjusted as follows:

[Show computation according to the appropriate subsection in Rule 252]

(Part-Year Resident or Non-Resident) Adjustment

You filed your Idaho return on Form 40, Idaho Individual Income Tax Return, as a full-year Idaho resident. *(The documentation you provided or information available)* shows that you were actually a *(part-year resident or non-resident)*, and therefore, you should have filed on Idaho Form 43. An adjustment has been made to change your filing status from a resident to a *(part-year resident or non-resident)*.

7 and 8. Idaho Percentage of Personal Deductions

Idaho Code section 63-3026A(4) allows a (part-year resident or non-resident) to deduct the Idaho percentage of either the standard deduction or itemized deductions (other than state and local income or sales taxes) and the exemptions allowable for federal income tax purposes. The Idaho percentage is the proportion that Idaho adjusted income bears to total adjusted income.

Grocery Credit Adjustment [delete if non-resident]

Idaho Code section 63-3024A allows a part-year resident a prorated grocery credit based on the number of months domiciled in Idaho during the taxable year. Idaho Income Tax Administrative Rule 771.02 provides that a fraction of a month exceeding 15 days is treated as a full month. If the credit exceeds a part-year resident’s tax liability, the individual is not entitled to a refund.

As a part-year resident, your grocery credit is limited by the number of months you were domiciled in Idaho. As a result, your credit has been reduced as follows:

| | |
|--|-------|
| XX Months Domiciled in Idaho | XX |
| Multiplied by Monthly Credit Amount | \$XXX |
| Idaho Grocery Credit Allowed – Per Audit | \$XXX |
| Less: Idaho Grocery Credit Claimed | (XXX) |
| Idaho Grocery Credit Adjustment | \$XXX |

Health Insurance & Long-Term Care Insurance Premiums Deductions

[Information redacted pursuant to Idaho Code §§ 74-109(4)]

When requesting documentation from the taxpayer, we may need to also ask for documentation for items on the federal income tax return, such as all Schedule A medical expenses. These requests for documentation should only be for information that could impact the Idaho HIP & long-term care insurance premium deductions. If the Financial Technician has concerns about other items of income or deductions on the federal or Idaho returns, the case should be referred to their manager for reassignment to an Auditor.

See the Appendix for S corporation implications.

Workpapers

Upon receipt of the records from the taxpayer, it may be necessary to create audit workpapers to schedule the records. On ITA’s SharePoint site click on ‘Audit Letter and Templates’ then click on ‘Audit Templates – Intrastate.’ You will find Health Care Insurance Deduction workpapers. There are two different schedules:

1. Sch. A – For audits where Schedule A medical expenses are also being reviewed.
2. No Sch. A – For audits where only the subtractions on the Form 39R are being reviewed.

The Reason Codes for Adjustments on these schedules should apply in most situations. However, the Financial Technician may need to add items to this list depending on the issues found in the review. If an item is disallowed, we must clearly identify why, and if needed, provide additional explanation in either a footnote on the audit workpapers or on the Page 2 explanation.

There is a section on the Schedule A workpapers titled Federal Schedule A Adjustment Summary. This section should be **deleted and not used** unless one or more of the following are true:

1. There are changes to federal adjusted gross income in the audit,
2. Total itemized deductions are limited by an income phase-out,
3. There are changes to any other Schedule A items, or
4. The Idaho itemized deduction allowed is less than the Idaho standard deduction allowed after adjustments.

If any of items 1 – 4 above occur in the review, this section will need to be completed. The Financial Technician will need to use the Deduction and Exemptions worksheet ([On ITA's SharePoint site under Audit Letters and Templates](#)) to calculate itemized deductions if they are subject to a phase-out. Any nonapplicable calculations, such as the exemption calculation, should be deleted.

When scheduling the taxpayer's records, you may come across multiple examples of the same expense (Example: monthly statement, annual statement showing monthly charges, & check for payment). Each expense and the related information only need to be scheduled once.

Records Retention – After Audit is Closed

As part of the examination, the employee will have scheduled the receipts and documents provided by the taxpayer. Once the audit has been closed there is no need for the ISTC to retain these documents. If they are original records, they are returned to the taxpayer. If they are copies, the documents can be shredded. These source documents do not need to be scanned and attached in GenTax, as the audit work papers should already contain all the important information from these records.

NODD Explanation Page Examples:

Schedule A, Medical Expense Adjustment

Internal Revenue Code section 213(a) allows a deduction for the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent to the extent that such expenses exceed 7.5 percent of adjusted gross income. Subsection (d)(1)(D) defines the term “medical care” to mean amounts paid for insurance covering medical care or for any qualified long-term care insurance contract.

We have reviewed the medical expenses claimed on your federal Schedule A, and have disallowed those that are unsubstantiated or do not otherwise qualify for the deduction per Internal Revenue Code section 213. See the attached Schedule 100 for an explanation of the items disallowed and the calculation of the adjustment to Schedule A medical expenses.

Standard Deduction vs. Idaho Itemized Deductions and Health Insurance Premiums Deduction

We have reviewed your documentation for your medical expenses, including health insurance premiums (HIP) [and long-term care insurance premiums] claimed on your federal Schedule A and Idaho Form 39R for tax years 20XX, 20XX, and 20XX.

