

# IDAHO STATE TAX COMMISSION

## INTRASTATE INCOME TAX AUDIT MANUAL

6-2018

ALTERNATIVE ENERGY DEVICE

SEC 0100

### 0110 LIMITATION

Idaho Code section 63-3022C allows a deduction from taxable income for the amount paid or accrued by an individual taxpayer (TP) during a tax year for the cost of constructing, reconstructing, remodeling, installing, or acquiring an alternative energy device (AED) to serve an Idaho residence. Forty percent of the cost is allowed as a deduction in the tax year in which the device is placed in service. Twenty percent of the cost is allowed as a deduction in each of the following three tax years. The maximum deduction in any tax year is \$5,000.

### 0120 POTENTIAL AUDIT ISSUES

1. The device installed doesn't qualify as an AED.

An AED is a system that uses solar radiation, wind, or geothermal resource to provide heating, cooling, or electrical power.

A wood burning stove, pellet stove, natural gas heating unit, or propane heating unit can also be considered an AED as long as all of the following criteria are met:

- a. The device installed meets the most current industry standards or has environmental protection agency certification.
- b. During the same tax year, the device replaces a wood burning stove designed for residential heating that doesn't meet the most current industry standards.
- c. The wood burning stove that was replaced must be surrendered to the Idaho Department of Environmental Quality (DEQ) for destruction no later than 30 days from the date of purchase of the qualifying AED.

Non-qualifying devices include, but aren't limited to:

1. Hydroelectric systems
2. Air-to-air heat pumps
3. Electric air conditioners.
4. Roofing
5. Doors and windows
6. Electric furnaces
7. Electric heaters
8. Washers and dryers
9. Siding

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2. The residence doesn't qualify.

Only an individual TP's Idaho residence qualifies for the deduction. The residence doesn't have to be the TP's principal residence. Rental housing doesn't qualify unless the device is installed or paid for by the renter.

3. The deduction is taken in the wrong year.

The first year a TP is eligible to take the AED deduction is the tax year when the construction, reconstruction, remodeling, installation or acquisition of the AED is completed and is placed in service by the taxpayer.

4. The deduction is taken for non-qualifying expenses.

Only the costs attributable to the construction, reconstruction, remodeling, installation, or acquisition of the AED are deductible. Expenses that don't fall under this classification aren't allowed. Examples of such nondeductible expenses include:

1. Purchase of reusable tools
2. Purchase of an extended warranty
3. Unrelated remodeling expenses
4. Mileage of the individual TP
5. Time of the individual TP
6. Cost of servicing and maintaining the AED

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

### **0140 APPLICABLE AUTHORITIES**

1. Idaho Code section 42-4002: Geothermal definition
2. Idaho Code section 63-3022C: Deduction for alternative energy device at residence
3. Income Tax Administrative Rules 121,150, 254: Rules on deduction for alternative energy device

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AMENDED RETURNS

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The procedures for processing an amended return depend on the circumstances. Because of variations in return processing, timing issues, and acceptability of amended returns, it is not always clear what actions need to be taken. Auditors need to select the procedure(s) that best fits the situation.

*[Information redacted pursuant to Idaho Code §§ 74-107(1), (15), and 74-109(4)]*

**0310 PROTECTIVE CLAIMS**

A protective claim requested on an amended return should be clearly marked as a protective claim. The purpose is to hold open the statute of limitations for a refund request pending judicial or legislative resolution of the issue.

When this type of amended return is received in income tax audit, the auditor should disallow the amended return and issue an audit report denying the refund request due to an insufficient claim for the deduction. If the taxpayer protests the NODD, the case will be sent to Tax Appeals for resolution of the protective claim.

**0315 AMENDED RETURN RECEIVED PRIOR TO AN NODD BEING ISSUED**

If an amended return is received in response to a Desk Audit Initial Letter, the following procedures apply:

1. If the amended return is acceptable:
  - a. Accept the return for processing. Next to the Idaho form number, put ITA and your initials.

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

- b.
- c.
- d.
- e. Create a work item and send to your manager for review. Create an electronic file with the audit narrative and a copy of the close letter that will be sent to the taxpayer letting them know the amended return has been accepted. Submit folder for manager review.
- f. Upon manager approval, send the taxpayer the letter acknowledging the amended return has been accepted. Make a CRM note stating

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that the amended return (with tax year and date received) is acceptable as filed, and the audit has been closed.

2. If the amended return is not acceptable:
  - a. Disallow the amended return. Make a CRM note stating the amended return has been denied.
  - b. Issue an NODD.
  - c. Include a statement that the amended return was received but not accepted because not all audit issues were addressed.

**0320 AMENDED RETURN RECEIVED AFTER AN NODD HAS BEEN ISSUED**

If an amended return is received in response to an NODD, the following procedures apply:

1. If the amended return is acceptable:
  - a. Accept the amended return for processing.
  - b. Close the audit.

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

- c.
  - d.
  - e. Create a work item and send to your manager for review. Submit an electronic folder in your manager's review file with the audit narrative and a copy of the close letter that will be sent to the taxpayer letting them know the amended return has been accepted.
  - f. Upon manager approval, send the taxpayer the letter acknowledging the amended return has been accepted, and that the NODD has been cancelled. Make a CRM note stating that the amended return (with tax year and date received) is acceptable as filed, and the NODD has been cancelled.
2. If the amended return is not acceptable:
  - a. Call the taxpayer to determine the purpose of the amended return. If the amended return is intended to be a protest of the NODD, send a 28-day Unperfected Protest Letter to the taxpayer.

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- b. If you are unable to reach the taxpayer, treat the amended return as an unperfected protest and send a 28-day Unperfected Protest Letter to the taxpayer.

**0325 CLOSED ISSUES**

Idaho Code section 63-3045B(1) states:

If a taxpayer does not file a protest within the sixty-three (63) day period allowed, the notice of deficiency of the tax commission becomes final on the day following the end of the protest period.

Income Tax Administrative Rule 880.05 states:

05. Closed Issues. The Tax Commission shall deny a credit or refund claim for a taxable year for which the Tax Commission has issued an NODD, unless the taxpayer shows that the changes on the amended return are unrelated to the adjustments in the NODD or that the changes result from a final federal determination.

However, Idaho Code section 63-3047 provides that the Tax Commission or its delegate may compromise any income taxes, penalties, or interest.

Therefore, if a taxpayer clearly substantiates a previously disallowed deduction or credit, the Tax Commission may accept the amended item even though the issue is closed.

Auditors have discretion to decide whether to accept or deny a closed issue with manager approval. Typical reasons for denying a closed issue included: (1) taxpayer has failed to provide any new information supporting their deduction or credit; (2) the taxpayer is taking an unsupported tax position; (3) the taxpayer was uncooperative during the audit; (4) the taxpayer has a history being unresponsive to Tax Commission request.

**AMENDED RETURN RECEIVED AFTER AN NODD HAS HARDENED**

The Tax Commission may receive an amended return after an NODD has hardened, and the taxpayer's protest time has expired.

After reviewing the changes made on the amended return, the following options are available:

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1. If the amended return after an audit has been completed (63 protest period expired without a protest) that attempts to reverse or otherwise modify the audit adjustments (no new issues on the amended return); audit may deny the amended return.
  - a. An NODD is not required to be issued (Memorandum, July 3, 2013).
  - b. Send a letter that cites Idaho Code section 63-3045B(1) and Income Tax Administrative Rule 880.05.
2. If the amended return attempts to reverse or otherwise modify the audit adjustments, and includes new deductions or credits that the taxpayer is entitled to.
  - a. Prepare a new NODD explaining the closed audit issues and addressing the new deductions or credits claimed. Begin with Idaho taxable income and income tax liability as adjusted in the previous NODD.
  - b. Schedule the accepted adjustments made on the amended return. These amended return adjustments may or may not be related to the original audit issues.
  - c. If the amended return is a refund request, interest is computed from the due date of the return or the date the tax was paid, whichever is later. Reflect the refund claimed and the refund allowed on the NODD page.
  - d. Forward the NODD to the audit manager for approval and processing. After approval, send to the taxpayer. The taxpayer has full protest rights for the new issues.
  - e. If the amended return shows tax due but not paid, Collections must be notified so they can manually adjust the billing process.
  - f. Scan and attach a copy of the NODD in GenTax.
3. If the amended return is acceptable (doesn't reverse prior audit adjustments and no additional audit adjustments are necessary):
  - a. Open a new audit for posting purposes and make a CRM note of the changes.
  - b. Prepare a 042/044 beginning with Idaho taxable income and income tax liability as adjusted in the previous NODD.

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- c. Schedule the accepted adjustments made on the amended return. These amended return adjustments may or may not be related to the original audit issues.
- d. If the amended return is a refund request, interest is computed from the due date of the return or the date the tax was paid whichever is later.
- e. Use a work item to forward the 042/044 and schedule of adjustments to the audit manager for approval and processing. Do not send a copy of the audit report to the taxpayer.
- f. Record the working papers in GenTax. The tax, penalty, and interest figures should be the same as the amounts on the 042/044.
- g. If the amended return shows tax due but not been paid, Collections must be notified so they can manually adjust the billing process.
- h. Scan and attach a copy of the 042/044 and schedule of adjustments in GenTax.

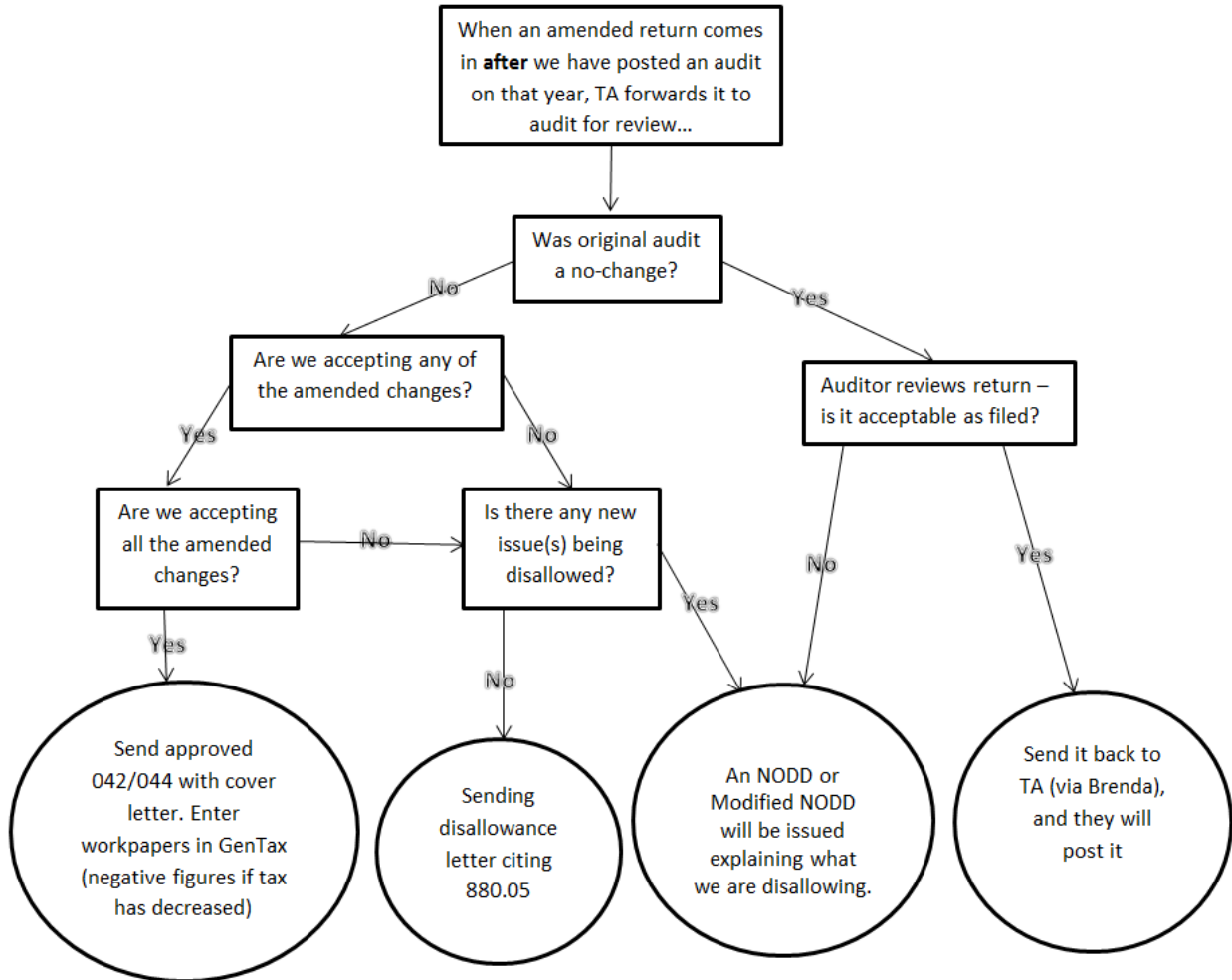
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**Amended return received after NODD hardened process flow chart**



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



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SEC 0500

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

**0510 THE AUDIT SCOPE**

In pre-audit analysis:

1. Review all open years for potential material audit adjustments, and
2. Include all years with potential material adjustments in initial correspondence.

**0515 CONFINING THE AUDIT SCOPE**

If the audit of the first year of a multi-year examination results in no material adjustments, consider whether audit time would be more productive on a new case.

**0520 INTRASTATE AUDITING STANDARDS FOR COMPREHENSIVE EXAMS**

Complete the following steps in comprehensive examinations:

1. Prepare a structural analysis that identifies related entities.
2. Reconcile taxpayers' records to the return. If the records don't reconcile, you may be wasting time on items that weren't even claimed or miss simple adjustments for items not identified.
3. Review audited financial statements, annual reports, corporate minutes and note any large and/or unusual items. Also note any related party transactions. (These must be disclosed in the footnotes to the financial statements.)
4. Reconcile Retained Earnings from the general ledger to the return. This includes an analysis of Schedule M-2.
5. Reconcile Schedule M-1 - book income to taxable income. Identify accounts included in the M-1 adjustments and review these accounts.
6. Review year-end adjusting entries.
7. Prepare a comparative analysis for the two-three year audit period (you may want to include a prior year for comparison purposes). Review the balance sheet and P/L statements for any large and/or unusual items and for accounts that have fluctuated from year to year.

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8. Probe for unreported income.
  - Consider internal controls.
  - Individual's standard of living.
  - Determine taxpayer's method of reporting income (i.e., deposits vs. reporting of receipts).
  
9. Review returns/books and records for other tax issues.
  - Sales tax - i.e., leases.
  - Form 75 Fuels Tax Refunds - review fuel receipts for out-of-state purchases.
  - Withholding - is there a permit?
  - Compensation for which withholding was not paid?
  
10. Review related party returns for shifting of income/expenses.
  
11. Examine issues with enough depth to determine the correct tax liability.
  
12. Support your findings - appropriate research conducted?
  
13. Consider and apply appropriate penalties.
  
14. Support conclusions with workpapers and narrative – both adjustments and no change issues.
  
15. Fully explain audit determination in NODD - (See TP Bill of Rights)
  
16. Protect statute of limitations when appropriate.

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

**0530 CUTOFF DATE FOR SCHEDULING AUDITS**

1. General Rule:
  - Desk Audits – Send NODD at least **60 days** prior to the expiration of the statute of limitations.
  - Field Audits - Schedule a return for examination at least **6 months** prior to the expiration of the statute of limitations.
  
2. Exceptions to the general rule can be made with supervisory approval.

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**0535 DATE FOR SUBMITTING COMPLETED CASES TO REVIEW**

Submit field audits for review **at least 60 days** prior to the statute expiration date including extensions. If the audit is not completed by this time, you need to get a waiver extending the statute of limitations. This is to allow sufficient time for review and any follow up needed.

Determine the statute expiration date on **paper filed returns** based on:

1. The postmark date on the envelope attached to the return (if available), or
2. The date that the taxpayer signed the return.

Determine the statute expiration date on **electronically filed returns** based on the date the return was received.

You may need to remind the taxpayer that the closing date for the audit is 60 days prior to the statute expiration date.

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

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An audit file contains all of the documents relating to a particular audit and must include:

- Audit narrative
- CRM notes
- Audit report or no change letter

If applicable, the audit file should also contain:

- Correspondence
- Supporting documentation (can be from the taxpayer or obtained by the auditor)
- Protest summary

The quality of your audit file either enhances or diminishes the perception of your audit work. A high-quality audit file pays big dividends in terms of quicker reviews and greater support during appeals.

Although the primary users of the audit file are typically ISTC employees, auditors should recognize that anything in the audit file and in GenTax can be obtained and viewed by the taxpayers during a discovery process or records request. Be mindful of the things you put into writing.

### **0705 GENERAL**

Good audit files are neat, relevant, and organized.

#### Neatness

Take the time to be neat. Just as your perceptions of a taxpayer's credibility are influenced by the quality of the records you review during an audit, the quality of your audit file will either enhance or detract from the perception of your work by those that use it. Make sure that your final work product reflects the quality of your work and demonstrates professionalism.

#### Relevance

Make sure that everything included in your audit file is relevant. Audit quality is not measured by the volume of paper included in a file. A user of your audit file shouldn't have to guess why something is in the file, or sort out what makes a difference and what doesn't. If a document is critical to your findings, include a copy in the file and reference it in your audit narrative. In most cases, examples of documentation provided are sufficient instead of duplicating everything.

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Organization

An audit file should be compiled in the following order (if applicable):

- Table of Contents
- Power of Attorney
- Notice of Deficiency Determination
- Protest
- Audit Narrative
- Statute Waiver
- Taxpayer Contacts & Correspondence (in chronological order)
- Audit Documents (specify documents included –sub-tabs ok)
- Returns
- Lead / FTI

**0710 AUDIT STANDARDS**

Audits, whether desk audits or field audits, must comply with the following audit standards:

- **Legality** - Audit activities and determinations must conform to established laws, legal interpretations and the policies of the ISTC.
- **Objectivity** - An objective analysis of all relevant, available factual data must be made in a fair and impartial manner.
- **Timeliness** - Audits must be conducted and completed promptly, with a minimum of inconvenience to taxpayers.
- **Supportability** - Recommendations must be adequately supported, consistent with both the facts and the law.

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### **0715 AUDIT REPORT**

When the ISTC determines a deficiency in tax exists, a notice must be sent to the taxpayer and include an explanation of the specific reasons for the determination (Idaho Code section 63-3045(1)(a)).

To comply with this requirement, ITA sends an audit report, either an NODD or a BL, to notify the taxpayer of the audit determination and explain the reasons for the determination.

Always begin the audit report with a new copy of the template from ITA's SharePoint site. This ensures you are working with the most current, updated version available. *Do not modify the template calculation fields.*

There are four basic parts to an audit report:

1. NODD/BL – section 0720
2. 042, 044, or TC68 – section 0725
3. Explanation of Adjustments – section 0730
4. Audit Schedules/Workpapers – section 0735

All audit reports must be reviewed by a supervisor or Auditor 4. See section 800

### **0720 NODD/BL**

#### NODD

The NODD is a standard one-page form included in the audit template. It summarizes the additional tax due or refund allowed, explains the taxpayer's right to appeal by a specific date, and explains that if no appeal is filed, the determination will be final and additional taxes, penalties, and interest will become a due and payable tax assessment. This is the legal document that, when issued, starts the taxpayer's formal due process rights and appeal procedures. The language of the form should not be modified.

#### BL

The BL is a standard one-page form included in the audit template. It is used when an audit adjustment can be made without requesting information from the taxpayer. The BL summarizes the proposed additional tax due or refund allowed and asks the taxpayer to sign a CTA waiving their right to appeal if they agree

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with the adjustments. If the signed CTA is not received by the requested date, usually 21 days from the date of the letter, an NODD must be issued.

### **0725 042, 044, and TC68**

ITA uses a standard form (042 for individuals, 044 for entities, and TC68 for nonfiled years) to summarize the specific items adjusted and calculation of taxes, penalties, and interest due. The forms are included in separate templates.