Idaho Code section 63-3022(j) allows an individual to deduct from gross income either the standard deduction or itemized deductions less state and local income or sales tax.

Internal Revenue Code section 213(a) allows a deduction for the expenses paid during the taxable year, not compensated for by insurance or otherwise, for medical care of the taxpayer, his spouse, or a dependent to the extent that such expenses exceed 7.5% of adjusted gross income.

Idaho Code section 63-3022P allows individual taxpayers to deduct the cost of their HIP if the cost has not been deducted elsewhere on the return or otherwise accounted for. When the HIP are included as a Schedule A medical expense, the Idaho HIP deduction is limited to the amount that the premium exceeds the itemized medical expense deduction. (Idaho Income Tax Administrative Rule 194.01).

[Idaho Code section 63-3022Q allows individual taxpayers to deduct the cost of long-term care insurance if the cost has not been deducted elsewhere on the return or otherwise accounted for. When the long-term care insurance premiums are included as a Schedule A medical expense, the Idaho long-term care insurance premium deduction is limited to the amount that the premium exceeds the itemized medical expenses deduction (reduced by the amount first allocated to HIP).

Based on our review of your documentation, we have disallowed the expenses that are unsubstantiated or do not otherwise qualify for the deductions. After these adjustments, we have determined that you will get a larger deduction for Idaho income tax purposes if we allow the standard deduction and the full Idaho HIP deduction [as claimed or as adjusted] rather than the adjusted Idaho itemized deductions and the limited Idaho HIP deduction for tax year[s] 20XX [and 20XX].

[In tax year 20XX, the adjusted Idaho itemized deduction and the limited Idaho HIP deduction provides the larger deduction for Idaho income tax purposes.]

See Schedule[s] 100 for the detail of the expenses allowed, comparison of the deduction amounts, and calculation of the net adjustment.

Idaho Itemized Deductions – State Tax Addback

Idaho Code section 63-3022(j) allows an individual to deduct from gross income either (1) or (2) at the option of the taxpayer:

- (1) The standard deduction as defined in Internal Revenue Code section 63.
- (2) Itemized deductions as defined in Internal Revenue Code section 63 except state or local taxes measured by net income and general sales taxes as either is defined in Internal Revenue Code section 164.

In calculating your Idaho itemized deductions, state or local taxes measured by net income and general sales taxes claimed as part of your federal itemized deductions were not added back. The required addback has reduced your Idaho itemized deductions by \$XXXX.

[Use the following explanation if not adjusting itemized deductions, but if after adjusting for the state tax addback, the standard deduction is greater.]

Idaho Itemized Deductions – State Tax Addback

As a result of the adjustment to subtract the state and local taxes from your total itemized deductions, the standard deduction[, which has been increased by \$X,XXX for xxxxxxxx*,] would give you a larger deduction on your Idaho return. Therefore, we have adjusted your return as follows:

| | |
|-----------------------------|--------------|
| Itemized deductions claimed | \$X,XXX |
| Standard deduction allowed | <u>X,XXX</u> |
| Adjustment | \$X,XXX |

[in tax years 2008, 2009, and 2010, the standard deduction may be increased. See federal Schedule L Remove brackets and text if not applicable, otherwise just remove brackets and *if applicable.]*

[If an adjustment is made for the addback of state and local income taxes, the auditor should check to see if the related state income tax refund subtraction should be allowed. If so, the following explanation should be used.]

State Income Tax Refund Subtraction

Idaho Code section 63-3022(a) allows an Idaho resident to subtract state income tax refunds included in taxable income.

In tax year 20XX, you reported your state income tax refund of \$X,XXX in federal taxable income. Therefore, we have allowed the state income tax refund subtraction.

Idaho Health Insurance Premiums Deduction

Idaho Code section 63-3022P allows individual taxpayers to deduct the amount paid by the taxpayer during the taxable year for insurance that constitutes medical care for the taxpayer, the spouse or dependents of the taxpayer. Deductions are not allowed for health insurance costs that are otherwise deducted or accounted for by the taxpayer for Idaho income tax purposes. They are also not allowed if the expense has been paid out of an Idaho medical savings account, a pre-tax wage or salary reduction plan, or for Social Security Medicare A.

We have reviewed your documentation for health insurance premiums claimed on your Idaho Form 39R, and have disallowed the amount that is unsubstantiated or otherwise doesn't qualify for the deduction per Idaho Code section 63-3022P and Idaho Income Tax Administrative Rules 193 and 194. See the attached Schedule [100 or 105] for an explanation of the items disallowed and the calculation of the adjustment to the Idaho health insurance premium deduction.

Idaho Long-Term Care Insurance Premiums Deduction

Idaho Code section 63-3022Q allows individual taxpayers to deduct the amount paid by the taxpayer during the taxable year for long-term care insurance as that term is defined in section 41-4603, Idaho Code. The long-term care insurance must be for the benefit of the taxpayer, a dependent of the taxpayer or an employee of the taxpayer. The deduction is not allowed for amounts paid that were otherwise deducted or accounted for by the taxpayer for Idaho income tax purposes. They are also not allowed if the expense has been paid out of an Idaho medical savings account, a pre-tax wage or salary reduction plan, or for Social Security Medicare A.

We have reviewed your documentation for long-term care insurance premiums claimed on your Idaho Form 39R, and have disallowed the amount that is unsubstantiated or otherwise doesn't qualify for the deduction per Idaho Code section 63-3022Q and Idaho Income Tax Administrative Rules 193 and 194. See the attached Schedule [100 or 105] for an explanation of the items disallowed and the calculation of the adjustment to the Idaho long-term care insurance premiums deduction.

Health Insurance Premiums Deducted on Schedule A

The Idaho deduction for health insurance premiums is allowable only when the premiums paid exceed the amount allowed as an itemized deduction. When total medical expenses exceed the amount allowed as an itemized deduction, the amount allowed is allocated first to insurance premiums, next to long-term care insurance, and then to other qualified medical expenses (Idaho Income Tax Administrative Rule 194.01). See the attached Schedule [100 or 105] for the calculation of the adjustment to the Idaho health insurance premiums deduction.

Idaho Long-Term Care Insurance Premiums Deducted on Schedule A

The Idaho deduction for long-term care insurance premiums is allowable only when the premiums paid exceed the amount allowed as an itemized deduction. When total medical expenses exceed the amount allowed as an itemized deduction, the amount allowed is allocated first to insurance premiums, next to long-term care insurance, and then to other qualified medical expenses (Idaho Income Tax Administrative Rule 194.01). See the attached Schedule [100 or 105] for the calculation of the adjustment to the Idaho long-term care insurance premiums deduction.

Provisional NODD – No Response to Requests for Documentation

We requested documentation to verify [Schedule A, medical expenses, Idaho health insurance premiums deduction, and Idaho long-term care insurance premiums deduction] by regular mail on XXXX, XXXX, and by certified mail on XXXX. As of the date of this notice, we have not received the requested documentation.

Idaho Code section 63-3042(a) authorizes the Idaho State Tax Commission to examine any books, papers, records, or other data that may be relevant or material for the purpose of determining the correctness of any return.

In addition to other enforcement provisions provided by statute, failure to produce records supporting amounts or information shown on a return may result in appropriate adjustments by the Tax Commission, including either or both of the following:

1. The disallowance of claimed deductions, credits, or exemptions to which the requested information relates;
2. The presumption that the information not provided is prejudicial to the taxpayer's position in regard to the issue or issues to which the requested information relates.
(Idaho Tax Commission Administration and Enforcement Rule 200.02)

This refusal to respond constitutes conduct that defeats the Idaho State Tax Commission's tax enforcement duties. Therefore, the [variable] claimed on your 20XX, 20XX and 20XX tax returns have been disallowed.

Schedule A, Medical Expenses & Idaho Itemized Deduction

The medical expenses claimed on your Schedule A have been disallowed as you have not provided the requested documentation. This adjustment reduces your Idaho itemized deduction by \$XXXXX.

[May need to also use Deduction & Exemption schedule and/or Standard Deduction vs. Idaho Itemized Deduction depending on impact of disallowing Schedule A, medical expense deduction.]

Idaho Health Insurance Premiums Deduction

The Idaho health insurance premiums deduction claimed on your Idaho Form 39R in the amount of \$XXXXX has been disallowed as you have not provided the requested documentation.

Idaho Long-Term Care Insurance Premiums Deduction

The Idaho long-term care insurance premiums deduction claimed on your Idaho Form 39R in the amount of \$XXXXX has been disallowed as you have not provided the requested documentation.

Other Adjustments Explanations:

Credit for Taxes Paid to Other States

Idaho Code section 63-3029 requires that the credit for income tax paid to other states be limited to the smaller amount of the tax actually paid to the other state, or the proportion of the Idaho tax that the adjusted gross income of the taxpayer derived from sources in the other state as modified by Idaho law, bears to total adjusted gross income for the taxpayer so modified. Because we have adjusted your Idaho tax, the credit for tax paid to another state has been recomputed.

Summary of Adjustments Schedule Changes

Due to audit adjustments to your Idaho source income, a larger percentage of your deductions and exemptions are allowable. Please see the attached Summary of Adjustments schedule for the calculation of your revised deductions and exemptions.

or

As a result of changing your filing status from an Idaho resident to a part-year resident, only a percentage of your deductions and exemptions are allowable. Please see the attached Summary of Adjustments schedule for the calculation of your revised deductions and exemptions.

Grocery Credit

Idaho Code section 63-3024A provides that any resident individual who is required to file and who has filed an Idaho income tax return is allowed a credit for each personal exemption. The amount of credit depends on the taxpayer's Idaho taxable income. The credit rate is reduced by \$20 when taxable income exceeds \$1,000.

Due to audit adjustments, your Idaho taxable income exceeds \$1,000. We have therefore reduced the grocery credit by \$20 for each exemption claimed.

PTE Withholding or Composite Filing

[Information redacted pursuant to Idaho Code §§ 74-109(4)]

Tax Year 2010 Returns

PTE withholding began on January 1, 2011. Prior to that date the Commission was allowed to tax PTE entities on the Idaho income of their nonresident members who failed to file the required Idaho nonresident income tax returns. The following are instructions for reviewing **tax year 2010** returns only.