Adjustments should be shown on the 042 or 044 in the order items are reported on an Idaho tax return, as shown below:

- Residency status
- Filing status
- Federal adjusted gross income (in the order they appear on Form 1040, 1065, 1120, etc.)
- Idaho additions (in the order they appear on Form 39R or 39NR)
- Idaho subtractions (in the order they appear on Form 39R or 39NR)
- Itemized deductions/ standard deduction
- Exemptions
- Nonrefundable Idaho credits (in the order they appear on Form 40, 43, 41, 65, etc.)
- Other taxes, including use tax and PBF
- Refundable credits, including grocery credit
- Penalties
- Interest

This organization makes it easier for a taxpayer to understand and evaluate the results of your audit.

### **0730 EXPLANATIONS OF ADJUSTMENTS**

A critical element of an audit is the communication of the audit findings to the taxpayer, practitioner, ISTC staff, and other parties who will read the audit report.

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Accordingly, the audit explanation must contain the following for each issue examined:

- Title of the adjustment(s) made to the return,
- The legal authority as it pertains to the issue,
- A discussion of the of the facts that relate to the issue and application of the legal authority to those facts , and
- The adjustment(s) made to the return, including either the calculation of the adjustment or a reference to the attached schedules showing the adjustment.

In some cases it may be more logical to relate the facts of the case first and then the legal authority. A conclusion should always be stated and the resulting adjustment clearly indicated.

Remember, the audit report can be reviewed by many parties. The explanation of the audit adjustments must be clear, well-researched, and informative. Even a high-quality audit with correct application of law is more likely to be protested and possibly overturned during an appeal if the taxpayer, representative, or appeals officer cannot understand the audit adjustments.

Auditors have considerable flexibility in how to explain an audit adjustment, but a taxpayer should never have to guess what was adjusted, why an adjustment was made, or the effect of the adjustment.

Examples of audit explanations can be viewed in the Audit Explanation and Narrative Examples folder on the ITA SharePoint site.

### Adjustment Title

Identify the line number on the 042, 044, or TC68 where the adjustment is listed and clearly describe the specific item adjusted. The adjustment title in the explanation should match the adjustment title shown on the 042, 044, TC68 or Summary of Adjustments schedule.

If you are including a net amount from the Summary of Adjustments schedule, the title should read "Summary of Adjustments". Your explanation should indicate the amount on this line is a net amount from that schedule, followed by a discussion of each adjustment on the Summary of Adjustments schedule identified by schedule line number. See Part-year and Nonresident Deductions and Exemptions in the Audit Explanation and Narrative Examples folder for an example.



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Descriptions that closely follow the wording on federal and state tax forms (e.g., Residency Status, Idaho Capital Gains Deduction, Credit for Income Tax Paid to Other States, Permanent Building Fund Tax), should be used to make it easy to identify specific items on the returns that have been adjusted.

### Legal Authority

Cite governing legal authority (IRC, Treasury Regulations, Idaho Code, ISTC rules, court cases, administrative decisions, etc.). Be careful to distinguish between Idaho Income Tax Administrative Rules and Tax Commission Administration and Enforcement Rules as they can be easily confused and the incorrect authority cited.

When citing legal authority:

1. Know your audience. Your explanations may need to be written in plain language if the target audience is unfamiliar with tax law.
2. Always err on the side of caution that the taxpayer does not understand terms and acronyms that are common to auditors. The abbreviations IRC, TR, IC, etc. may not mean anything to your audience. Your first reference should always include the complete title of your legal reference followed by the abbreviation in parentheses if it is used again in the explanation e.g., Internal Revenue Code (IRC).

An explanation is easier to read if you paraphrase the relevant portion of a code section instead of including long verbatim quotations. Remember, you are communicating with a taxpayer. Put yourself in the taxpayer's position.

Focusing your audit explanation on the specific points in the law, paraphrasing the law, and communicating in understandable language will generally communicate more effectively than "legal speak".

That doesn't mean direct quotations of code, regulations, or rules should never be used – just be judicious on how much to quote and make sure that, if the quote is difficult to understand, you restate it in clear language.

### Discussion of Taxpayer's Facts and Application of the Law to those Facts

In this part of the audit explanation, you should discuss the taxpayer's facts and apply the legal authority to the taxpayer's specific situation. Cite relevant facts, including what was reported on the return (income, loss, deduction, credit, etc.).

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For example:

**2a. S Corporation Loss**

Internal Revenue Code (IRC) section 1366(d) limits a shareholder's deduction of losses from an S corporation to the sum of the adjusted basis of the shareholder's stock in the corporation and the shareholder's adjusted basis in the corporation's debt to the shareholder. Any losses in excess of basis are carried forward to later years.

You deducted a \$157,000 loss from ABC Enterprises, Inc. (ABC) on Schedule E of your 2011 federal return. We have determined that the loss claimed exceeded the basis of your ABC stock and loans. At the end of 2011, the adjusted basis of your stock was \$0 and your adjusted basis in loans was \$10,000. We have therefore disallowed \$147,000 of the loss claimed. See Schedules 1 and 2 for our calculation of your basis.

**Conclusion**

The explanation of each adjustment should always include a clear statement of your audit conclusion.

It isn't necessary to include lots of numbers and calculations in the explanation. In fact, it's best to show any detailed calculations on audit schedules. The relevant schedules should be referenced in the explanation.

**0735 AUDIT SCHEDULES/WORKPAPERS**

**Header**

The upper left corner of each schedule should include:

- The taxpayer's name,
- The taxpayer's account number,
- The schedule title (should reflect the result of the schedule)
- The general source of the records or information, if not detailed in the body of the schedule, and
- The tax year(s) involved.

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The upper right corner of each schedule should include:

- The auditor's initials, and
- The date the schedule was created or modified.

### Purpose

The purpose of an audit schedule should be easily identified from the title of the schedule. The end result should be clearly identifiable. A user should never have to guess what the purpose of a schedule is. Know where you are going with a schedule before you begin entering data.

### Formatting

Dollar signs should either be eliminated entirely, or shown only for the first number in a list and the total.

Negative numbers should be shown in parentheses.

Highlight the most important items, especially the end result of the schedule, by either underlining or bolding the items.

Don't cram too much on one page.

### Relevance

Avoid entering data that makes no difference on a schedule. For example, if you audited only selected items on Schedule C, only those items should be shown on your schedule. Listing all line items from Schedule C and entering zeros just clutters up the schedule.

### Cross Referencing

The specific source of all data on a schedule should be clear. For example, if you are scheduling expenses from cancelled checks, credit card statements, and invoices, show the source for each item. If the source is the tax return, reference the form and line number. If the source is another audit schedule, reference that schedule.

### Footnotes

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Numbered notes (including reasons for disallowance) should be either on a separate page at the end of a schedule or, if there is adequate room, at the bottom of the last page of the schedule. While simple schedules may only have a few notes, more complex schedules can require many lengthy notes. Be consistent; place your footnotes in the same location on each schedule.

### Footer

A footer centered at the bottom of each schedule should include:

- The schedule reference (Schedule 1, 2, CGS, DE...)
- The page number

### Excel Formulas

#### *Rounding*

All numbers on schedules should be rounded to the nearest dollar unless you are working with the taxpayer's electronic records without re-entering the numbers. When rounding subtotals, footnote you have done so. All Excel formulas should include the ROUND function. This will avoid errors in calculations that include the result of the formula. Even if the result of a calculation displays as rounded to the nearest whole number, Excel will use the unrounded result of a formula internally unless the ROUND function is used in the formula.

#### *Other Formulas and Cell References*

The use of formulas or cell references can make updating schedules easier. It is important to verify that your formulas are referencing the cells that you intended. For example, if you are using a SUM function, make sure that you are including all of the numbers you intended to sum.

### Tips for Audit Schedules:

- Make a plan before you start (know your destination).
- Structure the schedule to clearly show the end result.
- Make your conclusion clear.
- Capture only relevant data.
- Use a consistent format for all schedules.
- Always include a header.
- Always include a footer.
- Always cross reference to other schedules and the explanation.

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- Highlight the most important items.
- Don't cram too much on one page.
- Use appropriate font size (don't get too creative with variations).
- Use a consistent format for numbers (don't overuse \$\$).
- Use good sense and skip the cents.
- Round all division and multiplication formulas to the nearest dollar [=ROUND(A34\*A55,0)].
- Make sure your totals total.
- Footnote, footnote, footnote!
- Use subtotals in multilevel calculations.
- Put complex calculations in schedules instead of explanations.
- Change your plan when warranted.
- Don't alter taxpayer documents (make copies if you want to add notes to the documents).

### 0740 PRELIMINARY AUDIT REPORTS

A preliminary audit report and related workpapers can be an effective tool in resolving issues, receiving needed information, and getting agreed-to audits.

#### Preliminary Audit Report

A preliminary audit report can be:

- Sent to the taxpayer at any time during the audit, prior to issuing an NODD,
- Sent in lieu of a second letter,
- Used for requesting information from a non-responsive taxpayer,
- Sent to allow the taxpayer time to determine if additional substantiation is cost beneficial, or
- Sent to allow the taxpayer time to review the issues and agree with your assessment.

The preliminary report must contain a cover letter explaining the issuance of the preliminary report and an offer to consider additional information. (See the letter titled Preliminary Audit Report on the ITA SharePoint work group site.) The 042, 044 or TC68 and all accompanying pages must be labeled "Preliminary" to avoid confusion when the final audit report is sent. **Do not include the NODD page.**

All preliminary audit reports must be reviewed by a supervisor or Auditor 4. See section 800.

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### Preliminary Workpapers

Preliminary workpapers, unlike a preliminary audit report, do not include an explanation of the audit adjustments. They are used to highlight where provided documentation is insufficient and request additional documentation or explanation.

Preliminary workpapers should contain a cover letter explaining the issuance of the preliminary workpapers and request the additional documentation and explanation. (See the letter titled Preliminary Workpapers on the ITA SharePoint work group site.) All of the workpapers should be labeled as "Preliminary" to avoid confusion when the final audit report is sent. In some cases the 042, 044 or TC68 will not be included with the preliminary workpapers. **Do not include the NODD page.**

### **0745 AUDIT NARRATIVE**

The audit narrative is an internal document that discusses what happened in the audit. A narrative should support and augment the audit explanation, not mirror it. Details of determinations, adjustments, and legal support belong in the audit explanation.

The purpose of an audit narrative is to:

- Document the scope of the audit (years audited and issues examined),
- Record procedures used to resolve issues (what you did to get the answer),
- Support your audit conclusions and adjustments,
- Facilitate faster review,
- Assist Tax Policy and/or Legal if the case is appealed, and
- Provide a historical record for subsequent auditors.

An audit narrative contains:

- Background - A brief discussion of the background on the taxpayer/business, and related parties,
- Scope - How the audit was selected and what issues were considered (rather pursued or not),
- Issues Examined - The issues examined, whether adjusted or not,
- Audit Findings - How you arrived at your determination:
  - Records requested and provided

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- Problems encountered
- Research conducted
- Work done to resolve the issues (the audit process)
- How and why you reached your determination
- Final conclusion reached on each examined issue,
- Impact on Future Years - Items affecting subsequent years (credits, losses, and deductions), and
- Conclusion - The expected response by the taxpayer.

Supporting workpapers should be referenced.

See the Audit Narrative template in the Audit Templates – Intrastate folder of the ITA SharePoint work group site. Examples of audit narratives can also be found on the ITA SharePoint site.

### **0750 CRM**

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

Every contact with the taxpayer or their POA, if applicable, should be documented. CRM notes should be kept brief and to the point. If the communication is lengthy, reference it in the CRM note and attach the typed conversation notes in GenTax. If relevant to your audit findings, reference/describe the exchange in the narrative.

#### **Initial Letter**

Identify all potential audit issues and years affected *before* sending the initial letter. Enlisting the aid of other auditors and your manager in the analysis can be helpful.

Be systematic and concise in your initial document request. Don't ask for documents already supplied with the income tax return or available in GenTax. The scope can be expanded and additional records may be requested, but a little research up front will ease the burden on taxpayers.

#### **Audit Conference**

Always begin the conference by identifying yourself to the taxpayer or the representative. Sample openers:

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- Did you have the opportunity to review the publications included with the initial audit letter?
- Do you have any questions about the pamphlets or the audit process?
- Describe the organization of your businesses, including affiliates and operations.
- Do you have the records we requested?
- How were the numbers on the returns derived? Request that the taxpayer/accountant show you how the records tie to the amounts reflected on the return.

Ask questions about unfamiliar areas of the audit. Take brief notes during the conference. Then, as soon as possible, write a summary of the conversation.

### **Other Conversations**

Frequently, explanations of matters raised by the auditor or questions about the audit are received by telephone or e-mail. These explanations should be noted in the GenTax CRM notes. The note should include:

- The date of the conversation
- The person involved
- The subject matter

Again, these notes should be made as promptly after the conversation as possible. Trusting to memory may lead to omissions or incomplete and inaccurate documentation.

For more detailed information on taxpayer contact see section 19300.

### **0755 SUPPORTING DOCUMENTATION**

Supporting documents are the detail records gathered during the investigative phase of the audit. They consist not only of the information provided by the taxpayer and POA, but data from third parties and your own research. They include:

- Copies of relevant taxpayer records,
- Taxpayer-provided documents that support adjustments or illustrate unacceptable documentation (sample where voluminous),
- Supplemental workpapers strengthening audit findings,
- Taxpayer correspondence,

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- Workpapers,
- Any records that would assist Collection,
- Third party research, and
- Other information used to reach audit conclusions.

Supporting documentation should be well-organized and systematic. Take the time to arrange the documents in a logical order (such as one following the sequence of the narrative or explanation). This is especially important when scanning in taxpayer documents at the close of the audit and when preparing the audit file for Tax Policy (Section 0760). Invalidate duplicated workpapers when updating attachments.

### **0760 ASSEMBLING AUDIT FILES FOR PROTESTED CASES**

Protested audits being forwarded to Tax Policy will need to be assembled with an Index sheet attached to identify the content. Categories listed on the index include:

- Table of Contents
- Power of Attorney
- Notice of Deficiency Determination
- Protest
- Audit Narrative
- Statute Waiver
- Taxpayer Contacts & Correspondence (in chronological order)
- Audit Documents (specify documents included –sub-tabs ok)
- Returns
- Lead / FTI

Other categories may be added to this list. The audit documents should be filed in a logical sequence keeping protested items and materiality in mind. Protest summaries are the first indexed documents.

### **0765 GENTAX ATTACHMENTS**

All pertinent documents related to the audit should be attached in the audit manager of GenTax.

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

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### **Items that must be promptly attached:**

It is the auditor's responsibility to ensure that these documents are attached in GenTax shortly after being received from the taxpayer/POA or being sent by the auditor:

- POA forms (typically attached by Administrative Support staff. See section 15600),
- Signed statute waivers,
- Letters sent by the auditor,
- Audit report,
- Protest letters,
- Signed CTA (use "Other" when attaching), and
- Signed PWS.

### **Other attachments:**

All other information can be attached in GenTax by the auditor before case submission or by administrative support staff at a later date. If there is a large volume of documents, it is recommended that the job be performed by the administrative support staff. When audit documents are given to the administrative support staff for imaging, organize the information as follows:

- Remove all staples from the papers,
- All papers should be clipped together (paper clip or binder clip), and
- Write the taxpayer's SSN/EIN or account ID and the Tax Year of the audit in the upper left hand corner of the first paper.

For information on closing an audit, see section 6100.

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### **0805 DATE FOR SUBMITTING COMPLETED CASES TO REVIEW**

The auditor must submit audits to be reviewed at least 60 days prior to the statute expiration date including extensions. If the audit won't be completed by this date, the auditor needs to get a waiver extending the statute of limitations or get approval from the reviewer to submit the case for review within the 60-day time period.

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

Depending on what you are adjusting, the statute date will be either 3 years after the original return or 3 years after April 15 of that year. Due dates change depending on when the day falls in a year. Due dates could be as late as April 18 depending on weekends and Emancipation Day in Washington DC. If your change is to adjustments in the amended return, then statute is 3 years after that file date.

#### **Paper filed returns**

Check the following when you have a paper filed return.

- The postmark date on the envelope attached to the return (if available), or
- The date that the taxpayer signed the return.

The auditor may need to remind the taxpayer that the closing date for the audit is 60 days prior to the statute expiration date.

### **0810 PREPARING AUDIT TO SUBMIT FOR REVIEW**

Audit file contains:

- 042 (make sure the electronic signature is included)
- Explanation Page
- Narrative
- Audit Schedules (if applicable)

If the taxpayer is an individual, the folder name should be last name, first name. If a business, use the business name. If a document with FTI is added to the folder, the folder name will need to include "FTI" after the taxpayer name. Each of the documents in the review folder should be labeled with the taxpayer's first/last name and a description (i.e.: 042, Explanation, Narrative, and Audit Workpaper).

**Note 1:** All schedules in the audit template or in separate excel files that need to be included in the audit report need to have a green tab. Right-click each tab you

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want then from the color menu select a green color. The standard schedules (042a/044a/TC68a, NODD/Billing Letter, and interest page) in the audit template are highlighted in green.

**Note 2:** It is important that you don't delete or hide unused sections of the 042/044/TC68 templates, as this will cause errors with the various macros.

**Note 3:** If your audit results in a refund, a NOR will be issued even if it is the first contact with the taxpayer. The due date for the NOR work item is 14 days. The NOR work item is assigned to Admin.

### **0815 AUDITS WITH NODDS OR BILLING LETTERS – LEVELS A AND B AUDITS:**

The intrastate manager pool reviews Levels A and B audits.

If the required adjustments are very clear, and don't require communication with the taxpayer, we send a Billing Letter.

If the auditor and taxpayer have had prior correspondence (written and/or verbal), a NODD or Billing Letter is issued. However, the auditor must issue an NODD if the taxpayer doesn't sign the Consent to Assessment, unless we receive payment for the Billing Letter.

The audit review file is saved in the Intrastate Managers - Review or Auditor 4's review folder on IAPUB.

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

#### **If the reviewer doesn't approve the audit:**

The reviewer will identify the corrections that need to be made. The reviewer will move the electronic files to a Returned Audits folder in IAPUB. The auditor then needs to make the corrections, put the updated files back in the Manager's review.

#### **If the reviewer approves the audit:**

The reviewer will move the applicable computer files to the support staff's NODD or Billing Letters folder. The reviewer then changes the work item to Admin NODD or Billing Letter. The manager will then forward the files to the applicable support staff for processing and mailing.

The support staff then prepares the audit report for mailing and attaching, including:

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- Updating the final report.
- Adding mailing and interest dates on the 042/044 template.
  - For Billing Letters, the support staff will use 21 days from the mailing date.
  - For NODDs, the support staff sets the mailing date and uses 9 weeks from that date for the hardening date and 10 weeks for the interest date.
  - If the auditor wants a different amount of time, it should be noted in the work item.
- Adding the power of attorney information to the NODD/Consent to Assessment, if applicable.
- Printing to PDF format the NODD or Billing Letter, 042/044/TC68 pages, applicable audit schedules, and interest pages from the template, audit explanation pages, and any other applicable audit schedules not in the template that need to be included with the report.
- Combining these PDFs into one report, printed, and mailed to the taxpayer and POA if applicable. The support staff mails all final audit reports with envelopes using the Boise office return address. Return envelopes included with the report will have the address of the office where the auditor is located and the support staff will add the auditor's initials to the envelope
- Preparing and printing vouchers.
- Assigning a work item to the auditor for final review before issuing the NODD or Billing Letter. Auditors must review the PDF attached in GenTax and make a note in the work item whether the report is ready for mailing or not. It is the responsibility of the auditor to make sure the audit report is signed, has all the applicable schedules, and is in the correct order.

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

### **0820 AUDITS WITH NODDS OR BILLING LETTERS – LEVEL C AND HIGHER**

Level C and higher audits are reviewed by the Auditor 4.

Use the same process as section 810. Save this folder in the Auditor 4's review folder on IAPUB. Send a work item notifying the Auditor 4 that the audit is ready for review.

**If the Auditor 4 doesn't approve the audit:**

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The Auditor 4 will contact the auditor through email or a phone call to discuss the case, identify any items that need correction or clarification, and provide suggestions on the audit explanation, and narrative.