[Information redacted pursuant to Idaho Code § 74-109(4)]

Idaho Code section 63-3030(a)(2) states that returns with respect to taxes measured by income in this chapter shall be made by any nonresident individual having for the current taxable year a **gross income** from Idaho sources in excess of two thousand five hundred dollars (\$2,500). [emphasis added]

A taxpayer's gross income from Idaho sources is not the amount reported on the federal Schedule K-1 and may not be properly reported on the Idaho K-1. Gross income consists of all income from all sources such as:

- Business income (net sales less cost of goods sold)
- Interest income
- Rents
- Dividend income
- Compensation for services

- Gain from the sale of property (not losses)

A PTE member's gross income from Idaho sources is calculated as follows:

Total of PTE federal gross income * Idaho apportionment factor * member's ownership percentage = gross income from Idaho sources.

After verifying that the nonresident individual has not filed and does meet the Idaho filing requirement, a billing letter or NODD will be sent to the PTE requiring it to pay the tax on the nonresident individual's Idaho income per Idaho Code section 63-3022L. The following is an example of an explanation page for a **Tax Year 2010** billing letter or NODD.

NON-FILING PARTNERS

Idaho Code section 63-3022L, effective in 2010, provides that individuals who are partners of a partnership transacting business in Idaho may elect to have the partnership report and pay Idaho tax on the individual's Idaho source income, including guaranteed payments, from the partnership. Income subject to the election is taxed at the rate applicable to corporations. If no election is made, and a partner of a partnership transacting business in Idaho fails to file an Idaho income tax return reporting all or any part of the items described in Idaho Code section 63-3022L(2) or fails to pay any tax due thereon, the partnership is liable for tax on such items at the rate applicable to corporations (7.6%).

Idaho Code section 63-3030 requires any nonresident individual having more than \$2,500 of gross income from Idaho sources during the current taxable year to file a return. Our records indicate that the partner listed below is required to file 2010 Idaho individual income tax returns as his share of Taxpayer Partnership's Idaho gross income exceeds \$2,500, but has not done so.

Gross income was determined as follows:

| | <u>2010</u> |
|------------------------------|--------------|
| Mister Partner | |
| Guaranteed payments | \$ x,xxx |
| Ordinary business income | xx,xxx |
| Interest income | <u>x,xxx</u> |
| Gross Income | \$xx,xxx |
| Idaho Apportionment Factor | <u>100%</u> |
| Gross Income – Idaho Sources | \$xx,xxx |

(Note: Items of gross income should be added or deleted as needed.)

The 2010 Idaho Partnership Return of Income has been adjusted to tax the Idaho income of the nonfiling partner at the corporate rate in accordance with Idaho Code section 63-3022L.

6. Income Reported on Partners' Returns

A subtraction has been allowed for: (1) the amount of income apportioned to Idaho that was reported by those individual partners who filed Idaho income tax returns for the tax year 2010; and (2) the distributive shares of income belonging to estates, trusts, corporations, partnerships, and other organizations who are partners.

8. Corrected Taxable Income

The amount on this line is income apportioned to Idaho attributed to the individual partner who is required to file Idaho returns, but has not done so.

| | <u>2010</u> |
|-------------------------------------|------------------|
| Mister Partner | |
| Ordinary business income | \$ x,xxx |
| Interest income | xx,xxx |
| Guaranteed payments | <u>x,xxx</u> |
| Section 179 deduction | (<u>x,xxx</u>) |
| Net Income subject to apportionment | \$ xx,xxx |
| Idaho Apportionment Factor | <u>100%</u> |
| Taxable Income | \$xx,xxx |

(Note: Items of income should be added or deleted as needed.)

9. Corrected Income Tax Liability

The unreported income for 2010 is taxed at the corporate rate (7.6%) in accordance with Idaho Code section 63-3022L in 2010.

14. Permanent Building Fund Tax

Idaho Code section 63-3082 provides that every person required to file an income tax return must pay a tax of ten dollars. This tax is in the nature of an excise tax upon the receipt of the income that requires the filing of such return. In accordance with Idaho Code section 63-3022L, if the income tax of an individual partner of a partnership is paid by the partnership, the partnership must also pay the permanent building fund tax for each individual.

The permanent building fund tax of \$10 has been assessed for 2010 for each partner whose Idaho income is taxed at the partnership level per Idaho Code section 63-3022L.

NON-FILING SHAREHOLDERS

Idaho Code section 63-3022L, effective in 2010, provides that individuals who are officers, directors, or shareholders of an S corporation transacting business in Idaho may elect to have the corporation report and pay Idaho tax on the individual's Idaho source compensation and other income from the corporation. Income subject to the election is taxed at the rate applicable to corporations. If no election is made, and a shareholder of an S corporation transacting business in Idaho fails to file an Idaho income tax return reporting all or any part of the items described in Idaho Code section 63-3022L(2) or fails to pay any tax due thereon, the corporation is liable for tax on such items at the rate applicable to corporations (7.6%).

Idaho Code section 63-3030 requires any nonresident individual having more than \$2,500 of gross income from Idaho sources during the current taxable year to file a return. Our records indicate that the shareholder listed below is required to file 2010 Idaho individual income tax returns as his share of Taxpayer Inc.'s Idaho gross income exceeds \$2,500, but has not done so.