The auditor must review the suggested changes and determine which to accept. The Auditor 4 doesn't expect that all suggested changes will be accepted, or need to review the audit explanation and narrative again unless the auditor requests a second review. The auditor will correct any errors in the NODD and schedules, then save the files in the auditor's review folder adding "V2", "V3", etc. to the file name, and email the Auditor 4 when those files are ready for another review.

### **If the Auditor 4 approves the audit:**

When the audit is approved, the Auditor 4 will send the folder with the approved files to the auditor's manager on IAPUB. The manager will then forward the files to the applicable support staff for processing and mailing as indicated for Level A and B audits.

### **0825 MODIFIED REPORT**

The auditor must place the Modified Report (modification cover letter, 042/044/TC68, audit explanation, supporting schedules, and interest page) in the managers' IAPUB review folder. The auditor should label each item in the folder as "modified" (for example: "Smith, John – modified NODD.xls"). Ensure the modification cover letter has an electronic image signature. Send a work item to the manager indicating the Modified Report is in their review folder. Upon approval, the manager will print the Modified Report and modified cover letter, and then place in the mailing basket. At this time, support staff will scan the Modified Report and attach in GenTax.

### **0830 NO-CHANGE AUDITS**

No-change audits are subject to the same review as a tax due or refund audit. By looking at the audit file, CRM notes, and audit narrative, the reviewer should be able to identify what issues were audited, what documents were provided by the taxpayer, and the conclusions reached by the auditor.

No-change audits that are level C or higher should go to the Auditor 4 and will follow level C audit procedures. A and B level no-change audits are reviewed by the Intrastate Managers.

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The auditor must save a copy of the no-change letter and narrative to a folder with the taxpayer's name in applicable review folder on IAPUB.

### **All Auditors (Boise and Field Offices):**

Attach all appropriate documents in GenTax and then send a work item to the applicable reviewer that the no-change audit is ready for review.

Once reviewed, the reviewer will return the work item to the auditor with his/her approval or recommended action that the auditor needs to take.

- If approved, the reviewer will forward the narrative to the support staff for attaching.
- If not approved, the reviewer will move the electronic file to the auditor's Returned Audits folder in IAPUB.

### **0835 BILLING LETTER TO NODD**

If the auditor sent a Billing Letter and we don't receive the signed consent to assessment or full payment from the taxpayer, support staff will then issue an NODD. Send the support staff a work item indicating the NODD needs issued. They will add one of the following paragraphs to the explanation page and issue the NODD:

#### **Paragraph If Protest of Billing Letter Received**

"We received your letter dated (DATE) protesting the Billing Letter dated (DATE). As required by Idaho law, we're sending this Notice of Deficiency Determination (NODD) making the adjustments described in the Billing Letter."

#### **Paragraph If No Response from Taxpayer to Billing Letter**

"We issued a Billing Letter dated (DATE) for tax year(s) 20XX (and 20XX). Because we didn't receive the signed Consent to Assessment included with the Billing Letter, we're required to send this Notice of Deficiency Determination."

#### **Partial Payment with no Signed Consent to Assessment \***

"We received your payment(s) of \$(and) \$) for tax year(s) 20XX (and 20XY), respectively. However, since we didn't receive the signed Consent to Assessment included with the Billing Letter dated (DATE), we're required to send a Notice of Deficiency Determination (NODD). If you want to protest this NODD, you must file a written protest within 63 days from the date of the NODD or until (DATE) stating the legal and factual reasons for your disagreement."

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\* Note: If this paragraph is necessary, the auditor must update the NODD page reflecting the payment made and put the NODD in the corresponding support staff's NODD folder. The auditor must email the support staff indicating that an NODD was added to their folder and that the support staff need to add the paragraph.

### **0840 BILLING LETTER – OTHER ISSUES**

If a billing letter is paid in full, but no signed Consent to Assessment Form is provided, an NODD doesn't have to be issued. As long as the taxpayer isn't paying with a protest, the auditor can close the audit. (See Administrative Guideline – Consent to Assessment after Billing Letter, for a detailed explanation. Administrative Guideline, 3-24-16)

If the billing letter is the first contact with a taxpayer, the use of a billing letter instead of an NODD is a policy tool of the Income Tax Audit Bureau, not a requirement set by statute. As such, there are times when it is appropriate to deviate from policy, for example:

- When a return will go out of statute in less than 90 days.
- When the taxpayer is in bankruptcy. (A billing letter is a demand for payment, which isn't allowed when a taxpayer is in bankruptcy. Instead, the auditor must issue an NODD after first discussing the case with the Idaho State Tax Commission's Bankruptcy Department.)
- Other scenarios discussed with and approved by management.

Audits of Pass-Through Entities (PTE) can raise questions on when to use a Billing Letter:

**Q:** If I have been working with the PTE on the audit, do I still need to send a Billing Letter to the owners?

**A:** Yes. If your only contact has been with the PTE, we will mail a billing letter to each owner that hasn't previously been contacted. The auditor has the option of issuing an NODD or a billing letter to the PTE and any owners who have received prior contact.

**Q:** If the individual signs the CTA, but the PTE doesn't, do I send a billing letter or an NODD?

**A:** There is an option to send the PTE an NODD and send the individual a BL. Both audits need to remain open through the protest period.

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**Q:** If the PTE owners sign the Consent to Assessment forms, but the PTE doesn't, can I close my audit?

**A:** No. When the auditor sends a billing letter, we must receive a signed Consent to Assessment Form from each taxpayer. Those that don't sign this form must receive an NODD.

**Q:** Can I close my audits if the taxpayers pay the billing letters but don't sign the Consent to Assessment Forms?

**A:** Yes. An auditor isn't required to issue an NODD or obtain a Consent to Assessment Form if the amount is paid in full.

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BANKRUPTCY

SEC 1000

Occasionally you'll encounter taxpayers who are undergoing bankruptcy. There are several different types of bankruptcy and the Tax Commission must issue a Notice of Deficiency to have a claim.

**1005 SHORT PERIOD RETURNS**

IRC Sections 1398 and 1399 may require that a separate estate or entity be created due to bankruptcy. If a separate entity return is required for federal purposes, the state will follow those provisions.

**1010 TYPES OF BANKRUPTCIES**

**Chapter 7 – Liquidation**

A trustee takes control over the debtor's non-exempt property, then liquidates it, and distributes the proceeds to the creditors in the order of their priority.

Although corporations don't receive a discharge, individuals are usually granted a discharge within 120 days.

**Chapter 11 – Reorganization**

Reorganization allows a corporation or an individual debtor with substantial liabilities to reorganize their financial affairs. The debtor continues to operate the business and submits a plan of reorganization that provides for payment of outstanding obligations via either reorganization or liquidation.

An individual debtor isn't discharged if the plan provides for the liquidation of all, or substantially all, of the property of the estate or if he doesn't engage in business after the reorganization plan begins.

All liabilities of a corporation arising pre-confirmation are discharged. Regardless of the discharge, claims will be paid per the terms of the confirmed plan. The bankruptcy reorganization plan constitutes a new contract with each of the creditors. The amounts owed to each creditor will be based upon the reorganization plan.

**Chapter 12 – Adjustment of Debts of a Family Farmer**

The debtor's confirmed plan allows for payments to a trustee who then disburses the monies to the creditors according to claim status. The discharge is granted after completion by the debtor of all payments under the plan.

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BANKRUPTCY

SEC 1000

**Chapter 13 – Individual with Regular Income**

The debtor's confirmed plan provides for payments to a trustee over a three to five year period. The trustee distributes the funds to the creditors according to claim status, and the discharge is granted after the debtor makes all of the payments under the plan.

For individuals under all chapters, debts not discharged include:

- unfiled returns
- trust fund taxes
- taxes for which that year's due date was less than three years from the bankruptcy filing date,
- taxes for which a return was filed within the past two years of the petition date,
- fraudulent or attempts to evade the tax,
- taxes assessed within 240 days of the bankruptcy filing date and,
- taxes not assessed before, but assessable, under applicable law after the commencement of the case.

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

**1015 CLAIMS**

If you're involved in an audit and you become aware of a bankruptcy filing, notify the Bankruptcy Unit of your intent to issue an NODD.

An NODD should be created to provide the Bankruptcy Unit an estimate of the tax, penalty and interest due. Don't send a Billing Letter. A Billing Letter demands payment from the taxpayer, which we aren't allowed to demand if the taxpayer is in bankruptcy. The Bankruptcy Unit will file a proof of claim with estimated amounts for the tax type and periods that are being audited. When the audit is completed, the claim will be amended by the Bankruptcy Unit to the actual amount due. Filing a timely claim will allow for payments through the bankruptcy and avoid having the debt discharged.

**1020 FORGIVENESS OF INDEBTEDNESS**

Generally forgiveness of debt must be included in income. There are five kinds of discharge of indebtedness that aren't included in income. They are:

- Debt canceled in a Title 11 bankruptcy case,

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- Debt canceled during insolvency,
- Cancellation of qualified farm indebtedness,
- Cancellation of qualified real property business indebtedness,
- Cancellation of qualified principal residence indebtedness.

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

The amount excluded from gross income in respect of the discharge of indebtedness in a bankruptcy case reduces the tax attributes described in IRC Section 108, and a similar reduction is made under Idaho Income Tax Administrative Rule 210. The order of reduction according to IRC Section 108 is:

- Any net operating loss deduction,
- General business credit,
- Minimum tax credit,
- Capital loss carryover,
- Basis reduction,
- Passive activity loss and credit carryovers,
- Foreign tax credit carryovers.

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3-2015                      IDAHO CAPITAL GAINS DEDUCTION                      SEC 2000

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**Caution: Section contains outdated information.**

Idaho Code section 63-3022H allows 60% of the capital gain net income from the sale of qualified Idaho property to be deducted in determining Idaho taxable income. Idaho Income Tax Administrative Rules 170-173 provide additional guidance to help understand what property qualifies and the calculation of the allowable deduction.

**2005 LIMITATIONS**

The Idaho capital gains deduction is limited to the amount of the capital gain net income included in federal taxable income. Claiming the Idaho capital gains deduction when the taxpayer doesn't have capital gain net income is more frequently found when reviewing part-year and nonresident returns as the taxpayer may not have capital gain net income on their federal return, but have an Idaho net capital gain from the sale of qualifying Idaho property.

Qualifying capital gains and losses have to be netted prior to figuring the Idaho capital gains deduction. A taxpayer doesn't qualify for the deduction if their losses are more than their gains from Idaho qualifying property even if they have a net capital gain for federal purposes.

Idaho follows the definition of capital gain net income found in IRC Section 1222(9).

**2010 WHAT QUALIFIES**

**1. Idaho Real Property**

Idaho real property qualifies if it was held by the taxpayer for 12 months. Real property is defined as land and, for taxable years beginning after 2009, includes a conservation easement, grazing permits or leases issued by the U.S. Forest Service, the Bureau of Land Management or the Idaho Department of Lands, and any other IRC Section 1250(c) property conveyed in perpetuity. Idaho Income Tax Administrative Rule 171 provides information about what constitutes real property. Non-Idaho property does not qualify for the deduction no matter how long it was held.

**2. Tangible Personal Property Used in a Revenue Producing Enterprise**

Tangible personal property may qualify for the deduction if it is used in a qualifying revenue-producing enterprise. Tangible personal property refers to

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SEC 2000

property, except land or buildings that can be seen, weighed, measured, felt, touched, or otherwise perceived by the senses.

Idaho Code section 63-3022H provides the definition of a revenue-producing enterprise for purposes of the Idaho capital gains deduction. See Income Tax Administrative Rule 172 for examples of activities that do not qualify as revenue-producing activities.

### **3. Cattle, Horses and Livestock**

Cattle or horses used for breeding, draft, dairy or sporting purposes must be held for at least 24 months and other breeding livestock must be held for 12 months to qualify.

If the animals are sold by an individual, to qualify for the deduction more than 50% of the taxpayer's gross income must come from farming or ranching operations in Idaho.

For tax years after December 31, 2014, if the animals are sold by a pass-through entity and the income is distributed to an owner, the capital gain deduction is available on the individual owner's distributive share if more than 50% of the entity's gross income is from farming or ranching activities in Idaho.

### **4. Timber**

Timber sales can qualify for the deduction. It must have been grown and held for a minimum of 24 months. Standing timber qualifies if it is held for investment and is a capital asset according to IRC Section 1221. Cut timber qualifies if the taxpayer treats the cutting of the timber as a sale or exchange under IRC Section 631(a).

### **5. Repossession Gains**

The portion of gain determined to be capital under Treasury Regulation 1.1038-1(d) qualifies for the Idaho capital gains deduction provided all other requirements are met for claiming the deduction.

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

## **2020 POTENTIAL AUDIT ISSUES**

1. Did the taxpayer sell real property?

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3-2015

IDAHO CAPITAL GAINS DEDUCTION

SEC 2000

Documentation to request from the taxpayer might include:

- Purchase and sale agreements
- Conservation easement legal agreement
- Lease agreements

2. Sale of Tangible Personal Property

Review the taxpayer's returns to determine if the equipment sold was used in a revenue-producing enterprise. For example, check Schedule C and Schedule F.

Documentation to request from the taxpayer might include:

- Sales contract
- Bill of Sale
- Descriptions of the activity in which the equipment was used along with supporting documentation

3. Sale of Cattle or Horses or Other Breeding Livestock

Documentation to request from the taxpayer might include:

- Sales contract
- Bill of Sale
- Herd registration

4. Capital Gains Deduction from the Sale of Timber

Documentation to request from the taxpayer might include:

- Sales contract
- Bill of Sale

5. Capital Gains Deduction from the Repossession of Real Estate

Documentation to request from the taxpayer might include:

- Sales contract
- Bill of Sale

6. Holding Period

*Installment Sales*

Installment sales prior to tax year 2005 had different holding periods in order for property to qualify for the Idaho capital gains deduction. Verify that the holding

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period for the year of sale has been used and the taxpayer is not using the holding period for the year in which the payment was received. Idaho Income Tax Administrative Rule 171.06.c.

Documentation to request from the taxpayer might include:

- Sales contract
- Bill of Sale

*Distribution of Property from Pass-Through Entities*

For tax years beginning on or after January 1, 2015, an owner receiving a distribution of qualified property from a pass-through entity can include the holding period of the entity when determining the holding period requirement for the capital gains deduction. In prior tax years, the holding period of the entity does not tack-on to the holding period of property received in a distribution. It does not have to be a liquidating distribution to qualify.

7. Capital Gains Deduction from the Sale of Partnership Interest

A partnership interest is an intangible asset and does not qualify for the deduction. It has also been referenced to as a membership interest. Idaho partnership law treats the sale of a partnership interest as personal property and that a partner does not have the right to the underlying assets of the partnership. See the following Idaho Code sections regarding the transfer of a partnership interest:

- 30-6-501
- 53-2-701
- 53-3-501
- 53-3-502

Documentation to request from the taxpayer might include:

- Sales contract
- Partnership agreement
- Bill of Sale

8. Sale of Other Intangibles

This may include grazing permits, water or mineral rights, easements and stock sales.

See the following IRC sections regarding the sale of these intangible assets.

- IRC Section 1250(c)

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- IRC Section 170(h)

Documentation to request from the taxpayer might include:

- Sales contracts
- Bill of Sale
- Brokerage statement

**2025 APPLICABLE AUTHORITIES**

1. Idaho Code section 63-3022H
2. Idaho Income Tax Administrative Rules 170, 171, 172, and 173

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### **2205 REQUESTS FOR PAYMENT PLANS**

When an individual under audit requests a payment plan, the auditor should refer the individual to the Payment Options on our website, tax.idaho.gov. Any other questions or requests regarding current or future collections on their account should be referred to the Collection staff at 800-972-7660 ext 7633, or 334-7633.

Example: Taxpayer requests that the auditor hold an audit for a month after the 63 day protest period expires so he has time to get the needed money together. The auditor should explain that the audit must be processed, and refer the taxpayer to a Collection staff to discuss payment options. Once the protest period has expired, post and close the audit according to ITA's procedures. For closing procedures see Intrastate Income Tax Audit Manual sections 700 & 6100.

### **2210 MODIFIED NODD IN AUDIT**

Tax, penalty, and interest on ITA's audits are not assessed until the 63 day protest period has expired or a final decision of the Commission, BTA, or the courts has been issued and the taxpayer's appeal rights are exhausted per Idaho Code sections 63-3045A and 63-3045B. Since tax, penalty, and interest have yet to be assessed during the audit process, we can reduce these amounts without performing a write-off or settlement. The auditor should issue a modified audit report showing the new amount of tax, penalty, and interest due; and have the taxpayer sign a PWS agreeing to the modified audit report.

Note: If the modified audit report results in an increase in tax, a new NODD with appeal rights must be issued. Per the Idaho Supreme Court decision in *Union Pacific Railroad Company v. State Tax Commission*, 105 Idaho 471, 670 P.2d 878 (1983), Idaho Code sections 63-3045(6)(b), 63-3047 and 63-3048, and Tax Commission Administration and Enforcement Rule 500, the Tax Commission may abate interest only when the following situations exist: disputed liability, doubt as to collectability, economic hardship of the taxpayer, and promotion of effective tax administration. As a result, any reduction in interest on the modified audit report must correspond to a decrease in tax since any abatement of interest would take place after an audit has gone to Collections or Appeals.

### **2215 HARDENED NODD, UNTIMELY PROTEST, NOT YET POSTED TO GENTAX**

Occasionally, an auditor will receive an untimely protest that provides new information showing some or all of the calculations on the NODD are in error. The auditor will evaluate any additional information the taxpayer provided with

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the protest. If the information is valid, the auditor can modify or cancel the NODD.

If based on this new information the NODD should not have been issued, the auditor must send a letter to the taxpayer canceling the NODD and close the audit.

If this new information shows that some of the calculations in the NODD are in error, the audit report should be modified and a copy sent to the taxpayer showing the new balance due. Even with the changes allowed for the NODD, the protest will not be accepted and the protest process will not be followed. A cover letter should also be sent explaining:

- The protest is not timely,
- The changes that were made to the audit report, and
- The case has been transferred to the Collection Division.

The support staff will scan the Modified Report and attach in GenTax.

### **2220 AUDIT IN COLLECTIONS, NEW INFORMATION PROVIDED**

During the collections process the taxpayer may submit information that they believe shows the audit to be in error. The Collection staff will forward this information to the auditor to review. The auditor may also be asked to speak with the taxpayer or their representative to answer any questions they have about the audit.

Once the audit figures have been posted to GenTax the audit staff no longer has control of the case, so it is important that when communicating with the taxpayer we make no promises about the collection process. For example, promising to abate penalty or delay a collection action. Audit's role in the collection process is to be an advisor to the Collection staff working the case. The auditor will advise the Collection staff whether the information provided by the taxpayer changes the audit or if a return can be accepted in lieu of a provisional NODD for a nonfiler. If requested to do so, the auditor will speak with the taxpayer or their representative to answer any questions about the audit.

**A. Provisional NODD for Nonfiler** – When the auditor determines that the actual return submitted by the taxpayer is accurate or the provisional NODD can be modified based on new information; the Collection staff will take the necessary steps to change the return record in the Financial Manager.

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**B. Audit of Filed Return** – When the auditor determines that the audit report must be modified as the result of new information, the auditor will communicate this to the assigned Collection staff, and if there are no objections, post a new audit work paper making the necessary changes.

Sometimes the taxpayer will send new information directly to the auditor, rather than working with the Collection staff. The auditor must still communicate with the assigned Collection staff before taking any action on the account. If Collection staff has not been assigned to the account, the auditor must contact the supervisor of the Collection Unit.

Note: The audit staff will not discuss or adjust the results of an audit for the following, as the Collection staff has their own procedures for these items:

- Ability to pay or financial hardship,
- Offer for settlement of a liability,
- Abatement of penalty after the audit is posted to GenTax, or
- Any prior or pending collections activities.

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Nine states have community property laws. They are:

- Arizona
- California
- Idaho
- Louisiana
- Nevada
- New Mexico
- Texas
- Washington
- Wisconsin

Several other jurisdictions have opt-in community property laws. They are:

- Alaska - property is separate unless both parties agree to make it community through a community property agreement or trust.
- Puerto Rico - allows property to be owned as community property.
- Various Indian jurisdictions - allows property to be owned as community property.

In Idaho, Louisiana, Texas and Wisconsin, income from separate property is generally treated as community income unless a written agreement specifically identifies the property and income as separate.