Gross income was determined as follows:

| | <u>2010</u> |
|------------------------------|--------------|
| Mister Shareholder | |
| Ordinary business income | \$xx,xxx |
| Interest income | <u>x,xxx</u> |
| Gross Income | \$xx,xxx |
| Idaho Apportionment Factor | <u>100%</u> |
| Gross Income – Idaho Sources | \$xx,xxx |

(Note: Items of gross income should be added or deleted as needed.)

The 2010 Idaho S Corporation Income Tax Return has been adjusted to tax the Idaho income of the nonfiling shareholder at the corporate rate in accordance with Idaho Code section 63-3022L.

6. Income Reported on Shareholders' Returns

A subtraction has been allowed for: (1) the amount of income apportioned to Idaho that was reported by those individual shareholders who filed Idaho income tax returns for the tax year 2010; and (2) the pro rata shares of income belonging to estates, trusts, and other organizations who are shareholders.

8. Corrected Taxable Income

The amount on this line is income apportioned to Idaho attributed to the individual shareholder who is required to file Idaho returns, but has not done so.

| | <u>2010</u> |
|-------------------------------------|----------------|
| Mister Shareholder | |
| W-2 | \$ x,xxx |
| Ordinary business income | xx,xxx |
| Interest income | <u>x,xxx</u> |
| Section 179 deduction | (<u>xxx</u>) |
| Net Income subject to apportionment | \$xx,xxx |
| Idaho Apportionment Factor | <u>100%</u> |
| Idaho Taxable Income | \$xx,xxx |

(Note: Items of income should be added or deleted as needed.)

9. Corrected Income Tax Liability

The unreported income for 2010 is taxed at the corporate rate (7.6%) in accordance with Idaho Code section 63-3022L in 2010.

14. Permanent Building Fund Tax

Idaho Code section 63-3082 provides that every person required to file an income tax return must pay a tax of ten dollars. This tax is in the nature of an excise tax upon the receipt of the income that requires the filing of such return. In accordance with Idaho Code section 63-3022L, if the income tax of an individual shareholder of an S corporation is paid by the corporation, the corporation must also pay the permanent building fund tax for each individual.

The permanent building fund tax of \$10 has been assessed for 2010 for each shareholder whose Idaho income is taxed at the S corporation level per Idaho Code section 63-3022L.

Tax Year 2011 Returns

For tax year 2011 a PTE had two options for its nonresident members with Idaho income of at least \$1,000. They could either (1) pay the tax for the individual on their return (composite filing) as elected by the individual or (2) pay to the Commission back up withholding equal to 7.8% of the nonresident's Idaho distributable income. The withholding payment is credited to the individual's account in GenTax, and the entity is supposed to include the PTE-12 schedule with its return identifying the individuals they made withholding payments for.

In reviewing returns for 2011 we are trying to identify PTEs where:

1. The entity did not pay the tax for the nonresident individual (composite filing), and
2. The entity did not pay withholding for the nonresident individual, and
3. The nonresident individual has not filed their Idaho Nonresident Income Tax Return. (Technically, withholding would still be required, but we would likely have to refund any payments collected from the entity.)

Penalty: Since 2011 is the first year PTE withholding is required, the Commission has elected to not assess the negligence penalty in most cases. However, we may assess this penalty in later years if it is warranted.

The following is an example of an explanation page for a **Tax Year 2011** billing letter or NODD.

NON-FILING PARTNERS

Idaho Code section 63-3022L, effective in 2011, provides that nonresident individuals who are owners of an interest in a pass-through entity may have the entity report and pay Idaho tax on the individual's share of Idaho source income from the entity at the rate applicable to corporations. Idaho Code section 63-3036B generally requires the entity to withhold tax at the highest marginal rate applicable to individuals (7.8%) for the tax year on an owner's share of income from the entity that is required to be included in Idaho taxable income if the owner doesn't choose to have the entity pay the tax. A nonresident individual's share of income, guaranteed payments, and compensation of the pass-through entity from Idaho sources is exempt from the withholding requirement if it is less than one thousand dollars (\$1,000) for the taxable year in which the income is subject to tax per Idaho Income Tax Administrative Rule 877.

Idaho Code section 63-3030 requires any nonresident individual having more than \$2,500 of gross income from Idaho sources during the current taxable year to file a return. Our records indicate that the partner listed below is required to file 2011 Idaho individual income tax returns as his share of Taxpayer Partnership's Idaho gross income exceeds \$2,500, but has not done so.

Gross income was determined as follows:

| | <u>2011</u> |
|------------------------------|--------------|
| Mister Partner | |
| Guaranteed payments | \$ x,xxx |
| Ordinary business income | xx,xxx |
| Interest income | <u>x,xxx</u> |
| Gross Income | \$xx,xxx |
| Idaho Apportionment Factor | <u>100%</u> |
| Gross Income – Idaho Sources | \$xx,xxx |

(Note: Items of gross income should be added or deleted as needed.)