The Tax Commission has published a brochure that covers the basics of how community property laws affect tax law. [Publication 175, Community Property](#), can be found on the Tax Commission's website.

The IRS also has a guide for community property. [Publication 555](#) can be found on irs.gov.

## **2305 IDAHO RESIDENT INCOME TAX RETURNS**

### **Married filing jointly**

If both spouses are domiciled in Idaho and filing a joint return, all income is taxable in Idaho.

### **Married filing separately**

If both spouses are domiciled in Idaho and filing separate returns, first identify if the requirements of [IRC section 66](#) apply. If they do, certain community income

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items are treated as separate income. If they don't, all income is community income.

Earned Income

One-half of community income is attributed to each spouse, as stipulated by Idaho community property law. Community income is net, not gross, therefore, expenses incurred to earn or produce community income is applied against such income. Expenses incurred to earn or produce separate income are deductible by the spouse owning that income if paid by that spouse from separate funds. Most income in Idaho will be community income.

Unearned Income

Special rules apply to different types of unearned income. On SharePoint under issue analysis, the document [Idaho Source Income - Community Property](#) discusses how unearned income is treated for community property purposes.

Deductions

Personal expenses deductible in computing adjusted gross income, such as moving costs, and itemized deductions are divided equally if paid from community funds, and deducted by the spouse who paid them if paid from separate funds. Idaho additions and subtractions are also equally divided if derived from or paid for out of community property funds.

Personal Exemptions and Dependents

Each spouse claims his or her own exemption.

The exemption for a dependent cannot be divided between the two spouses. Each individual dependent supported with community funds may be claimed on only one spouse's return. If there are multiple dependents, the number of dependents claimed by each spouse does not have to be evenly divided. The couple determines which spouse may claim the dependent(s).

**2310 SPLIT DOMICILE**

When one spouse is domiciled in Idaho and the other spouse is domiciled in another state, it can be difficult to determine Idaho taxable income. The taxpayer's state of domicile governs the application of community property laws. See the [Community Property Worksheet](#).

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**Marital discord – Idaho and Washington split domicile**

When one spouse is domiciled in Idaho and one is domiciled in Washington, the auditor must determine whether "marital discord" or a "defunct" marriage as defined by [Revised Code of Washington Section 26.16.140](#) exists.

Mere physical separation does not dissolve the community. However, the fact that there is no legal separation or divorce does not preclude marital discord. The following items support separation as the result of marital discord:

- The available facts show that the marriage was over.
- Individuals were separated and living apart for 11 months or more.
- Spouses no longer contribute to the support of each other.
- Neither asserted a claim to property accumulated by the other.
- Each managed their business and affairs separately.
- Substantial distance existed between the two spouses with little contact.
- Statements from friends and family attested that it was fairly clear that the marriage was over.

Reconciliation in later years does not preclude marital discord separation in prior periods.

If marital discord exists:

The Idaho resident spouse will treat his/her earned income as community income, while the Washington resident spouse will treat his/her earned income as separate income.

Example 1: A husband lives and works in Idaho, his wife lives and works in Washington, and marital discord exists. The income earned by the spouse living in Idaho is attributed one-half to the husband and one-half to the wife. The income earned by the wife residing in Washington is attributed solely to her. Furthermore, under Idaho Code section 63-3026A and Income Tax Administrative Rule 270, compensation for services performed in Idaho is Idaho source income. As a result, the nonresident wife will be required to report her share of her husband's compensation to Idaho as Idaho source income received by a nonresident individual. The husband, as a resident of Idaho, is also required to report his share of the community income to Idaho. In the aggregate, 100% of the earned income of the husband is reported to Idaho, while none of the earned income of the wife is reported to Idaho.

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Example 2: Assume the same facts as in Example 1 except both spouses work in Washington. The income of the husband domiciled in Idaho is attributed one-half to each spouse. The income earned by the wife domiciled in Washington is attributed solely to her. Since all income is from Washington sources, only the husband's share of his wages is taxable in Idaho. The wife's share of his wages is not taxable in Idaho because it is not Idaho source income. In the aggregate, only 50% of the husband's income is taxable in Idaho.

If no marital discord:

Both the Idaho resident spouse and the Washington resident spouse will treat their earned income as community income. The spouse residing in Idaho must report one-half of his earned income plus one-half of his wife's earned income to Idaho, and the spouse residing in Washington must report one-half of her husband's Idaho source earned income to Idaho.

Example 3: Same facts as in Example 1 except the separation is not due to marital discord. All income is community income. The resident husband is taxable in Idaho on one-half of all income regardless of source. The nonresident wife is taxable in Idaho on only her half of the income from Idaho sources. In the aggregate, 100% of the husband's income (all Idaho source) plus 50% of the wife's income (Washington source income attributed to the husband) is taxable in Idaho.

Example 4: Same facts as in Example 2, except the separation is not due to marital discord. All income is community income. In the aggregate, 50% of the husband's income (all Washington source income) plus 50% of the wife's income (Washington source income attributed to the husband) is taxable in Idaho.

**2315 GUIDELINES FOR ATTRIBUTION OF INCOME**

**A. Both spouses domiciled in Idaho, filing a joint return:**

No special problems: all income is taxable in Idaho.

**B. Both spouses domiciled in Idaho, filing separate returns:**

(a) Total all community income; attribute 50% to each spouse.

(b) Identify each spouse's separate income, attribute to the appropriate spouse.



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**C. Both spouses domiciled in Idaho, meeting the requirements of IRC section 66, and filing separate returns:**

- (a) Identify all items of community income qualifying for treatment as separate income under section 66, and attribute to the appropriate spouse.
- (b) Divide remaining community income items equally between the spouses.
- (c) Identify each spouse's separate income, attribute to the appropriate spouse.

**D. Both spouses domiciled in Idaho, divorced during taxable year:**

- (a) Total all community income up to date of divorce; attribute 50% to each spouse.
- (b) Total each spouse's separate income up to date of divorce, attribute to the appropriate spouse.
- (c) Attribute all income received by each spouse for the balance of the year to the spouse receiving it.

**E. One spouse domiciled in Idaho, the other domiciled in another state, filing a joint return:**

Add the following items to arrive at Idaho AGI:

- (a) Idaho spouse's one-half of all community income from all sources (including community income of the out-of-state spouse if domiciled in a community property state).
- (b) Idaho spouse's separate income.
- (c) That portion of the out-of-state spouse's half of community income that is derived from Idaho sources.\*
- (d) That portion of the out-of-state spouse's separate income that is derived from Idaho sources.\*

**F. One spouse domiciled in Idaho, the other domiciled in another state, filing separate returns:**

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- (a) Add the following items to arrive at income for the Idaho spouse's separate return:
- (1) One-half of all community income from all sources (including community income received by the out-of-state spouse if domiciled in a community property state).
  - (2) Idaho spouse's separate income.
- (b) Add the following items to arrive at Idaho adjusted gross income for the out-of-state spouse's Idaho nonresident separate return:
- (1) That portion of his/her half of community income that is derived from Idaho sources.\*
  - (2) That portion of his/her separate income that is derived from Idaho sources.\*

\*Nonresidents are taxed on income from Idaho sources under the authority of Idaho Code sections 63-3002 and 63-3026A.

A [Community Property Worksheet](#) can be found on SharePoint under Audit Letters and Templates, then Audit Templates – Intrastate.

**2320 RESPONSIBLE PARTY FOR TAX PAYMENT**

Either or both spouses who file a joint return are liable for the tax due on that return. Idaho Code section 63-3031(b)(3) states, in part, "...the liability with respect to the tax shall be joint and several." A court order under a divorce decree that requires the tax be paid by either the husband or wife does not affect the Tax Commission's right to hold both parties liable for the assessment and collection of taxes due on a joint return.

Innocent Spouse: Federal determinations for innocent spouse relief are honored by ISTC regardless of the tax year at issue. See the [Administrative Guideline – Innocent Spouse Relief](#) on Tax Insider.

**2325 DIVORCED TAXPAYERS**

**A. Refunds:**

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Under Idaho law, amounts earned and property acquired after marriage are, as a general rule, community property. Each spouse has an equal interest in all community property (Idaho Code section 32-906).

Where taxpayers have divorced following the filing of a joint return, a question may arise concerning the handling of any refund due on audits or amended returns. In such a case, it should be assumed that each taxpayer has an equal interest in the refund. When it is known that the parties are divorced and have separate residences, each should be notified of the amount of the total refund and informed that they will receive one-half. If either taxpayer has an outstanding tax liability that was incurred after the divorce, one-half of the refund can be applied against the tax liability. The remaining half should be refunded to the taxpayer's ex-spouse.

**B. Deficiencies:**

- (a) Prepare two audit reports showing both spouses names. Then:
  - One report will use the address of one spouse.
  - The other report will use the address of the other spouse.
- (b) All other information on the audit report will be as normally prepared for a joint return. Do not split the amounts.
- (c) At the bottom of the NODD, cc: the opposite spouse of the addressee. This informs each ex-spouse that the other has been issued the NODD.

**2330 APPLICABLE AUTHORITY**

**A. Federal Rules**

Treatment of Community Income Where Spouses Live Apart

IRC section 66(a) states:

If -

- (1) two 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 IRC section 6013 with each other for a taxable year beginning or ending in the calendar year;

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- (3) one or both of such individuals have earned income for the calendar year that 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 any community income of such individuals shall be treated in accordance with the rules provided by IRC section 879(a):

In the case of a married couple... who have community income for the taxable year, such community income shall be treated as follows:

- (1) Earned income (within the meaning of IRC section 911(d)(2)), other than trade or business income and a partner's distributive share of partnership income, shall be treated as the [separate] income of the spouse who rendered the personal services,
- (2) Trade or business income, and a partner's distributive share of partnership income, shall be treated as provided in section 1402(a)(5),
- (3) Community income not described in paragraph (1) or (2) which is derived from separate property of one spouse shall be treated as the income of that spouse, and
- (4) All other such community income shall be treated as provided in the applicable community property law.

Qualified Retirement Plans

Title 4, section 114, United States Code, enacted in 1996 by Public Law 104-95, section 1(a) prohibits a state from taxing the following retirement income of individuals who are not domiciled in that state:

- qualified pension, profit-sharing and stock bonus plans – IRC section 401(a)
- simplified employee pensions – IRC section 408(k)
- employee annuity plans – IRC section 403(a)
- annuity plans of 501(c)(3) organizations or public schools – IRC section 403(b)
- individual retirement accounts – IRC section 408(a)
- individual retirement annuities – IRC section 408(b)
- deferred compensation plans – IRC section 457
- governmental plans – IRC section 414(d)

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- employee contribution pension trusts – IRC section 501(c)(18)
- nonqualified deferred compensation plans – IRC section 3121(v)(2)

Distributions from IRAs

IRC section 408(g) provides that community property laws shall be disregarded for purposes of individual retirement accounts. Accordingly, distributions from IRAs are taxable for federal purposes only to the distributee spouse.

Federal law determines how property is taxed, but state law determines whether, and to what extent, a taxpayer has "property" or "rights to property" subject to taxation ([Aquilino v. United States, 363 U.S. 509, 80 S. Ct. 1277 \(1960\)](#); [Morgan v. Commissioner, 309 U.S. 78 \(1940\)](#); [Internal Revenue Manual Part 25, Chapter 18, Section 1](#)).

**B. Idaho Statutes**

Separate Property of Husband and Wife

Idaho Code section 32-903 defines separate property as “all property of either the husband or the wife owned by him or her before marriage, and that acquired afterward by either gift, bequest, devise or descent, or that which either he or she shall acquire with the proceeds of his or her separate property, by way of moneys or other property.”

Community Property

All other property acquired after marriage by either husband or wife is community property. The income of all property, separate or community, is community property unless the conveyance by which it is acquired provides or both spouses, by written agreement specifically so providing, declare that all or specifically designated property and the income from all or the specifically designated property shall be the separate property of one of the spouse to whom the property belongs. Such property shall be subject to the management of the spouse owing the property and shall not be liable for the debts of the other member of the community (Idaho Code section 32-906(1)).

The exception for conveyances and written agreement between spouses only applies to “income from all or the specifically designated property.” It does not apply to other types of income that are not income from property. For example, wages and other compensation for services are not income from

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property. Such income cannot be treated as separate property even if the spouses agree.

Idaho Source Income

Idaho Code section 63-3026A(1) provides that for nonresident individuals, “the term ‘Idaho taxable income’ includes only those components of Idaho taxable income as computed for a resident which are derived from or related to sources within Idaho.”

- Business Income

Idaho Code section 63-3026A(3)(a)(i) provides that Idaho-source income includes income derived from “any business, trade, profession or occupation conducted or carried on in this state, including the distributive share of partnership income and deductions, and the pro rata share of S corporation income and deductions.” Partnership income is sourced to Idaho based upon the Idaho apportionment factor of the partnership. Certain guaranteed payments are excluded from the Idaho apportionment factor.

- Gains

Idaho source income includes income derived from:

- the ownership or disposition of any interest in real or tangible personal property located in Idaho – 63-3026A(3)(a)(ii)
- the ownership or disposition of any interest in intangible personal property employed in any Idaho business, trade, profession or occupation – 63-3026A(3)(a)(iii)
- the conduct of pari-mutuel wagering, charitable gaming or any other form of gambling taking place within this state, except as expressly limited in Idaho Code section 67-7439 – 63-3026A(3)(a)(vi)
- gains or losses realized from the sale or other disposition of a partnership interest or stock in an S corporation – 63-3026A(3)(a)(vii)

- Trust Income

A nonresident is taxable on income from a resident trust only to the extent the income would be Idaho source income if such income had been received directly by a nonresident individual (Idaho Code section 63-3026A(3)(iv)).

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Idaho Code section 63-3026A(3)(v) provides that a nonresident is taxable on income from a nonresident trust only to the extent the income and deductions of the trust were derived from or related to sources within Idaho.

**C. Idaho Case Law**

Property Acquired During Marriage:

A presumption exists that property acquired during marriage is community property, and the party asserting the separate nature of such property has the burden of so proving ([Eliassen v. Fitzgerald, 105 Idaho 234, 668 P 2d 110 \(1983\)](#)). This is true even if the husband and wife are separated and living apart ([Suter v. Suter, 97 Idaho 461, 546 P 2d 1169 \(1976\)](#); [Bliss v. Bliss, 898 P 2d 1081, 127 Idaho 170 \(1995\)](#)). This presumption may be overcome with sufficient evidence ([Maslen v. Maslen, 822 P 2d 982, 121 Idaho 85 \(1991\)](#)).

Commingled Property:

When separate and community property is commingled so that tracing is impossible, it is presumed to be community property, and the burden of proof is on the person asserting the separate character of the property ([Martsch v. Martsch, 103 Idaho 142, 645 P 2d 882 \(1982\)](#)).

Salaries, Rents and Profits:

The gross amounts of all salaries are community property, but only the net proceeds of rents and profits are community property ([Martsch v. Martsch, 103 Idaho 142, 645 P 2d 882 \(1982\)](#); [Weilmunster v. Weilmunster, 858 P 2d 766, 124 Idaho 227, \(1993\)](#)).

Increase in Value of Separate Property:

The natural increase in value of a spouse's separate property during the marriage generally is not community property. However, when community efforts or funds enhance the value of separate property, such enhancement is community property ([Suter v. Suter, 97 Idaho 261, 546 P 2d 1169 \(1976\)](#); [Gapsch v. Gapsch, 76 Idaho 44, 277 P 2d 278 \(1954\)](#)).

**D. Community Property Rules for Other States**

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Arizona

[Arizona Revised Statute 25-211](#)

- A. All property acquired by either husband or wife during the marriage is the community property of the husband and wife except for property that is:
- (1) Acquired by gift, devise or descent.
  - (2) Acquired after service of a petition for dissolution of marriage, legal separation or annulment if the petition results in a decree of dissolution of marriage, legal separation or annulment.
- B. Notwithstanding subsection A, paragraph 2, service of a petition for dissolution of marriage, legal separation or annulment does not:
- (1) Alter the status of preexisting community property.
  - (2) Change the status of community property used to acquire new property or the status of that new property as community property.
  - (3) Alter the duties and rights of either spouse with respect to the management of community property except as prescribed pursuant to section 25-315, subsection A, paragraph 1, subdivision (a).

California

[California Family Code 7.2581](#)

For the purpose of division of property on dissolution of marriage or legal separation of the parties, property acquired by the parties during marriage in joint form, including property held in tenancy in common, joint tenancy, or tenancy by the entirety, or as community property, is presumed to be community property. This presumption is a presumption affecting the burden of proof and may be rebutted by either of the following:

- (a) A clear statement in the deed or other documentary evidence of title by which the property is acquired that the property is separate property and not community property.
- (b) Proof that the parties have made a written agreement that the property is separate property.

Louisiana

[Louisiana Civil Code \(LCC\) Article 2338](#)



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The community property comprises: property acquired during the existence of the legal regime through the effort, skill, or industry of either spouse; property acquired with community things or with community and separate things, unless classified as separate property under [LCC Article 2341](#); property donated to the spouses jointly; natural and civil fruits of community property; damages awarded for loss or injury to a thing belonging to the community; and all other property not classified by law as separate property.

[LCC Article 2341](#) “The separate property of a spouse is his exclusively. It comprises: property acquired by a spouse prior to the establishment of a community property regime; property acquired by a spouse with separate things or with separate and community things when the value of the community things is inconsequential in comparison with the value of the separate things used; property acquired by a spouse by inheritance or donation to him individually; damages awarded to a spouse in an action for breach of contract against the other spouse or for the loss sustained as a result of fraud or bad faith in the management of community property by the other spouse; damages or other indemnity awarded to a spouse in connection with the management of his separate property; and things acquired by a spouse as a result of a voluntary partition of the community during the existence of a community property regime.

Nevada

[Nevada Revised Statute \(NRS\) 123.220](#)

All property, other than that stated in [NRS 123.130](#), acquired after marriage by either husband or wife, or both, is community property unless otherwise provided by:

- (1) An agreement in writing between the spouses.
- (2) A decree of separate maintenance issued by a court of competent jurisdiction [NRS 123.190](#).
- (3) A decree issued or agreement in writing entered pursuant to [NRS 123.259](#).

New Mexico

[New Mexico Statute 40-3-12\(A\)](#) (You must enter the specific statute into the search engine.)

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Property acquired during marriage by either husband or wife, or both, is presumed to be community property.

Texas

[Texas Family Code \(TFC\) section 3.001 \(1997\)](#)

A spouse's separate property consists of:

- (1) the property owned or claimed by the spouse before marriage;
- (2) the property acquired by the spouse during marriage by gift, devise, or descent; and
- (3) the recovery for personal injuries sustained by the spouse during marriage, except any recovery for loss of earning capacity during marriage.

[TFC section 3.002 \(1997\)](#)

Community property consists of the property, other than separate property, acquired by either spouse during marriage.

[TFC section 3.003 \(1997\)](#)

(a) Property possessed by either spouse during or on dissolution of marriage is presumed to be community property. (b) The degree of proof necessary to establish that property is separate property is clear and convincing evidence.

Washington

[Revised Code of Washington \(RCW\) § 26.16.030](#)

Washington community property law provides that income earned through the labor of a spouse is presumed to be community income ([RCW § 26.16.030](#)). "Earnings arising from services performed during marriage are community property" ([Matter of Marriage of Hurd, 848 P 2d 185, 69 Wn. App. 38 \(1993\)](#)). However, the Washington community property laws provide an exception to this general principle where the husband and wife are living separate and apart even though they are not legally divorced. Specifically, [RCW § 26.16.140](#) provides that "when a husband and wife are living separate and apart, their respective earnings and accumulations shall be the separate property of each." Thus, under Washington law, earnings of a spouse are community property except where the spouses

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are separated and living apart, in which case each spouse's earnings are treated as his or her separate property.

Washington Courts have consistently held that in order for [RCW § 26.16.140](#) to apply, the married couple must be living separate and apart as a result of marital discord. The fact that the couple is living apart is not, by itself, sufficient to give rise to separate property treatment. For example, in [Aetna Life Ins. Co. v. Bunt, 754 P 2d 993, 110 Wn 2d 368 \(1988\)](#), the Washington Supreme Court held that for [RCW § 26.16.140](#) to apply the marriage must be, for all practical purposes, "defunct." Likewise, in [Oil Heat Co. of Port Angeles, Inc. v. Sweeney, 613 P 2d 169, 26 Wn App. 351 \(1980\)](#), the Washington Court of Appeals held that the mere physical separation of the husband and wife does not establish that they are living "separate and apart" to the degree necessary to negate the existence of the community. Finally, in [Seizer v. Sessions, 940 P 2d 261, 132 WA 2d 642 \(1997\)](#), the Washington Supreme Court emphasized that the "separate and apart" requirement of [RCW § 26.16.140](#) "contemplates permanent separation of the parties - a defunct marriage." Thus, the separate property treatment of [RCW § 26.16.140](#) should not be presumed simply because the couple is residing in different states. Instead, the party seeking to employ that code provision has the burden of proving that the marriage is, for all practical purposes, defunct.

Wisconsin

[Wisconsin Statute 766.31](#)

- (1) All property of spouses is marital property except that which is classified otherwise.
- (2) Presumption. All property of spouses is presumed to be marital property.
- (3) Subject to subsequent terms in the statutes, each spouse has a present undivided one-half interest in each item of marital property.

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**2700 INTRODUCTION**

This section covers nonrefundable and refundable credits. A nonrefundable credit can only reduce the tax liability. A nonrefundable credit not absorbed by the tax liability is lost unless the statute authorizing the credit includes a carryover provision.

Generally, an adjustment to Idaho taxable income creates a corresponding adjustment to Idaho credits. Generally, because of the priority of credits, an adjustment to one credit creates a corresponding adjustment to other credits.

Adjustments to the amount of a credit earned are determined pursuant to the law applicable to the taxable year in which the credit was earned.

Adjustments to the amount of a credit earned may be made even though the taxable year in which the credit was earned is closed due to the statute of limitations. Such adjustments to the earned credit shall also apply to any taxable years to which the credit was carried over.

If the taxable year in which the credit was earned or carried over to is closed due to the statute of limitations, any adjustments to the credit earned shall not result in any tax due or refund for the closed taxable years. However, the adjustments may result in tax due or a refund in a carryover year if the carryover year is open to the statute of limitations.

Whenever an adjustment to Idaho taxable income is made, the Idaho credits may need to be adjusted.

**2705 IDAHO NONREFUNDABLE TAX CREDITS**

Idaho nonrefundable tax credits include:

- Credit for taxes paid to other states as authorized by Idaho Code section 63-3029 (discussed in ITA Audit Manual 8600)
- For residents and part-year residents only, the grocery credit as authorized by Idaho Code section 63-3024A
- Credit for contributions to Idaho educational institutions as authorized by Idaho Code section 63-3029A
- Investment tax credit as authorized by Idaho Code section 63-3029B (discussed in ITA Audit Manual 8900)
- Credit for contributions to Idaho youth facilities, rehabilitation facilities, and nonprofit substance abuse centers as authorized by Idaho Code section 63-3029C

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- Credit for equipment using post-consumer waste or post-industrial waste as authorized by Idaho Code section 63-3029D
- Promoter-sponsored event credit as authorized by Idaho Code section 63-3620C
- Credit for qualifying new employees as authorized by Idaho Code sections 63-3029EE and 63-3029F
- Credit for Idaho research activities as authorized by Idaho Code section 63-3029G
- Broadband equipment investment credit as authorized by Idaho Code section 63-3029I
- Incentive investment tax credit as authorized by Idaho Code section 63-3029J
- Small employer investment tax credit as authorized by Idaho Code section 63-4403
- Small employer real property improvement tax credit as authorized by Idaho Code section 63-4404
- Small employer new jobs tax credit as authorized by Idaho Code section 63-4405
- Credit for live organ donation expenses as authorized by Idaho Code section 63-3029K
- Biofuel infrastructure investment tax credit as authorized by Idaho Code section 63-3029M

Idaho nonrefundable credits, per Idaho Code section 63-3029P, are applied to the tax liability before refundable credits in the order in which the statutes authorizing the credits were enacted. A prioritized list of the credits and the relevant code sections can be found in Idaho Income Tax Administrative Rule 799 or at CheatSplit on the ITA SharePoint work group site.

**CREDITS & EXPIRATION DATES**

Credit	Form #	Expiration Date	Carryover
Biofuel	71	12/31/2011	5 years
Broadband	68		14 years
Hire One	72	12/31/2013	No C/O
Research	67		14 years
Incentive ITC	69	12/31/2001	14 years
Investment Tax Credit	49, 49C, 49R		14* years
Small Employer New Jobs	85	12/31/2030	10 years
Qualifying New Employees	55	12/31/2013	5
Small Employer ITC	83	12/31/2030	14 years

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Small Employer Real Property	84	12/31/2030 14 years

- \*See Cheat Split

**2710 CREDIT FOR CONTRIBUTIONS TO IDAHO EDUCATIONAL INSTITUTIONS**

Idaho Code section 63-3029A allows a credit for Idaho for contributions to Idaho educational entities.

**Limitations – Prior to 2011:**

- Contributions must be made in cash or in kind during the taxable year the credit is claimed
- The credit is 50% of the amount contributed limited to the lesser of:
  - 50% of the individuals income tax liability
  - \$100 if filing other than a joint return or \$200 if filing a joint return.
- Must be made to an Idaho educational entity

**Limitations – 2011 and later:**

- Noncash donations no longer qualify
- The credit is 50% of the amount contributed limited to the lesser of:
  - 50% of the individuals income tax liability; or
  - \$500 for person filing single, or \$1,000 for a couple filing jointly
  - Corporations, credit limited to the lesser of:
    - 10% total income or franchise tax under Idaho Code section 63-3025 and 63-3025A, or
    - \$5000
- Must be made to an Idaho educational entity

**Potential Audit Issues:**

- Credit claimed for donations of goods (after 2010)
- Lack of substantiation
- Donations to non-qualifying entities
- The 50% limitation not being applied
- Contribution to athletic association for **rights** to purchase tickets up to 80% of amount paid
- Taxpayers claiming the credit for tuition, room and board, student fees, admission fees and similar charges that are not contributions

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- The amount shown on the Idaho K-1 is the amount eligible for the credit, not the credit amount. The credit amount is calculated on Form 39R or 39NR.

**Audit Techniques:**

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

1. *Substantiation audit*

Generally, the taxpayers must provide donation receipts and indication of value for adequate substantiation. Substantiation is required regardless of the dollar value of the contribution. We require documentation of the amount donated.

2.

3. *80% deductible donations for tax years beginning before January 1, 2018*

Under IRC section 170(l), 80% of an amount paid to or for the benefit of an institution of higher education to receive the right to purchase tickets for seating not available to the general public is allowed as a charitable contribution.

- The 50% AGI limitation is applied to the eligible 80%
- The 80% amount is subject to the Idaho credit limitations above

One example would be contributions to the Bronco Athletic Association, which gives you the right to purchase certain tickets.

4. *Qualifying entities*

For a museum to qualify as an educational entity, the public or private nonprofit institution must be organized for the purpose of collecting, preserving, and displaying objects of aesthetic, educational, or scientific value and must be open to the general public on a regular basis (Idaho Code section 63-3029A). the entity must be operated exclusively for the benefit of institutions of learning located in the state of Idaho.

**2715 CREDIT FOR CONTRIBUTIONS TO IDAHO YOUTH & REHAB FACILITIES**

Idaho Code section 63-3029C allows a credit for contributions to Idaho youth facilities, rehabilitation facilities, and nonprofit substance abuse centers.

**Limitations:**

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- Contributions must be made in cash or in kind during the taxable year the credit is claimed
- The credit is 50% of the amount contributed limited to the lesser of:
  - 20% of the individual's income tax liability; or
  - \$100 for person filing single, or \$200 for a couple filing jointly
  - Corporations, credit limited to the lesser of:
    - 10% of total income or franchise tax under Idaho Code section 63-3025 and 63-3025A, or
    - \$500
- Must be made to a qualifying Idaho facility listed in the statute

**Potential Audit Issues:**

- Lack of substantiation
- Non-qualifying entity
- 50% limitation not applied
- The amount shown on the Idaho K-1 is the amount eligible for the credit, not the credit amount. The credit amount is calculated on Form 39R or 39NR.

**Audit Techniques**

1. *Lack of substantiation*

Generally, the taxpayers must provide donation receipts and indication of value for adequate substantiation. Substantiation is required regardless of the dollar value of the contribution. Higher value donations have higher substantiation requirements under IRC section 170 and related Treasury regulations.

Here are some links to donation value guides:

The Salvation Army

<http://satruck.org/donation-value-guide>

Goodwill

[http://www.goodwill.org/wp-](http://www.goodwill.org/wp-content/uploads/2010/12/Donation_Valuation_Guide.pdf)

[content/uploads/2010/12/Donation\\_Valuation\\_Guide.pdf](http://www.goodwill.org/wp-content/uploads/2010/12/Donation_Valuation_Guide.pdf)

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

2.

3. *50% Limitation* – see dollar amount limitations above.



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**2720 CREDIT FOR MAINTAINING A HOME FOR A FAMILY MEMBER AGE 65 OR OLDER OR A FAMILY MEMBER WITH A DEVELOPMENTAL DISABILITY**

Idaho Code section 63-3025D allows a resident individual who maintains a household for a family member who is age 65 or older or developmentally disabled to claim a \$100 refundable credit in lieu of the deduction from taxable income allowed by Idaho Code section 63-3022E.

**Potential Audit Issues**

- Taxpayers must provide more than half the support for maintaining the household for the qualifying person
- No more than three qualifying persons may be claimed on one return
- Cannot take both the \$1,000 deduction for maintaining a home for aged and/ or developmentally disabled and this credit
- Taxpayers **may not** claim themselves for the age 65 and older credit
- Taxpayers **may** claim a family member, including themselves and their spouses for the developmentally disabled credit
- Prorate the allowable credit if the taxpayer maintained a home for the qualifying individual(s) for less than a full year

**Audit Techniques**

1. Qualifying person

Check the information provided on the qualifying person listed on the return.

Sometimes the taxpayer will check the box for age 65 or older, and will list themselves or their spouse in the qualifying person's column.

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

**2725 CREDIT FOR PRODUCTION EQUIPMENT USING POST-CONSUMER WASTE**

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

Idaho Code section 63-3029D allows a credit for qualified equipment utilizing post-consumer waste or post-industrial waste. When enacted, the legislation specifically targeted a plastics company to enable them to buy specific qualified equipment. The legislation is so narrowly defined that it limits the taxpayers who qualify for the credit (Docket No. 11665).

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### Qualified Equipment

"Qualified equipment" means machinery or equipment located in Idaho that has an estimated useful life of at least three years and of which at least 90% of the total production thereof is used by the taxpayer to manufacture products utilizing post-consumer waste or post-industrial waste.

"Qualified equipment" does not include any machinery or equipment that is used for the collection of post-consumer waste or post-industrial waste.

### Collection

"Collection" means:

- The acquisition of materials from businesses or the general public through purchase or donation, including the organization of systems for such acquisitions
- The preparation of materials for over-the-road transportation through cleaning, densification by shredding, baling, or any other method, or coalescence, including the organization of systems for such preparation
- The transportation of post-consumer waste or post-industrial waste between separate geographical locations

### Post-consumer Waste

"Post-consumer waste" or "post-industrial waste" means only those products and materials consisting of paper, glass or plastic generated by businesses or consumers that have served their intended end use or usefulness and either have been or would normally be disposed of as solid waste except for the fact that they are separated from solid waste for purposes of collection, recycling or reuse. "Post-consumer waste" or "post-industrial waste" does not include radioactive waste, as defined in Idaho Code section 63-3029D, or hazardous waste, as defined in chapter 44, title 39, Idaho Code.

### Potential Audit Issues:

- Substantiation. The taxpayer didn't include a schedule showing the computations, listing the qualified equipment, identifying the post-consumer or post-industrial waste products, nor identifying the newly manufactured products as requested in the instructions.
- Non-qualifying equipment. The taxpayer is claiming the credit for machinery or equipment that is used for the collection of post-consumer waste or post-industrial waste.

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- Non "post-consumer waste" or "post-industrial waste." The taxpayer is claiming the credit for waste and products not defined by the code.
- The property is not located in Idaho.

**References:**

For more information see Docket No. 11665. **2730**

**PROMOTER-SPONSORED EVENT CREDIT**

If a taxpayer issued temporary sales tax permits to participants of a promoter-sponsored event on behalf of the Tax Commission, the taxpayer may claim a \$1 credit for each temporary permit issued during the tax year as allowed by Idaho Code section 63-3620C. Promoter-sponsored events include swap meets, flea markets, gun shows, and fairs.

If the taxpayer organizes an event where two or more retailers sell or exchange their products and any related services, the taxpayer is considered a "promoter" and the event is considered a "promoter-sponsored event."

The taxpayer must have filed Forms ST-124 with the Tax Commission to qualify for the credit.

**Audit Techniques:**

The promoter claiming the credit should have an active, unpermitted, temporary or closed sales tax account. In general, the account should contain information to help determine if the taxpayer is entitled to the credit (Form ST-124, compliance notes, and letters).

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

For more information see the following:

- Promoter-Sponsored Events - <https://tax.idaho.gov/i-1037.cfm>
- ISTC Publication 463 - [http://tax.idaho.gov/pubs/EBR00643\\_10-24-2014.pdf](http://tax.idaho.gov/pubs/EBR00643_10-24-2014.pdf)

**2735 CREDIT FOR QUALIFYING NEW EMPLOYEES**

Idaho Code sections 63-3029E, 63-3029F, and 63-3029EE allow a credit for qualifying new employees.

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The credit has been created, repealed, reinstated with modifications, specialized, and changes rescinded since its first introduction in the “Job Expansion Act of 1982.” The most recent version of the credit was known as the Hire One Act Credit. The credit allowed by the Hire One Act was only allowed to be earned in tax years beginning in 2011 through 2013.

Form 55 was used to calculate the credit for “qualifying new employees”. Form 72 was used to calculate the credit for the “Idaho Hire One Act Credit.”

**References:**

For more information see the following:

- Hire One Act Credit PowerPoint
- Hire One Act Credit training handout
- Idaho New Jobs Tax Credit PowerPoint

**2740 CREDIT FOR IDAHO RESEARCH ACTIVITIES**

Idaho Code section 63-3029G allows a credit for Idaho research activities. The credit is earned by increasing research activities in Idaho. The credit is based on IRC section 41. Form 67 is used to calculate the credit.

**References:**

For more information see the following:

- Research Credit Claims Audit Techniques Guide
- Idaho Research Credit PowerPoint

**2745 BROADBAND EQUIPMENT INVESTMENT CREDIT**

Idaho Code section 63-3029I allows a credit for qualifying broadband infrastructure in Idaho. Form 68 is used to calculate the broadband equipment investment credit earned or allowed.

Taxpayers must obtain an order from the Idaho Public Utilities Commission (PUC) confirming that the installed equipment is qualified broadband equipment. The PUC provides the ISTC with a copy of the order. These forms are now attached in GenTax under the customer level.

**Credit Transfer**

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Idaho Code section 63-3029I allows unused broadband equipment investment credits to be transferred to another taxpayer or an intermediary. Form 70, Idaho Statement of Credit Transfer, notifies the ISTC of this intent to transfer credits. Based on return information, ITA verifies the tax credit and the number of carry forward years available for transfer.

We still have the right to examine the transferor's books and records to verify the correctness of the credit claimed. Form 70 is attached in GenTax under the account level under both the transferor and transferee.

**References:**

For more information see the following:

- Broadband Credit Transfer – Legal Opinion
- MTA Manual Section 2300

**2750 INCENTIVE INVESTMENT TAX CREDIT**

Idaho Code section 63-3029J allowed a credit to be earned on qualified investments in Idaho that were placed in service in tax years beginning in 2001 only. Although the credit can no longer be earned, it may be carried over from 2001 for 14 years or transferred to another taxpayer. Credit received through a transfer may be carried forward only for the time that would have been allowed to the transferor had the credit not been transferred. 2015 is the last year that any remaining credit can be claimed. Form 69 is used to calculate the incentive ITC allowed.

**References:**

- For more information see ITA Audit Manual 8900.

**2755 SMALL EMPLOYER INCENTIVE ACT**

In general, the small employer tax incentive criteria are the minimum requirements a taxpayer must meet in order to be eligible for small employer tax incentives. To meet the small employer tax incentive criteria, a taxpayer must satisfy the following requirements at the project site, during the project period:

1. Capital investment in new plant and building facilities of at least \$500,000,
2. Increased employment by at least 10 new employees who each earn at least \$19.23 per hour and receive health benefits

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3. For new employment increases above the 10 new employees, the average wages of the additional new employees are at least \$15.50 per hour worked. See the instructions for who is included in this calculation.

A taxpayer shall certify that he has met, or will meet, the small employer tax incentive criteria before he can claim any of the small employer tax incentives. Certification shall be accomplished by filing the applicable form (Form 89SE) as prescribed by the Tax Commission.

**2760 SMALL EMPLOYER INVESTMENT TAX CREDIT**

Idaho Code section 63-4403 allows a small employer investment tax credit (SE-ITC) for property that qualifies for the 3.75% investment tax credit. Form 83 is used to calculate the Idaho SE-ITC.

Qualifying property for SE-ITC is identical as regular ITC under Idaho Code Section 63-3029B, since SE-ITC also uses IRC sections 46 and 48. See Audit Manual Section 8900.

Limitations:

- Cannot claim SE-ITC if the taxpayer claimed the personal property tax exemption on the property
- Can't take regular ITC and SE-ITC on the same property
- SE-ITC is also subject to recapture on Form 83R

**2765 SMALL EMPLOYER REAL PROPERTY IMPROVEMENT TAX CREDIT**

Idaho Code section 63-4403 allows a small employer real property improvement tax credit. Form 84 is used to calculate the credit.

**2770 SMALL EMPLOYER NEW JOBS TAX CREDIT**

Idaho Code section 63-4405 allows a small employer new jobs tax credit. Form 85 is used to calculate the credit.

**2775 CREDIT FOR LIVE ORGAN DONATION**

Idaho Code section 63-3029K allows a credit for live organ donation.

Limitations:

**The credit cannot exceed the taxpayer's tax liability and the lessor of:**

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- The amount of the live organ donation expenses paid by the taxpayer during the taxable year, or
- \$5,000

**Qualifying Live Organ Donation:**

A live organ donation means a donation by a living individual who donates the following for transplanting in another individual:

- Human bone marrow
- Intestine
- Kidney
- Liver
- Lung
- Pancreas

**Qualifying Medical Expenses:**

- For the procedure including travel expenses under IRC § 213 are allowable for this deduction.

**2780 BIOFUEL INFRASTRUCTURE INVESTMENT TAX CREDIT**

Idaho Code section 63-3029M allows a credit for investment in biofuel infrastructure. The credit is calculated on Form 71.

**2785 REIMBURSEMENT INCENTIVE ACT CREDIT**

Idaho Code section 67-4737 provides for the “Idaho Reimbursement Incentive Act.” This act allows a refundable tax credit for business expansions and job creation. In order to claim the credit, the tax return should include a copy of a certificate received by the taxpayer from the Department of Commerce. ITA’s responsibility in regards to this credit is to verify a copy of a valid certificate was received. The Department of Commerce is responsible for auditing the validity of the credit.

**References:**

For more information see the following:

- [28.04.01 - Rules Governing The Idaho Reimbursement Incentive Act \(2015\)](#)

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- [Idaho Department of Commerce Website – Tax Reimbursement Incentive](#)



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DECEASED SPOUSE

SEC 3100

### **3105 PROCEDURES RELATING TO INITIAL CONTACT**

When initial contact must be made regarding a year in which a joint return was filed and one of the spouses has subsequently died, take the following steps:

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

- [S]ee if the deceased individual has a valid power of attorney (POA) form on file.
- If the attorney-in-fact (AIF) for their individual income tax account isn't the spouse on the joint return you're reviewing, send the initial letter to the surviving spouse and one to the AIF for the deceased spouse. Use the "Desk Audit Initial Letter" template.
- If the POA, will, or other testamentary document is attached and appoints the surviving spouse as the representative for the deceased spouse, send the initial letter to the surviving spouse. Use the "Desk Audit Initial Letter" template.
- If there is no AIF for the deceased spouse, send the initial letter to the surviving spouse.
- For more information on POAs, see Income Tax Audit Manual Section 15600 – Power of Attorney.