Since Taxpayer Partnership did not withhold and pay to the Idaho State Tax Commission the tax required by Idaho Code sections 63-3022L and 63-3036B, the 2011 Idaho Partnership Return of Income has been adjusted for the amount of tax that was required to be withheld that was not paid.

15. Change to Idaho Withholding

Line 15 is the amount that was required to be withheld and paid to the Idaho State Tax Commission for 2011 under Idaho Code section 63-3036B as back-up withholding. It is computed by multiplying the highest marginal tax rate applicable to individuals (7.8% for 2011) by the partner's taxable income from the partnership.

| | <u>2011</u> |
|----------------------------|----------------|
| Mister Partner | |
| Ordinary business income | \$ x,xxx |
| Interest income | xx,xxx |
| Guaranteed payments | x,xxx |
| Section 179 deduction | (<u>xxx</u>) |
| Net Distributable Income | \$xx,xxx |
| Idaho Apportionment Factor | <u>100%</u> |
| Idaho Taxable Income | \$xx,xxx |
| Tax Rate | <u>.078</u> |
| Back-up Withholding | \$ x,xxx |

NON-FILING SHAREHOLDERS

Idaho Code section 63-3022L, effective in 2011, provides that nonresident individuals who are owners of an interest in a pass-through entity may have the entity report and pay Idaho tax on the individual's share of Idaho source income from the entity at the rate applicable to corporations. Idaho Code section 63-3036B generally requires the entity to withhold tax at the highest marginal rate applicable to individuals (7.8%) for the tax year on an owner's share of income from the entity that is required to be included in Idaho taxable income if the owner doesn't choose to have the entity pay the tax. A nonresident individual's share of income and compensation of the pass-through entity from Idaho sources is exempt from the withholding requirement if it is less than one thousand dollars (\$1,000) for the taxable year in which the income is subject to tax per Idaho Income Tax Administrative Rule 877.

Idaho Code section 63-3030 requires any nonresident individual having more than \$2,500 of gross income from Idaho sources during the current taxable year to file a return. Our records indicate that the shareholder listed below is required to file 2011 Idaho individual income tax returns as his share of Taxpayer Inc.'s Idaho gross income exceeds \$2,500, but has not done so.

Gross income was determined as follows:

| | <u>2011</u> |
|------------------------------|--------------|
| Mister Shareholder | |
| Ordinary business income | \$xx,xxx |
| Interest income | <u>x,xxx</u> |
| Gross Income | \$xx,xxx |
| Idaho Apportionment Factor | <u>100%</u> |
| Gross Income – Idaho Sources | \$xx,xxx |

(Note: Items of gross income should be added or deleted as needed.)

Since Taxpayer Inc. did not withhold and pay to the Idaho State Tax Commission the tax required by Idaho Code sections 63-3022L and 63-3036B, the 2011 Idaho S Corporation Income Tax Return has been adjusted for the amount of tax that was required to be withheld that was not paid.

15. Change to Idaho Withholding

Line 15 is the amount that was required to be withheld and paid to the Idaho State Tax Commission for 2011 under Idaho Code section 63-3036B as back-up withholding. It is computed by multiplying the highest marginal tax rate applicable to individuals (7.8% for 2011) by the shareholder's taxable income from the S corporation.

| | <u>2011</u> |
|----------------------------|----------------|
| Mister Shareholder | |
| W-2 | \$ x,xxx |
| Ordinary business income | xx,xxx |
| Interest income | x,xxx |
| Section 179 deduction | (<u>xxx</u>) |
| Net Distributable Income | \$xx,xxx |
| Idaho Apportionment Factor | <u>100%</u> |
| Idaho Taxable Income | \$xx,xxx |
| Tax Rate | <u>.078</u> |
| Back-up Withholding | \$ x,xxx |

Tax Year 2012 Returns

For tax year 2012, a PTE had two options for its nonresident members with Idaho income of at least \$1,000. They could either (1) pay the tax for the individual on their return (composite filing) at the corporate rate or (2) pay to the Commission back up withholding computed at the highest individual tax rate (7.4%) of the nonresident's Idaho source income from the PTE. The withholding payment is credited to the individual's account in GenTax, and the entity is supposed to include the Form PTE-12 with its return identifying the individuals for whom they made withholding payments or paid tax and the amounts.

In reviewing returns for 2012 we are trying to identify PTEs where:

1. The entity did not pay the tax for the nonresident individual (composite filing), and
2. The entity did not pay withholding for the nonresident individual, and
3. The nonresident individual has not filed their Idaho nonresident income tax return.

Guaranteed Payments: The law was changed effective for tax years beginning on or after 1-1-13 to provide that guaranteed payments will be treated as Idaho source income as follows:

- Guaranteed payments to a retired partner per 4 U.S.C. section 114(b)(1)(I) are sourced to the recipient's state of domicile
- Guaranteed payments up to \$250,000 in a calendar year are sourced to the state where the personal services are performed - Idaho sourced amount is determined according to Income Tax Administrative Rule 270
- Guaranteed payments in excess of \$250,000 are sourced to Idaho using the Idaho apportionment factor.

The \$250,000 threshold is indexed to the CPI.

The following is an example of an explanation page for a **Tax Year 2012** billing letter or NODD.

NON-FILING PARTNERS

Idaho Code section 63-3022L, effective in 2012, provides that nonresident individuals who are partners of a partnership transacting business in Idaho may have the partnership report and pay Idaho tax on the individual's Idaho source income, including guaranteed payments, from the partnership on a composite return. Income reported on the composite return is taxed at the rate applicable to corporations (7.4%). Reporting the income on a composite return and paying the tax on this income is done in lieu of the partnership paying backup withholding for the nonresident partner. If the partnership does not pay the backup withholding and does not pay tax on the partner's Idaho income, and the partner fails to file an Idaho income tax return reporting all or any part of the Idaho source income, or fails to pay any tax due thereon, the partnership is liable for tax on the Idaho source income at the corporate rate.

Idaho Code section 63-3030 requires any nonresident individual having more than \$2,500 of gross income from Idaho sources during the current taxable year to file a return. Our records indicate that the partner listed below is required to file 2012 Idaho individual income tax returns as his share of Taxpayer Partnership's Idaho gross income exceeds \$2,500, but has not done so.

Gross income was determined as follows:

| | <u>2012</u> |
|--|-----------------|
| Mister Partner | |
| Guaranteed payments in excess of threshold | \$ x,xxx |
| Ordinary business income | xx,xxx |
| Interest income | <u>x,xxx</u> |
| Gross Income | <u>\$xx,xxx</u> |
| Idaho Apportionment Factor | <u>100%</u> |
| Gross Income – Idaho Sources from Apportioned Income | \$xx,xxx |
| Gross Income – Idaho Source Compensation | <u>xx,xxx</u> |
| Total Gross Income- Idaho Sources | \$xx,xxx |

(Note: Items of gross income should be added or deleted as needed.)

The 2012 Idaho Partnership Return of Income has been adjusted to tax the Idaho income of the nonfiling partner at the corporate rate in accordance with Idaho Code section 63-3022L.

6. Income Reported on Partners' Returns

A subtraction has been allowed for: (1) the amount of income apportioned to Idaho that was reported by those individual partners who filed Idaho income tax returns for the tax year 2012; (2) the amount of income apportioned to Idaho for individual partners for whom the corporation paid withholding, and (3) the distributive shares of income belonging to estates, trusts, corporations, partnerships, and other organizations who are partners.

8. Corrected Taxable Income

The amount on this line is income apportioned to Idaho attributed to the individual partner who is required to file Idaho returns, but has not done so.

| | | |
|--|-----------------|--------------|
| | <u>2012</u> | |
| Mister Partner | | |
| Ordinary business income | \$ x,xxx | |
| Interest income | xx,xxx | |
| Guaranteed payments in excess of threshold | | <u>x,xxx</u> |
| Section 179 deduction | <u>(x,xxx)</u> | |
| Net Income subject to apportionment | \$xx,xxx | |
| Idaho Apportionment Factor | <u>100%</u> | |
| Taxable Income - Apportioned Income | \$xx,xxx | |
| Taxable income – Idaho compensation | | <u>x,xxx</u> |
| Total Taxable income | \$xx,xxx | |

(Note: Items of income should be added or deleted as needed.)

9. Corrected Income Tax Liability

The unreported income for 2012 is taxed at the corporate rate (7.4%) in accordance with Idaho Code section 63-3022L in 2012.

14. Permanent Building Fund Tax

Idaho Code section 63-3082 provides that every person required to file an income tax return must pay a tax of ten dollars. This tax is in the nature of an excise tax upon the receipt of the income that requires the filing of such return. In accordance with Idaho Code section 63-3022L, if the income tax of an individual partner of a partnership is paid

by the partnership, the partnership must also pay the permanent building fund tax for each individual.

The permanent building fund tax of \$10 has been assessed for 2012 for each partner whose Idaho income is taxed at the partnership level per Idaho Code section 63-3022L.

NON-FILING SHAREHOLDERS

Idaho Code section 63-3022L, effective in 2012, provides that nonresident individuals who are shareholders of an S corporation transacting business in Idaho may have the corporation report and pay Idaho tax on the individual's Idaho source compensation and other income from the corporation on a composite return. Income reported on the composite return is taxed at the rate applicable to corporations (7.4%). Reporting the income on a composite return and paying the tax on this income is done in lieu of the corporation paying backup withholding for the nonresident shareholder. If the S corporation does not pay the backup withholding and does not pay tax on the shareholder's Idaho income, and the shareholder fails to file an Idaho income tax return reporting all or any part of the Idaho source income, or fails to pay any tax due thereon, the corporation is liable for tax on the Idaho source income at the corporate rate.

Idaho Code section 63-3030 requires any nonresident individual having more than \$2,500 of gross income from Idaho sources during the current taxable year to file a return. Our records indicate that the shareholder listed below is required to file 2012 Idaho individual income tax returns as his share of Taxpayer Inc.'s Idaho gross income exceeds \$2,500, but has not done so.

Gross income was determined as follows:

| | <u>2012</u> |
|------------------------------|--------------|
| Mister Shareholder | |
| Ordinary business income | \$xx,xxx |
| Interest income | <u>x,xxx</u> |
| Gross Income | \$xx,xxx |
| Idaho Apportionment Factor | <u>100%</u> |
| Gross Income – Idaho Sources | \$xx,xxx |

(Note: Items of gross income should be added or deleted as needed.)