### **3110 PROCEDURES RELATING TO SUBSEQUENT ADJUSTMENTS**

When any change is made to a year in which a joint return was filed and one of the spouses has subsequently died, take the following steps in addressing the audit report:

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

1.

If GenTax doesn't show a deceased date, do the following:

- If a return hasn't been filed for the year the spouse died, no immediate action in GenTax is required. ARM will update GenTax when that return is filed.
- If the spouse died in a prior year and the return for that period has been filed but GenTax doesn't show them as deceased, notify ARM of their account number, name, and date of death. (You can find an individual's

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DECEASED SPOUSE

SEC 3100

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date of death by searching the social security death index found on websites like [ancestry.com](http://ancestry.com))

2. Include both spouses on the audit report and indicate who is deceased, e.g., John and Jane (Decd) Jones.
3. Include both account numbers on the audit report. Any correspondence, refund checks, forms, etc., will be issued to the surviving spouse when GenTax has been updated for a deceased taxpayer.

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DISCLOSURE

SEC 3600

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Disclosure, whether intentional or unintentional, is the act of revealing confidential or proprietary information to another individual. Understanding when you're authorized to disclose information is essential.

### **3605 CONFIDENTIAL INFORMATION**

Auditors have access to a myriad of confidential information, including FTI received from the IRS. That access comes with a legal and ethical duty to the public to safeguard the information. Unauthorized disclosure of tax information can result in a potential jail sentence, fine, or both. Lesser consequences, including dismissal, are also possible.

### **3610 PROPRIETARY INFORMATION**

Proprietary information is defined as information owned and/or developed by a company or government agency that must not be disclosed to unauthorized persons. Examples of proprietary information include:

- Information that impairs the assessment, enforcement, or collection of tax, e.g., audit selection process
- Hardware and software configuration information

### **3615 FEDERAL TAX INFORMATION (FTI)**

The ISTC, through an exchange of information agreement with the IRS, has access to FTI. Information can be received from our government liaison, support staff, or found in the GenTax warehouse. For information on the type of information that is available, how to request copies, and safeguarding procedures, see section 5300.

Disclosure of FTI to a taxpayer or their representative is allowed **only** if the information has been used as a basis for an NODD. **Don't reveal FTI that isn't related to your audit deficiency!** Inadvertent disclosures could jeopardize our agreements with federal agencies.

### **3620 AUTHORIZED DISCLOSURE**

Limited confidential information may be disclosed to others only if allowed by Idaho Code. The following is a list of those entitled to specific, limited information.

- Individual taxpayers
- Flow-through entities

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- Attorney-in-fact authorized by a valid POA
- ISTC employees with a need to know
- Authorized designees of entities with whom the ISTC has a current exchange agreement

### **A. Individual taxpayers**

Each taxpayer has the right to information relating to how their tax liability was determined.

- Married Filing Separate

If a couple is using a filing status of married filing separate, disclosure of one spouse's tax return information to the other spouse isn't permitted, even if one or both reside in a community property state.

- Divorced Taxpayers

You can disclose information pertaining to a tax return to either former spouse for any year they filed a joint return.

### **B. Flow-through entities**

Taxpayers with an ownership interest in a flow-through entity have the right to know the basis of the audit changes to that entity, but not to information on how those entity-level changes affect other investors.

- Partnerships

Disclosure of the changes made during an audit and how the determination was made on a partnership return can be made to an authorized employee, the tax matters partner, or an attorney-in-fact.

How the audit affects each individual partner must not be disclosed to partnership employees, partners, or its authorized representative.

- S Corporations

Disclosure of the adjustments made during an audit and how the determination was made on an S corporation return can be made to an authorized employee, a shareholder, or an attorney-in-fact.

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How the audit affects each individual shareholder must not be disclosed to S corporation employees, shareholders, or its authorized representative.

### **C. Attorney-in-fact**

An attorney-in-fact has the same rights as the taxpayer or entity that they are representing. For more information, see section 15600.

### **D. ISTC employees**

It's okay to discuss the specifics of our audits with other auditors in ITA who are seeking our help or providing guidance. In order to provide accurate assistance or advice, your co-worker needs to know enough detail to evaluate the case. However, take care not to talk in areas accessible to the public, such as shared hallways, lunchrooms and public establishments.

Disclosure can happen when you're talking to another employee about a case that doesn't impact your work and/or theirs. Not all ISTC employees have a need to know the particulars of our audits. Casual discussion of your audit with a coworker who isn't working on the audit or seeking or providing advice is unauthorized disclosure.

Examples of authorized disclosure include when an ISTC employee in another bureau has questions regarding the liability arising from an NODD or seeks your input in evaluating an amended or original return and this information is necessary for them to perform their work.

If in doubt ask yourself, "Will providing the details of my case help either of us in the performance of our jobs?"

### **E. Exchange agreements/memorandum of understanding (MOU)**

The ISTC is statutorily authorized to disclose certain information to and enter into written agreements for information exchanges with specified federal, state, and interstate agencies including:

- IRS
- Multistate Tax Commission
- Other states' revenue departments
- Idaho Department of Labor
- Idaho Industrial Commission

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- Idaho Department of Fish and Game
- Idaho State Treasurer
- Duly constituted committee of Idaho legislature

A list of the Idaho code sections authorizing the exchange agreements/MOUs can be found in section 3635. A full list of exchange agreements and MOUs can be found on Tax Insider on the Safety-Security and Facilities page.

The information that can be disclosed varies depending on who the authorized recipient is. Auditors are responsible for determining that the recipient is statutorily authorized to receive the particular information requested before making any disclosure.

Exchange agreements with the IRS and other states allow us to exchange information when there is a tax administration purpose and a legitimate need for the information. Not all employees are authorized to give or receive information. Employees are identified by name in the agreement or in a supplemental letter if they are approved to request and receive information.

MOUs are agreements between the Tax Commission and other Idaho agencies. These agreements, like exchange agreements, allow us to get or provide specific information. Unlike exchange agreements, a list of specific employees authorized under the agreement usually isn't required.

Information we receive from another state or agency may **not** be given to a third party, Idaho or other state's agency, or any other state revenue department. Inadvertent disclosures could jeopardize our agreements. If you have a question as to whether information may be provided to another agency, discuss the issue with your manager **before** providing any information.

### **3625 THIRD-PARTY CONTACTS**

An auditor may examine third-party records when necessary to determine a correct tax liability (Idaho Code section 63-3042). Disclosure shouldn't be made to the taxpayer about information from the third-party that isn't **directly relevant** to the taxpayer's own tax liability.

### **3630 UNAUTHORIZED DISCLOSURE**

There are two types of unauthorized disclosure: intentional and unintentional.

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Any unauthorized disclosure of information, whether intentional or unintentional, **must** be reported to your manager.

### **A. Intentional Unauthorized Disclosure**

Intentional unauthorized disclosure is when you **knowingly** give confidential information to an individual, entity, or agency not authorized to obtain, use, or view the information.

The intentional disclosure of confidential information to someone not authorized to obtain, use, or view the information is a crime.

### **B. Unintentional Unauthorized Disclosure**

Unintentional unauthorized disclosure is usually the result of not paying attention as you are performing your work.

A few examples of unintentional unauthorized disclosure are:

- Discussing a taxpayer's audit with someone other than the taxpayer, their authorized representative, or a coworker who doesn't have a legitimate business purpose.
- Putting a letter in an envelope addressed to the wrong taxpayer.
- Copying a previous version of your schedules/workpapers, explanation, waiver, letter, etc., to use in a current audit and not changing the taxpayer's name and/or account number.
- Emailing or faxing the wrong taxpayer.

Preventing an unintentional unauthorized disclosure is fairly simple - slow down and take the time to double check your work! The following actions can help you avoid unintentional unauthorized disclosures:

- Take the time to verify who you are talking to. Become familiar and use the guidelines the ISTC has published on verifying a taxpayer's identity.
- Make sure the recipient on the letter matches the recipient on the envelope and the headings on all pages.
- We all like to take the shortcut of not "reinventing the wheel" when we already have a schedule, workpaper or explanation for an audit adjustment. But if you are copying work, double and triple check all the places that list the taxpayer's name and verify the account numbers match

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those in GenTax. Do a word search to make sure there aren't any remaining instances of the replaced items.

- Before you hit "send", especially if you aren't replying by accessing an email you received, confirm the email address.
- Before you push "send" on a fax, validate the fax phone number.

### **3635 APPLICABLE AUTHORITY**

#### Penalty for Divulging Information

Any employee who knowingly discloses any tax return or tax information except as provided by statute, rule, or court order is subject to a fine of not less than \$100 and not more than \$5,000 and/or imprisonment for up to five years (Idaho Code section 63-3076(4)).

#### Disclosure of Information

Idaho Code sections:

- 63-3077 (IRS, other states, county assessors)
- 63-3077A (Department of Labor)
- 63-3077B (Industrial Commission)
- 63-3077C (Fish and Game)
- 63-3077E (State Treasurer)
- 63-3077F (victims of identity theft)
- 39-8405 (Attorney General)

Tax Commission Administration and Enforcement rules:

- 700 (information that isn't return information)
- 702 (third parties)
- 703 (general public)
- 704 (government agencies)



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Idaho Code section 63-3002 states that the legislature's intent by adopting the Idaho Income Tax Act is to make Idaho taxable income identical to the taxable income reported to the IRS except for adjustments to income that are specifically provided by Idaho or federal law. When IRS audit adjustments are made to taxable income, these must be accounted for in calculating Idaho taxable income to comply with the legislative intent. We use the Examination Operational Automation Database (EOAD) information to make the IRS audit adjustments that affect the Idaho return.

### **5105 EOAD DISCOVERY & LEADS PROCEDURES**

#### **Discovery - Processing**

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

The ISTC receives EOAD data from the IRS approximately once per month.

### **5110 FEDERAL AUDITS – ADJUSTMENTS THAT MAY BE MADE WHEN A TAX YEAR IS REOPENED**

Idaho Code section 63-3068(f) allows two different types of corrections to be made to an Idaho income tax return when a federal audit has been finalized, assuming the statute of limitations is past.

#### **1. Adjustments**

These are federal audit adjustments to taxable income, which change Idaho taxable income. For example, increases or decreases in the following items are "adjustments":

- Income items
- Gains and losses
- Deductions and exemptions
- Changes in filing status

*Example:* If the amount of a net capital gain reported on the federal return (and therefore the Idaho return) was \$500,000 but was adjusted to \$750,000 as a result of the federal audit, the amount of the gain reported on the Idaho return must be adjusted to \$750,000.

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### **2. Re-computations**

These are math calculations necessary to correctly determine Idaho tax due even though these specific items weren't adjusted by the IRS. Some examples of re-computations include:

- Decreasing the Idaho capital gains deduction when the federal audit reduced the gain on a particular item or reduced net capital gain income.
- Increasing ITC allowed in the current year and decreasing carryover when the federal audit adjustments result in higher Idaho tax.
- Decreasing ITC when the federal audit allowed an item to be expensed instead of capitalized.
- Decreasing an Idaho NOL deduction when the federal audit reduced the loss allowed in a prior year.
- Decreasing the Idaho bonus depreciation adjustment when the federal audit reduced federal bonus depreciation.
- Decreasing the grocery credit when the federal audit disallows an exemption.

### **5115 FINAL DETERMINATIONS**

IRS final determinations are received from either the EOAD leads or directly from the taxpayer. No matter how we receive the final determination, the process is the same as outlined above in Adjustments and Re-computations.

### **5120 SITUATIONS THAT REQUIRE OTHER ADJUSTMENTS**

When your review of a federal audit shows that there were errors in the federal adjustments or that other issues should've been considered, determine whether the issue is an Idaho or federal adjustment and then follow these procedures:

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

### **5125 FEDERAL TAXPAYER INFORMATION (FTI) HANDLING PROCEDURES**

FTI – Do's and Don'ts.

- Do keep information in an **orange** folder
- Do keep information locked up at night
- Do provide a copy to the taxpayer or their authorized representative (AIF), if requested
- Don't attach FTI to returns or in GenTax

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- Don't discuss FTI with anyone other than the taxpayer, their authorized representative, or your supervisor
- Don't e-mail FTI (including letters, NODDS, and billing letters containing FTI in the explanation). This includes:
  - E-mails to taxpayers or their authorized representatives.
  - E-mails to other ISTC employees, regardless if they're in the same department, a field office, or other department (such as TDB or Tax Appeals).
  - The use of multifunction copiers that copy, print, and scan, that e-mail the scanned document to the user.

Refer to [IRS Publication 1075](#) for more information on FTI disclosure.

### **5130 INTRASTATE FEDERAL AUDIT CHECKLIST**

Reconcile Idaho income to federal income.

Check for any Idaho adjustments.

- Remember that only Revenue Agent Report (RAR) adjustments can be made in closed years.
- If federal audit adjustments affect a net operating loss, review the returns for the tax years that the net operating loss was applied to.
- Check for ITC adjustments.
  - Change in tax amount can change the amount of ITC absorbed and the ITC carryforward
  - Non-qualifying vehicles
  - Mobile property used within and outside of Idaho
  - For more information see Intrastate Income Tax Audit Manual Section 8900

Decide if you need any additional information to complete the audit.

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

If the income matches and you don't need additional information, make the federal audit adjustments.

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- Schedule the federal audit adjustments.
- Explain any additional adjustments.

### Penalties:

Assess the 5% negligence penalty if it has been more than 120 days since the date of the final federal determination, and the taxpayer hasn't amended or provided a copy of the federal final determination.

Check for penalties assessed by the IRS and assess corresponding Idaho penalties. For example, if the IRS assessed a federal negligence penalty, assert the Idaho negligence penalty, Idaho Code section 63-3046(a).

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Federal Tax Information (FTI) is any return or return information received from the Internal Revenue Service (IRS) or secondary source. FTI includes any information created by the recipient that is derived from a return or return information and may contain personally identifiable information.

Income Tax Audit (ITA) uses FTI in a variety of ways including when we have insufficient information to resolve an audit, and also to verify information we have. As a result, auditors will often need to request and use FTI.

**5305 PROCEDURE FOR REQUESTING FEDERAL INFORMATION**

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

Auditors can request federal tax transcripts from the Government Liaison Specialist or from staff who are authorized to obtain the information.

**5310 FEDERAL TAX REPORTS AVAILABLE**

For individual taxpayers, the following tax reports are available:

**Account Transcript (all tax years)**

- Taxpayer's name, address, SSN, tax year balance, and filing status
- Federal Adjusted Gross Income (AGI), federal taxable Income, self-employment taxable income, and self-employment tax
- Date tax return was received
- Payments, interest and penalties
- Additional tax, interest, and penalties as a result of an IRS audit
- Transaction trail

**Return Transcript (three most current tax years)**

- A line by line listing of the federal return as filed (all lines and all forms)

**Record of Account (three most current tax years)**

- A combination of the Account Transcript and the Return Transcript

**Wage & Income Report (from 2000 to the current tax year)**

- A recap of all wages and income reported to the IRS by third parties

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If the information you need isn't available through the online search, you can request this through the Government Liaison Specialist.

**5315 SAFEGUARD PROCEDURES FOR IRS MATERIAL**

If you have access to FTI, you need to be aware that you could be subject to penalties if you improperly disclose such information. This includes FTI obtained (printed or written) from GenTax Warehouse Manager.

When FTI is delivered to you, a record is made in our FTI tracking system of the delivery date, location, and format (paper or electronic). When you receive or print FTI, the following procedures are required:

- FTI shouldn't be taken out of the office.
- FTI (including letters, Notice of Deficiency Determinations (NODD), and Billing Letters (BL) containing FTI in the explanation) shouldn't be e-mailed to anyone. This includes:
  - a. e-mails to taxpayers or their representatives;
  - b. e-mails to other Tax Commission employees, regardless if they are in the same department, a field office, or another department (like Taxpayer Discovery Bureau or Tax Policy); and
  - c. using a multifunction copier that copies, scans, and prints that scanned document as an e-mail to the user.
- NODDs, BLs, and letters containing FTI that are returned due to bad addresses or are otherwise undeliverable should be shredded and a CRM note added to GenTax indicating the mail was returned. This **doesn't** apply to items sent via certified mail that are returned as Unclaimed or Refused. These items are resent to the taxpayer via regular mail with a cover letter (Example: NODD Returned letter).
- Storage of FTI:
  - a. Preferably, you shouldn't print or write down FTI from the GenTax warehouse. If you do print or write it down, these documents are considered FTI and need to be protected as such.
  - b. Keep the printed information in an **orange** folder at all times and in a locked file cabinet when not being used.
  - c. Don't make photocopies of the printed information.

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- d. Label the printed information as “FTI” or “Federal Information” by using a stamp or writing it across the top of the document.
- e. Label the cabinet storing the FTI as “Contains FTI”.
- f. Don’t place electronic FTI in folders on your p: drive.
- g. For the field offices: Keep electronic FTI in your auditor folder on \\taxGfile\FIELDOFFICETDS. Reviewers will go to this folder to view the FTI when necessary.
- All FTI (including print-outs from Warehouse Manager) must be destroyed in the appropriate manner. If printed from Warehouse Manager, it can be shredded. If it comes from an FTI request, it needs to be destroyed.
  - a. Disposal of paper FTI
    - i. For the Boise office: Paper FTI is kept in a locked file cabinet until the information is destroyed.

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

- ii. For the field offices: Paper FTI can go in a secure shred bin in your office (this includes paper requests our IRS liaison has sent you).
  - b. Disposal of electronic FTI
    - i. When you’re done with electronic transcripts, the only thing you need to do is move them into the “FTI - To Be Destroyed” folder; you don’t need to notify Support.
    - ii. Managers will periodically check the folder, delete the contents, and log that they are destroyed. Please remember that as long as other electronic or paper copies of the FTI exist, it can’t be logged as destroyed, so be especially careful not to copy electronic files into other folders.

Refer to IRS Publication 1075 for more information on Federal information disclosure.

Link: <http://www.irs.gov/pub/irs-pdf/p1075.pdf>

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FILING REQUIREMENTS

SEC 5600

Idaho Code section 63-3030 provides that returns are required to be filed by individuals and entities if they meet filing requirements regarding gross income level and business activity in Idaho.

### **5605 INDIVIDUAL REQUIREMENTS**

#### **A. Residents**

Idaho Code section 63-3030(a)(1) requires that every resident of Idaho whose gross income equals or exceeds the allowed standard deductions and exemptions outlined in Internal Revenue Code § 6012 file a return. Idaho residents should file Idaho Form 40.

#### **B. Non-Residents**

Idaho Code section 63-3030(a)(2) requires that any Idaho non-resident whose gross income from Idaho sources exceeds \$2,500 file a return. Idaho non-residents should file Idaho Form 43. The following income is excluded from gross income of a non-resident:

- Guaranteed payments to a non-resident partner for services performed outside of Idaho up to \$250,000; any amount in excess of \$250,000 is Idaho taxable income based upon the partnership's Idaho apportionment factor, and would require a return to be filed.
- Investment income from a qualified investment partnership is not taxable to a non-resident of Idaho. A qualified investment partnership is a partnership with at least ninety percent (90%) of its gross income is from investments that produce income that would not be taxable if the investment were held directly by the individual.

#### **C. Part-Year Residents**

Idaho Code section 63-3030(a)(2) requires that every part-year resident having more than \$2,500 of gross income from Idaho sources to file a return. Part-year residents should file Form 43. Idaho gross income includes gross income from all sources during the time they resided in Idaho and gross income from Idaho sources received during the time they were nonresidents.

#### **D. Military Personnel**

For members of the military, please see Audit Manual Section [12300](#) Military Information.

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**5610 PASS THROUGH ENTITIES**

**A. S-Corporations**

Every S-Corporation that is transacting business in Idaho, is authorized to transact business in Idaho, or has income attributable to Idaho must file a Form 41S.

**B. Partnerships**

Partnerships must file Form 65 if the partnership is transacting business in Idaho or has Idaho income.

**C. Trusts**

Every resident trust which has gross income of \$100 or more must file a Form 66. Also, a non-Idaho trust which has gross income from Idaho sources in excess of \$100 must file a Form 66.

**5615 C-CORPORATIONS**

Every C-Corporation which is transacting business in Idaho, authorized to transact business in Idaho, or has income attributable to Idaho must file a Form 41.

**5620 POTENTIAL AUDIT ISSUES**

**A. Temporary Work Assignments**

Many individuals file returns using an incorrect residency status. In some cases, taxpayers who are out of state on temporary work assignments incorrectly file as part year residents. Review the taxpayer's domicile and residency information to verify if a part-year return is correct.

**B. Incorrect State of Residence**

On non-resident returns, some taxpayers that work in Idaho do not report any of their wages because they live out of state. Regardless of where the taxpayer lives, wages earned in Idaho are taxable to Idaho and must be reported.

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### **C. Non-filing Partners and Shareholders**

Partners and shareholders in Idaho entities are required to report their pass-through share of the income earned by the entity to Idaho. If the entity does not report backup withholding on non-resident owners, those owners are generally required to report the income to Idaho. Backup withholding is not required for partners and shareholders whose share of income and guaranteed payments of the pass-through entity from Idaho sources is less than \$1,000 for the tax year. Review the K-1's issued by the entity, and check to see if the partner or shareholder filed a return with Idaho. Also, examine the PTE Form and see which partners/shareholders have had the entity pay tax their behalf. If the entity has submitted the backup withholding tax for an individual, then the individual is not required to file.

#### **5625 AUDIT TECHNIQUES**

See Audit Manual Section 13800 regarding Non-Residents/Part-Year Residents for more information.

For audit techniques regarding the filing requirements for residency, see the Residency Manual.

#### **5630 APPLICABLE AUTHORITIES**

- Idaho Code section 63-3030 provides the filing requirements.
- Idaho Code section 63-3011 defines "gross income."
- Idaho Code sections 63-3013, 63-3013A, and 63-3014 define "resident," "part-year resident," and "domicile."
- Idaho Code section 63-3015(2) defines "resident trust."
- Idaho Code section 63-3023 defines "transacting business."
- Idaho Code section 63-3026A defines "Idaho taxable income" and Idaho source income of part-year residents and non-residents.
- Idaho Code section 63-3036B provides the laws on backup withholding by pass-through entities.
- IRC § 6012 provides federal filing requirements.

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IDAHO AUDIT ISSUES (MISC)

SEC 8000

This section covers some miscellaneous audit issues that are not covered in other sections of the audit manual.

**8005 DAY CARE CENTER LICENSING**

**A. Introduction**

Subject to a gross income limitation, a taxpayer may deduct expenses related to the regular use of their home for the trade or business of operating a qualified day-care center, without meeting the exclusive-use test. A qualified day-care center provides day care for children, people 65 years old or older, or those who are mentally or physically incapable of taking care of themselves (IRC Sec. 280A(c)(4)). Deductions related to the use of the home for these purposes are allowed only if the owner or operator of the business has applied for, holds, or is exempt from having a license, certificate, registration, or approval as a day-care center under state law (IRC Sec. 280A(c)(4)(B)).

**B. Idaho Rules for Governing Standard for Day Care Licensing**

Idaho Department of Health and Welfare Rules, Title 06, Chapter 02, "Rules Governing Standard for Child Care Licensing", govern day care in Idaho. To summarize the basics:

- A center with seven or more children must be licensed.
- However, if the center is licensed by a county or city ordinance with equal or greater requirements, the center is exempt from state licensing requirements.
- The occasional or irregular care of a neighbor's, relative's, or friend's child or children by a person not ordinarily in the business of providing daycare is exempt from licensing requirements.
- The provision of care for children of a family within the second degree of relationship is exempt from licensing requirements.

**C. "Kith and Kin" (Care Provided by Relatives, Friends and Neighbors)**

These caregivers are generally the most informal type of child care providers. It is often called "Kith and Kin" care and can take place in the caregiver's home or in the child's home. In some instances, the provider will be a spouse caring for his/her own children and also taking care of one or two additional children for the

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extra income. Others can be grandparents or other relatives, friends, or neighbors who welcome the extra money or are not paid, but are willing to look after the children. This type of care is generally not under much regulatory control and in some states may be exempt from licensing requirements.

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

#### **D. Audit Techniques**

- Request proof that the owner or operator of the business has applied for, holds, or is exempt from having a license, certificate, registration, or approval as a daycare center under state law. If the owner or operator of the business has a “license” under an Idaho county or city ordinance, it is assumed the center meets state licensing requirements.
- If the owner or operator of the business has “applied” for the license, request proof of application. If an application has been filed, accept the business use of home deduction (subject to gross income limit).

### **8010 LUMP-SUM DISTRIBUTIONS**

#### **A. Introduction**

Generally, retirement plan distributions to employees (or their beneficiaries or estates) are taxable as ordinary income to the extent that the distributions are not allocable to the employees' cost basis. However, recipients of lump-sum distributions made with respect to employees who were born before 1936 may be eligible to elect: (1) to have the portion of the distribution attributable to the employee's pre-1974 participation in the retirement plan taxed at a flat 20% capital gains rate; (2) 10-year averaging of the post-1973 portion of the distribution; or (3) 10-year averaging of the entire distribution.

This preferential treatment for certain lump-sum distributions excludes income in calculating federal adjusted gross income. Taxpayers use Form 4972 to figure the tax on a qualified lump-sum distribution.

However, Idaho doesn't recognize this preferential treatment. Idaho Code requires an addback of the capital gain income as well as the ordinary income portion to arrive at Idaho taxable income if these items were not previously included in federal AGI (Idaho Code Sec. 63-3022(k)).

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

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**8015 SCHEDULE A - PERSONAL PROPERTY TAXES**

**A. Introduction**

Personal property taxes imposed by a state or local government are deductible (IRC Sec. 164(a)(2)). The tax must be imposed annually on personal property based on the value of the property (IRC Sec. 164(b)(1)).

Personal property tax is deductible if it is based on the value of the personal property and charged on a yearly basis (IRC Sec. 164(a)). The license fee on recreational vehicles based on the fair market value of the vehicle is deductible under state and local taxes on Schedule A for federal and state returns. This deduction does not include the vehicle registration fee based on weight or age.

**B. Examples**

- For passenger cars, the Idaho Department of Motor Vehicles (DMV) charges a fee of \$35.00 to \$60.00, depending on the vehicles age and county of residence. This fee does not qualify for the deduction since it is based on the on the value of the personal property.
- For recreational vehicle (RV) trailers, the DMV charges a \$9.00 fee. Also, RV trailer owners are required to purchase a RV sticker. The cost of this sticker is \$8.50 for the first \$1,000 of market value, and \$5.00 for each additional \$1,000 or portion thereof of market value. The \$9.00 fee is not deductible. However, the cost of sticker based on market value is deductible.

**8020 SCHEDULE A - MORTGAGE INTEREST DEDUCTION (SEC 163)**

**A. Introduction**

Only interest on debt that is secured by the taxpayer's principle residence and second residence is deductible as qualified home mortgage interest. The second residence must qualify as a vacation home to qualify for the mortgage interest deduction.

Qualified home mortgage interest includes both acquisition debt and home-equity debt. Acquisition debt is any debt incurred to acquire, construct, or substantially improve a qualified residence of the taxpayer. Home-equity debt is any debt that is secured by a personal residence that is not acquisition debt. The proceeds of

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home-equity debt can be used for any purpose; however, there is a cap on the level of indebtedness for each type of qualified home mortgage interest.

**B. Limitations**

The following limitations apply to the IRC Sec. 163 deduction for mortgage interest deduction:

- Interest paid on acquisition debt of \$1,000,000 or less is deductible. Interest on debt in excess of \$1,000,000 is considered personal interest and is not deductible. The limit is \$500,000 if married-filing-separately.
- Interest paid on home-equity debt of \$100,000 or less is also deductible. Interest on debt in excess of \$100,000 is considered personal interest and is not deductible. The limit is \$50,000 if married filing separate.

**C. Potential Audit Issues**

The following are potential audit issues found during examination:

- Substantiation
- Exceeding limitations
- Allocation of mortgage interest between primary residence (Schedule A) and rental properties (Schedule E)

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

**8025 INTEREST ON CERTAIN HOME MORTGAGES (SEC 25)**

IRC Sec. 25 allows certain home buyers to claim a federal tax credit of up to 50% of the interest paid on mortgage indebtedness covered by a Mortgage Credit Certificate (MCC). Idaho Housing Agency participates in this federal program and has issued MCC's to Idaho taxpayers with a credit rate of 20%. On their federal return, these taxpayers are entitled to claim a nonrefundable credit of 20% of the mortgage interest paid. Any unused credit may be carried forward three years. Taxpayers must reduce their itemized deduction for mortgage interest by the amount of the mortgage credit allowed.

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The Idaho Supreme Court has stated that the federal option of choosing a deduction or credit does not affect the definition of deductions for state income tax (*Bogner v. Idaho Tax Commission*, 107 Idaho 854, 693 P.2d 1056 (1984)).

When advising taxpayers of our policy to allow qualified Mortgage Credit Certificate (MCC) holders a deduction for all the interest paid or accrued during the year without reduction for the IRC Sec. 25 credit, the following reporting directions should be given:

- The taxpayer must deduct the same amount of mortgage interest on their Schedule A for Idaho as on their Schedule A for the federal return.
- On the Other Subtractions line of Form 39, the taxpayer may deduct the amount that should be shown on line 3, federal Form 8396. (The amount cannot exceed \$2,000.)
- Taxpayer must attach a copy of federal Form 8396, Mortgage Interest Credit, to his Idaho return.

### 8030 Foreign Income Elections

U.S. citizens, whether they reside in the U.S. or abroad, are generally subject to federal income tax on their income from sources within and outside the U.S. However, in general, taxpayers may elect one of the following:

- Exclude the foreign earned income from gross income; subject to limitations (IRC Sec. 911(a)(1)), or
- Take a foreign tax credit against federal income tax (IRC Sec. 901), or
- Claim a deduction (IRC Sec. 164(a)(3)).

### 8035 Foreign Earned Income Exclusion

#### A. Introduction

For any tax year in which an individual is a qualified individual, the individual may elect to exclude from gross income his foreign earned income up to the inflation-adjusted exclusion amount (IRC Sec. 911(a)(1)).

A taxpayer “qualifies” for the foreign earned income and housing cost exclusion for a tax year if his “tax home” is in a foreign country and he is either:

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(a) a U.S. citizen who can establish that he/she has been a bona fide resident of one or more foreign countries for an uninterrupted period that includes the entire tax year, or

(b) a U.S. citizen or resident who, during any period of 12 consecutive months, is present in one or more foreign countries during at least 330 full days.

**B. Tax Home Rule**

IRC Sec. 911(d)(3) provides that, within the context of the foreign earned income tax exclusion, the term 'tax home' refers to an individual's home for purposes of determining allowable traveling expenses while away from home under IRC section 162(a)(2). It also provides that an individual shall not have a tax home in a foreign country for any period for which his abode is within the United States of America.

Treasury Regulations § 1.911-2(b) further defines tax home. The term "tax home" has the same meaning that it has for purposes of section 162(a)(2) (relating to travel expenses away from home). Thus, under section 911, an individual's tax home is considered to be located at his regular or principal (if more than one regular) place of business or, if the individual has no regular or principal place of business because of the nature of the business, then at his regular place of abode in a real and substantial sense. An individual shall not, however, be considered to have a tax home in a foreign country for any period for which the individual's abode is in the U.S. Temporary presence of the individual in the U.S. does not necessarily mean that the individual's abode is in the U.S. during that time. Maintenance of a dwelling in the U.S. by an individual, whether or not that dwelling is used by the individual's spouse and dependents, does not necessarily mean that the individual's abode is in the U.S.

**C. Bona Fide Residence Rule**

A U.S. citizen, who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire tax year, can exclude certain income attributable to services performed during such uninterrupted period, subject to limitations. The term "entire tax year" has been held to mean a full 12-month period even in case of a decedent; and a calendar year for a calendar year taxpayer. The determination whether a U.S. citizen is a bona fide resident of a foreign country or countries is governed by principles of Code § 871 which determine whether an alien is a U.S. resident (Reg §1.911-2(c)).

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Decisions dealing with determination of bona fide residence for the income earned abroad exclusion take into account the taxpayer's intent to become a resident of the foreign country, the character of his foreign abode, his integration into the social and economic life in the foreign country, and other attendant circumstances.

**D. Physical Presence Rule**

A U.S. citizen who doesn't qualify under the bona fide residence rule, but who is present in a foreign country or countries for at least 330 full days during any period of 12 consecutive months, can exclude certain income attributable to services during such period, subject to limitations.

- *Twelve month test.* A period of twelve consecutive months may begin with any day but must end on the day before the corresponding day in the twelfth succeeding month. The twelve-month period may begin before or after arrival in a foreign country and may end before or after departure.
  
- *330-day test.* The 330 full days need not be consecutive but may be interrupted by periods during which the individual is not present in a foreign country. In computing the minimum 330 full days of presence in a foreign country or countries, all separate periods of such presence during the period of twelve consecutive months are aggregated. A full day is a continuous period of twenty-four hours beginning with midnight and ending with the following midnight. An individual who has been present in a foreign country and then travels over areas not within any foreign country for less than twenty-four hours shall not be deemed outside a foreign country during the period of travel. If an individual who is in transit between two points outside the United States is physically present in the United States for less than twenty-four hours, such individual shall not be treated as present in the United States during such transit but shall be treated as travelling over areas not within any foreign country. For purposes of this paragraph (d)(2), the term "transit between two points outside the United States" has the same meaning that it has when used in § 7701(b)(6)(C).

**E. Audit Techniques**

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- *Initial Desk Audit Letter*

The initial contact should request: (a) a completed Foreign Earned Income Questionnaire, (b) passport and travel logs, and (c) employment contract. If the taxpayer is claiming a significant amount of unreimbursed travel expenses, it is recommended that substantiation be requested for expenses; it is possible the travel expenses are the non-deductible costs of traveling back home to visit their family.

- *Abode Focused Audits*

In determining where an individual has his/her tax home, it is critical to focus on the period for which the exclusion is being claimed. Although the statute states that “an individual shall not have a tax home in a foreign country for any period for which his abode is within the United States,” the regulation provides that “Temporary presence of the individual in the United States does not necessarily mean that the individual's abode is in the United States during that time. Maintenance of a dwelling in the United States by an individual, whether or not that dwelling is used by the individual's spouse and dependents, does not necessarily mean that the individual's abode is in the United States.” If the individual has only returned to the U.S. on a limited basis during the qualifying period, it is likely that the individual's ties to the foreign country will be found to be more extensive than those in the U.S. and a conclusion that the taxpayer's abode was not in the U.S. during this time will likely result. If it is determined that the taxpayer's abode was in the U.S., you should also investigate whether the taxpayer satisfied the bona fide resident or physical presence requirement, and if not, include that determination in the NODD explanation.

## **8040 FOREIGN TAX CREDIT**

### **A. Introduction**

Taxpayers can claim a credit for foreign income, war profits, and excess profits taxes paid or accrued during the tax year, including such taxes imposed by U.S. possessions (IRC § 901). Income, war profits, and/or excess profits taxes are referred to as “foreign taxes.”

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In general, a taxpayer “qualifies” for the tax credit if a U.S. citizen, domestic (U.S.) corporations, U.S. residents and persons who are bona fide residents of Puerto Rico. The credit is generally allowed for income taxes imposed by foreign countries and possessions of the U.S.

If a taxpayer claims a foreign tax credit for a foreign tax, no deduction is allowed under Code Sec. 164 for that tax. Claiming the credit is generally more advantageous than claiming a deduction: the credit can be used to offset a taxpayer’s U.S. income tax liability on a dollar-for-dollar basis, whereas a deduction only reduces taxpayer’s taxable income;

Since the credit doesn’t apply to Idaho, there is no Idaho audit issue with the foreign tax credit.

**B. Idaho Deduction**

An individual taxpayer is allowed a deduction on his Idaho return for foreign income taxes for which a credit is claimed on his federal return under IRC § 901. Since taking the federal credit is generally more advantageous than claiming a federal deduction, in general, a taxpayer will claim the federal credit and claim a deduction on the Idaho return.

The Idaho Supreme Court has stated that the federal election of choosing a deduction for foreign income taxes or the foreign tax credit does not affect the definition of deductions for state income tax. Itemized deductions allowable for Idaho purposes will include the foreign taxes even though a federal foreign tax credit is elected and the foreign taxes are not allowed as a deduction on the federal return (Bogner v. Idaho Tax Commission, 107 Idaho 854, 693 P.2d 1056 (1984)).

When the foreign tax credit is claim on the federal, and a deduction claimed on the Idaho return, the Idaho itemized deductions may not match the federal itemized deduction. Taxpayers should filed a separate Schedule A for Idaho, however, it is not uncommon for taxpayer to overlooking filing a separate Schedule A and just reported different itemized figures on the Idaho return (40/43).

**8045 Foreign Tax Deduction**

Taxpayers can claim a deduction for foreign income, war profits, and excess profits taxes paid or accrued during the tax year, including such taxes imposed

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by U.S. possessions (IRC § 164(a(3))). Income, war profits, and/or excess profits taxes are referred to as “foreign taxes.”

When a taxpayer claims the foreign tax deduction on the federal return and the Idaho return, the only audit issues tends to be substantiation of the taxes paid. Since claiming the credit is generally more advantageous than claiming the deduction, it is rare for taxpayers to claim the foreign tax deduction on the federal return.

**8050 DEDUCTION OF CERTAIN RETIREMENT BENEFITS**

1. Unremarried Widow(er)

An unremarried widow(er), for purposes of determining the deduction of retirement benefits under Idaho Code section 63-3022A, is defined as a surviving spouse who has not remarried. Once the unremarried widow(er) remarries, she (or he) can never again be unremarried with regard to that specific deceased spouse; thus, once the widow(er) remarries, she (or he) loses the deduction and cannot reinstate the deduction by getting a divorce. A taxpayer can only become an unremarried widow(er) again if a subsequent spouse dies.

2. Civil Service Retirement

A federal retiree generally must have established eligibility in the Civil Service Retirement System (CSRS) prior to 1984 to qualify for the retirement benefits deduction. Federal employees retired under the Federal Employees Retirement System (FERS) **do not** qualify.

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

You can determine the source of the annuity by looking at the Account number (Retirement Claim No.) for the payee on the Form CSA 1099-R. Account numbers where the first digit starts with 0, 1, 2, 3, or 4 indicate that the annuity was paid out of CSRS. Account numbers where the first digit is a 7 or 8 indicate that the annuity was paid out of FERS. The Account Number (Retirement Claim No.) can be found on the Form 1099-R in the encircled box. Those identified as CSRS retirement funds qualify. Those identified with FERS retirement funds do not qualify.

*[Information redacted pursuant to Idaho Code § 74-106(5)]*

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If the taxpayer indicates that they are receiving both FERS and CSRS amounts in their annuity, request a copy of Form RI 38-38, Notice of Annuity Adjustment. This will indicate if there was a split annuity comprised of FERS and Non-FERS components. It will also identify whether the retiree is having federal dental, vision, or long-term care insurance premiums deducted, as these amounts will not be included in Box 5 on the CSA 1099-R.

*[Information redacted pursuant to Idaho Code § 74-106(5)]*

Survivors of federal employees receive a CSF 1099-R, Statement of Survivor Annuity Paid.

3. Firemen's and Policemen's Retirement Fund

A policeman or fireman may only qualify for the Idaho retirement benefits deduction for retirement benefits received from an Idaho government employer. Retirement benefits received from private and non-Idaho government employers **do not** qualify.

The PERSI 1099-R form will specifically indicate that the payments are from a firemen's or policemen's retirement fund. If the 1099-R form does not specify one of these retirement funds, the retirement benefits **do not** qualify.

**8055 PERMANENT BUILDING FUND TAX - PUBLIC ASSISTANCE**

The Permanent Building Fund (PBF) tax of \$10 does not apply to any person who, on the last day of his taxable year, is blind or lawfully receiving public assistance payments from the State. Does the term "Public Assistance" extend to Medicaid benefits?