The 2012 Idaho S Corporation Income Tax Return has been adjusted to tax the Idaho income of the nonfiling shareholder at the corporate rate in accordance with Idaho Code section 63-3022L.

6. Income Reported by Shareholders' to Idaho

A subtraction has been allowed for: (1) the amount of income apportioned to Idaho that was reported by those individual shareholders who filed Idaho income tax returns for tax year 2012; (2) the amount of income apportioned to Idaho for individual shareholders for

whom the corporation paid withholding for, and (3) the pro rata shares of income belonging to estates, trusts, and other organizations who are shareholders.

8. Corrected Taxable Income

The amount on this line is income apportioned to Idaho attributed to the individual shareholder who is required to file Idaho returns, but has not done so.

| | <u>2012</u> |
|-------------------------------------|----------------|
| Mister Shareholder | |
| W-2 | \$ x,xxx |
| Ordinary business income | xx,xxx |
| Interest income | <u>x,xxx</u> |
| Section 179 deduction | (<u>xxx</u>) |
| Net Income subject to apportionment | \$xx,xxx |
| Idaho Apportionment Factor | <u>100%</u> |
| Idaho Taxable Income | \$xx,xxx |

(Note: Items of income should be added or deleted as needed.)

9. Corrected Income Tax Liability

The unreported income for 2012 is taxed at the corporate rate (7.4%) in accordance with Idaho Code section 63-3022L in 2012.

14. Permanent Building Fund Tax

Idaho Code section 63-3082 provides that every person required to file an income tax return must pay a tax of ten dollars. This tax is in the nature of an excise tax upon the receipt of the income that requires the filing of such return. In accordance with Idaho Code section 63-3022L, if the income tax of an individual shareholder of an S corporation is paid by the corporation, the corporation must also pay the permanent building fund tax for each individual.

The permanent building fund tax of \$10 has been assessed for 2012 for each shareholder whose Idaho income is taxed at the S corporation level per Idaho Code section 63-3022L.

Other Issues – PTE or Individual Returns

In reviewing returns the scope of the Financial Technicians work is limited to those items specifically discussed in this manual. Any other potential audit issues or adjustments must be referred to your manager for review and reassignment to a Tax Auditor.

Note: Once the audit of the pass-through entity has been completed, you will need to close all associated Tax Cases set up for the individual partners.

Individual Returns Filed – NODD/Billing Letter Assessment Not Yet Posted in GenTax

If an individual files their missing return prior to the audit assessment being posted to GenTax, we will modify or cancel the NODD/Billing Letter to remove the income and associated tax for that individual. If a withholding payment has been made for the individual, Brenda can reallocate it to the individual's account as a PTE payment.

Individual Returns Filed – NODD/Billing Letter Assessment Posted in GenTax

Tax Year 2010 – Composite Filing: If the PTE's assessment has been posted to GenTax, we will have to open a new audit and post a second audit work paper that removes the income and tax associated with the individual who has now filed a return. Any refunds resulting from this change would go back to the entity that made the original payment.

Tax Year 2011 – Backup Withholding: If the PTE's assessment has been posted to GenTax, we will have to open a new audit and post a second audit work paper that removes the withholding associated with the individual who has now filed a return. The portion of the PTE's audit payment that corresponds with the taxpayer's withholding will be reallocated to the individual's account as a PTE Payment.

Tax Year 2012 and Forward – Backup Withholding: Starting in 2012, the Form 43 has a line for taxes paid by the PTE. The auditor needs to add a CRM note for the individual stating how much backup withholding was paid for them by the entity, so it can be claimed on this line on the Form 43.

Appendix

S Corporation Implications

When the taxpayer is claiming a deduction for health insurance premiums paid by an S corporation:

- If the taxpayer is a 2% shareholder, the S corporation should be treating the health insurance as compensation and including it in the taxpayer's Form W-2 in box 1 taxable income in order for the S corporation to deduct the amount. If included under a plan or system to benefit all or part of a class of employees and dependents, this will not be considered wages for social security or Medicare tax and won't be included in box 3 or box 5 of the W-2.
- If the health insurance is treated as discussed above, the taxpayer is entitled to an above-the-line deduction on his federal return for self-employment health insurance as if the premiums were paid by a self-employed person. This should be noted in box 14 of the Form W-2. If this is the case, the taxpayer will have already deducted the health insurance premium amount and would not be entitled to the Idaho deduction.

- This federal deduction is limited to the shareholder's earned income from the S corporation, which shouldn't be a problem if properly included in the W-2. However, for 2009 only, the taxpayer was also required to have earned income in addition to the insurance premium amount (must have Medicare wages in box 5 of the W-2).
- Some taxpayers don't report this as provided above. Instead they treat the health insurance premiums paid as a distribution. In these cases the corporation is not entitled to a deduction and the taxpayer is not allowed the above-the-line-self-employment health insurance deduction. The S corporation should also be reducing the shareholder's basis for the distribution. In this scenario, the taxpayer would qualify for the Idaho deduction if they didn't claim it as an itemized deduction.

[Information redacted pursuant to Idaho Code § 74-107(1)]

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