- The taxpayer, or the taxpayer's spouse, is receiving Medicaid benefits.
  - Medicaid payments received **from Idaho**, by a taxpayer who is required to file an income tax return, **do** exempt him from the \$10 PBF tax. Payments paid to a provider of medical services or products for the benefits of a person will be deemed to have been paid to him.
  - Medicaid payments received **from federal** sources **do not** exempt a taxpayer from the PBF tax. If the taxpayer is receiving Social Security benefits, his Medicaid payments may be federally funded.

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- A dependent of a person required to file an income tax return is receiving Medicaid payments.
  - State Medicaid or Federal Medicaid received by a taxpayer's dependent **does not** exempt the taxpayer from the \$10 PBF tax.

**8060 RAILROAD BENEFITS**

Benefits paid by the Railroad Retirement Board that are included in federal adjusted income are not taxable on the Idaho return. This is shown as subtraction on the Idaho return. These benefits include:

- Tier I and Tier II Retirement Benefits
- Railroad Sick Pay
- Railroad Unemployment Compensation

Railroad income or pensions received from other sources (Example: Harriman Plan) are fully taxable.

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Idaho source income is income from transactions or activities that take place in Idaho, or from property in Idaho.

**8205 RESIDENTS**

Idaho Code section 63-3002 declares that the state may tax residents on their income for the year, regardless of where the income was derived.

**8210 NON-RESIDENTS AND PART YEAR RESIDENTS**

Idaho Code section 63-3026A details types of Idaho income for non-residents and part year residents. Income shall be considered derived from or relating to sources within Idaho when such income is attributable to or resulting from:

- Any business, trade, profession or occupation conducted or carried on in this state, including the distributive share of partnership income and deductions, and the pro rata share of S corporation income and deductions.
- The ownership or disposition of any interest in real or tangible personal property located in this state.
- The ownership or disposition of any interest in intangible personal property if property is employed in a business carried on in this state.
- Interest income from an installment sale of real or tangible personal property shall constitute income from sources within this state to the extent that the property sold was located within this state.
- A resident estate or trust; provided however, that income distributed to beneficiaries to the extent the income would be Idaho source income if such income had been received directly by a nonresident individual.
- A nonresident estate or trust income and deductions were derived from or related to sources within this state.
- Any form of gambling taking place within this state, unless under the \$600 exemption as expressly limited in section 67-7439, Idaho Code;
- Gains or losses realized from the sale or other disposition of a partnership interest or stock in an S corporation to the extent of the Idaho apportionment factor in the taxable year immediately preceding the year of sale.



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- If a nonresident individual performs personal services, either as an employee, agent, independent contractor, partner, or otherwise, both within and without Idaho, the portion of his total compensation that constitutes Idaho source income is determined by multiplying that total compensation by the Idaho compensation percentage. For further detail see Administrative Rule 270.

**8215 DEFERRED COMPENSATION SETTLEMENT**

Deferred compensation is a payment resulting from employment or a performance of a service. This income is only taxable in the state of domicile.

**8220 AGREEMENT NOT TO COMPETE**

A lump sum payment for an agreement not to compete in the future is Idaho sourced income to the extent the promisor forfeited his right to act in Idaho.

**8225 MILITARY INCOME**

Compensation paid by the United States for active service in the armed forces of the United States, performed by an individual not domiciled in this state, shall not constitute income derived from or related to sources within this state. Refer to Audit Manual Section 12300.

**8230 TRAVELING SALESMEN**

A non-resident salesman who works in Idaho is subject to Idaho taxation regardless of the location of his starting point, per Administrative Rule 45.

If an individual is paid on a mileage basis, the gross income from sources within Idaho includes that portion of the total compensation for personal services that the number of miles traveled in Idaho bears to the total number of miles traveled within and without Idaho. If the compensation is based on some other measure, such as hours, the total compensation for personal services must be apportioned between Idaho and other states and foreign countries in a manner that allocates to Idaho the portion of total compensation reasonably attributable to personal services performed in Idaho.

**8235 TRANSPORTATION EMPLOYEES**

Compensation paid to an interstate transportation employee who has regularly assigned duties in more than one state is subject to income tax only in the

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employee's state of residence. This applies to motor carrier, water carrier, air carrier, and rail carrier employees.

- Motor Carrier Employees are defined in title 49 Section 31132(2), United States Code and includes:
  - An operator, including an independent contractor of a commercial motor vehicle.
  - A mechanic,
  - A freight handler, and
  - An individual who in the course of directly affects commercial motor vehicle safety.
  
- Water Carrier Employees wages covered by Title 46 Section 11108 are only taxable to the employee's state of residence if:
  - The employee works on a vessel as a pilot in more than one state, or,
  - Is a master, officer or crewman on a vessel operating on the waters of more than one state.
  
- Air Carrier Employees that works in more who works in more than one state is subject to income tax laws in:
  - The taxpayers state of residence or,
  - A state in which the employee earned more than 50% of wages paid by the air carrier.
  
- Rail Carrier Employees that work in more than one state are subject to income tax only in their state of residence.

**8240 APPLICABLE AUTHORITY**

- Idaho Code section 63-3002 declaration of intent to tax residents, and non-residents.
- Idaho Code sections 63-3013, 63-3013A, and 63-3014 define "resident," "part-year resident," and "domicile."
- Idaho Code section 63-3023 defines "transacting business".
- Idaho Code section 63-3026A defines "Idaho taxable income" and Idaho source income of part-year residents and non-residents.
- Idaho Income Tax Administrative Rule 045 provides rules regarding Idaho source income for Traveling Salesmen and Transportation Employees.
- Idaho Income Tax Administrative Rules 260 through 275 provides detail on Idaho source income.

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**8405 IDAHO ADDITION FOR NON-IDAHO STATE AND LOCAL BOND INTEREST AND DIVIDENDS**

Interest and dividends received or accrued during the taxable year from foreign securities and from securities issued by states and other political subdivisions are taxable by the State of Idaho, but are not taxable at the federal level (Idaho Code section 63-3022M(1)); thus, if a taxpayer has earned federal tax-exempt interest that is not Idaho tax-exempt, they are required to add this interest to Idaho taxable income on Idaho Form 39R, Part A, Line 3. This addition should not include Idaho state and local bond interest.

Total interest and dividends exempt from federal tax should appear on the front page of Federal Form 1040, Line 8b. (There is no corresponding line on the federal return for tax-exempt dividends because tax-exempt dividends are supposed to be reported on line 8b as well.)

		Add numbers entered on lines above >	02
d Total number of exemptions claimed			
7	Wages, salaries, tips, etc. Attach Form(s) W-2)	7	
8a	Taxable interest income). Attach Schedule B if required	8a	335
b	Tax-exempt interest. DO NOT include on line 8a	8b	3429
9a	Ordinary dividends. Attach Schedule B if required	9	91
b	Qualified dividends (see page 23)	9b	91
10	Taxable refunds, credits, or offsets of state and local income taxes (see instructions)	10	

**A. Additions. See instructions, page 20.**

1.	Federal net operating loss carryover included in Form 40, line 7	1	
2.	Capital loss carryover incurred outside the state before becoming an Idaho resident	2	
3.	Non-Idaho state and local bond interest and dividends	3	
4.	Idaho college savings account withdrawal	4	
5.	Other additions. Include explanation.	5	
6.	Total additions. Add lines 1 through 5. Enter on Form 40, line 8	6	

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

If the bond was issued by an Idaho state or local government, the tax-exempt interest on the 1099-INT is exempt from Idaho tax and should not be added back into Idaho taxable income. If all tax-exempt interest or dividends are identified and the non-Idaho state and local interest and dividends have not been added back into Idaho taxable income, an adjustment may be made for these amounts.

**8410 IDAHO SUBTRACTION FOR INTEREST FROM U.S. GOVERNMENT OBLIGATIONS**

Interest income earned on U.S. government obligations are taxable at the federal level, but not by the State of Idaho (63-3022M(a)); thus, if a taxpayer has included this interest in federal taxable income, they are entitled to a deduction of

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this amount from Idaho taxable income on Idaho Form 39R, Part B, Line 3. This deduction should not include state or municipal bond interest or dividends, as these forms of income are not taxable on the federal level and therefore cannot be subtracted from taxable income.

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

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

The following sources of interest income are taxable by the federal government but not by the State of Idaho:

**A. Interest Income Not Taxable by Idaho:**

- Banks for Cooperatives
- Central Banks for Cooperatives
- Commodity Credit Corporation
- Consolidated Bonds
- Consolidated Discount Notes
- Consolidated System Bond, Series L
- Consolidated Systemwide
- Discount Notes
- Export-Import Bank of the United States
  - Series 197-B Debentures
  - If Eximbank is acting as guarantor, the interest is nontaxable only if actually paid by Eximbank
- Farm Credit Banks
- Farm Credit System Financial Assistance Corp.
- Farmers Home Corporation
- Federal Deposit Insurance Corp.
- Federal Farm Credit Bank
- Federal Farm Loan Corp.
- Federal Farm Mortgage Corp.
- Federal Financing Bank
- Federal Home Loan Bank - except Overnight/Time deposits
- Federal Homeowners Loan Bank
- Federal Intermediate Credit Bank
- Federal Intermediate Credit Corp.
- Federal Land Bank
- Federal Land Banks Association
- Federal Participation Certificates

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- Federal Savings and Loan Insurance Corporation
- GSA Participation Certificates
- General Insurance Fund (only these obligations):
  - Debentures issued under War Housing Insurance Law
  - Debentures to acquire rental housing projects
  - Armed Services Housing Mortgage Debentures
- General Services Admin. Public Bldg. Trust Participation Cert.:
  - 1st series A through E
  - 2nd series F
  - 3rd series G
  - 4th series H and I
- Home Owner's Loan Corp.
- H.U.D./New Communities
- Joint Stock Land Banks
- Maritime Administration
- Guam
- National Service Life Ins. (interest on accumulated dividend paid via Veteran Administration) (Rev. Rul. 91-14)
- North Mariana Islands (U. S. Code, Title 48, Section 607(a))
- U. S. Government Life Insurance (paid via Veterans Administration; Rev. Rul. 91-14)
- Production Credit Associations
- Puerto Rico
- Resolution Trust Corporation
- Small Business Administration
- Student Loan Marketing Association
- Tennessee Valley Authority (bonds only)
- Territory of Alaska
- Territory of Hawaii
- Territory of Samoa
- U. S. Government Bonds
- U. S. Government Certificates
- U. S. Housing Authority
- U. S. Maritime Commission
- U. S. Postal Service
- U. S. Savings Bonds - Series E, F, G, H, EE, HH
- U. S. Treasury Bills and Notes
- U. S. Treasury Strips (Audit Manual Section 8420 - a portion may be taxable)
- Virgin Islands

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**B. Interest Income Taxable by Idaho:**

No Idaho deduction is allowed for the following sources of interest income:

- Asian Development Bank
- Build America Bonds
- Building and Loan Associations
- Credit Union Share Accounts
- District of Columbia
- District of Columbia Armory Board
- Environmental Financing Authority
- Export-Import Bank of Washington D. C.
- Farmers Home Administration
- Federal Financing Corporation
- Federal Housing Administration
- Federal Home Loan Bank - Overnight/Time deposits, stock dividends
- (Bell Fed S & L v ILL) (Ill App. Ct. 1983)
- Federal Home Loan Mortgage Corp.
- Federal National Mortgage Association (FNMA)
- Federal Savings and Loan Associations
- Government National Mortgage Association (GNMA)
- Inter-American Development Bank Bonds
- Internal Revenue Service (interest on refunds)
- International Bank for Reconstruction and Development (World Bank)
- Inter-American Development Bank
- Jonathan Development Corp. (Obligations guaranteed under New Communities Act of 1986)
- Panama Canal Bonds
- Participating Loans in the Federal Reserve System (Federal Funds)
- Participation Certificates in the Federal Assets Financing Trust
- Participation Certificates issued by the FNMA
- Philippine Bonds
- R.F.K. Stadium Bonds
- Railroad Retirement Act
- Repurchase agreements
- Federal Reserve Dividends for stock purchased after 1942
- The Special Food Service Program
- U. S. Merchant Marine
- U. S. Treasury Strips - a portion is tax-exempt (See Audit Manual Section 8410 below)
- Washington Metropolitan Area Transit Authority Bonds

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**C. Interest from Securities for which the U.S. Government is only  
Secondarily Liable**

If the government is only secondarily liable for payment of principle and interest on a security, the interest is not interest "on an obligation of the government" until there has been a default by the primary obligor, triggering the government's liability as a guarantor.

**D. U.S. Treasury Strips**

A "stripped bond" is a bond issued at any time with interest coupons where there is a separation in ownership between the bond and any coupon which has not yet become payable. IRC section 1286 provides for the tax treatment of stripped bonds; which can be partly tax-exempt and partly taxable for Idaho income tax purposes.

**8415 ORIGINAL ISSUE DISCOUNT**

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

IRC section 1272(a)(1) defines original issue discounts (OID) as interest income. 1099-OID documents available in GenTax show OID allocated to the current year, which may be taxable by Idaho. OID from U.S. Treasury Obligations is not taxable at the federal level, but is taxable at the Idaho level and must be added back to Idaho taxable income. If the total of all interest from U.S. bonds equals the amount subtracted on Idaho Form 39R, Part B, Line 3, the issue has no audit potential.

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

**8420 MUTUAL FUND INTEREST**

Interest income from a mutual fund that invests in both nonexempt securities and exempt U.S. government securities must be specifically identified by the mutual fund to be deductible. The auditor should request brokerage statements or other documents from the taxpayer that allocate fund interest between exempt and nonexempt securities. An adjustment may be made adding all underreported mutual fund interest that is not clearly identified as Idaho sourced to taxable income.

**8425 PROCEDURE FOR REQUESTING INVESTMENT INFORMATION**

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

Auditors reviewing any issue related to securities interest, dividends, capital gain (or loss) from sale of stocks or bonds, investment expenses, and other issues should request complete brokerage statements for the tax years under audit.

**8430 INVESTMENT EXPENSE OFFSET FOR TAX EXEMPT INCOME**

Interest and other expenses disallowed in the determination of federal taxable income under the provisions of IRC sections 291 and 265, which are related to income from non-Idaho state and local bonds, are an allowable subtraction from Idaho taxable income.

Because state and local bond interest, dividends, and original issue discounts are not taxable on the federal return, no deduction is allowed at the federal level for investment expenses paid on these investments; however, because Idaho taxes non-Idaho state and local bond interest, dividends, and original issue discounts, a deduction is allowed on the Idaho level for investment expenses paid on these taxed investments. (Idaho state and local bond interest, dividends, and original issue discounts are not taxable at the federal or Idaho level; thus, no deduction is allowed for investment expenses for these investments.)

When auditing tax-exempt interest addback for non-Idaho state and local bond interest, dividends, and original issue dividends, the auditor must calculate any deduction allowed for interest expenses for that tax-exempt income that was not allowed as a deduction on the federal return. See the example below:

	2011	2012	2013
1 Idaho state and local bond interest, dividends, and OID	1,000	2,000	5,000
2 Total income + tax-exempt interest - bond premiums	10,000	25,000	8,000
3 Line 1 / line 2	10.00%	8.00%	62.50%
4 Investment expenses paid on all state and local bonds	800	700	1,000
5 Idaho tax exempt income expense offset (Line 3 x line 4)	(80)	(56)	(625)
6 Allowed deduction for investment expense on non-Idaho state and local bond interest (Line 4 – line 5)	720	644	375
7 Claimed deduction for investment expense on non-Idaho state and local bond interest	610	66	412
8 <b>Adjustment to 042a, Line 2a. (Line 7 - Line 6)</b>	<b>(110)</b>	<b>(578)</b>	<b>37</b>

**8435 INTEREST RECEIVED ON FEDERAL INCOME TAX REFUNDS**



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INCOME - TAX EXEMPT

SEC 8400

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

Idaho does not tax state and local income tax refunds. Taxpayers are allowed to deduct state and local income tax refunds included in taxable income, unless the refunds have already been subtracted pursuant to Idaho Code section 63-3022(a)(Idaho Income Tax Rule 120.01). Refunds are issued on Forms 1099-G.

Interest earned on federal, state, and local income tax refunds; however, is taxable by the federal and state tax agencies. No Idaho deduction is allowed on that interest. Interest income earned on those refunds is issued on Forms 1099-INT.

**8440 LOTTERY WINNINGS EXEMPT FROM TAX**

For prizes awarded on lottery tickets purchased in Idaho after January 1, 1998, a subtraction is allowed for each lottery prize that is less than six hundred dollars (\$600). If a prize equals or exceeds six hundred dollars (\$600), no subtraction is allowed. The full amount of the prize is included in income (Idaho Income Tax Rule 120.03(b)).

*[Information redacted pursuant to Idaho Code § 74-106(5)]*

Prizes issued prior to 1998 are entirely tax-exempt in Idaho, including prizes that are issued as yearly annuity payments (Idaho Code section 67-7439).

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5-2015                      INCOME TAXES – OTHER STATES                      SEC 8600

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Idaho Code section 63-3029 allows an individual a credit against tax otherwise imposed for the taxable year by another state on income derived from sources therein while domiciled in Idaho.

The credit is allowed when a resident taxpayer is required to file a return with another state reporting that states income. The taxpayer receives the credit because the other states income is reported twice and should only be taxed once, by the other state. The income has to be reported to Idaho to receive proper credit for taxes paid to another state.

**8605 TAXES PAID TO OTHER STATES – ADJUSTMENTS BY FEDERAL AUDITS**

When a federal audit is received and the revenue agent's adjustments affect the amount of taxes payable to another state, the auditor will:

Recompute, if possible, the amount of taxes payable to the other state(s).

A. If the calculation indicates a **decrease** of taxes payable to the other state:

- Use the revised amount in computing the allowable credit.
- Cite appropriate code in the explanation.

B. If the calculation indicates an **increase** of taxes payable to the other state:

- If the revised tax due is not available, use the original tax due in recomputing the allowable credit.
- In the explanation, inform the taxpayer of his statute of limitations for amending to claim the credit, and if filed, the need for documentation to substantiate the additional tax paid to the other state.

**8610 STATE AND OTHER TAXES THAT DO NOT QUALIFY FOR THE CREDIT**

The following state taxes on business returns (partnerships, S corporations, etc.) do not qualify for the Idaho credit for taxes paid because they do not meet the requirements necessary to be “measured by income” as defined in Idaho Code section 63-3029(7)(b).

California	Minimum Franchise Tax
	Annual LLC Tax

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Georgia	Net Worth Tax
Louisiana	Franchise Tax
Massachusetts	Net Worth Tax
Michigan	Single Business Tax (repealed in 2008) Modified Gross Receipts Tax (repealed in 2011)
New Mexico	Franchise Tax
North Carolina	Franchise Tax
Ohio	Commercial Activity Tax
Pennsylvania	Capital Stock/Franchise Tax
Tennessee	Franchise Tax
Texas	Franchise Tax (phased out after 2006) New Franchise (Margin) Tax (qualifies after 12/31/11)

Also, no credit is allowed for income tax paid to cities, counties, or foreign countries.

**8615 CREDIT FOR INCOME TAXES PAID ANOTHER STATE**

**Idaho Residents**

The credit can't exceed the tax paid to the other state, or the percentage of tax due Idaho in the proportion that adjusted gross income of the other state (as modified by the Idaho Income Tax Act) bears to Idaho adjusted income. This percentage is rounded as follows:

- From 2001 through 2006, the percentage is rounded to the whole percent.
- For tax years beginning in 2007, the percentage shall be rounded four (4) digits to the right of the decimal point. For example, 0.25387 = 25.39%.

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INCOME TAXES – OTHER STATES

SEC 8600

**Idaho Part-Year Residents**

For part year residents, not all income taxed by another state is also taxed by Idaho. Consequently, a two-step formula is applied to determine how much of the other state's income is actually double-taxed. See the calculation "Credit for Income Tax Paid to Other States by Part-Year Residents" on the Idaho Form 39NR.

**8620 POTENTIAL AUDIT ISSUES**

**In any audit of the credit for taxes paid to another state a complete copy of the other state's return should be requested.**

1. Did the taxpayer take a credit for the states listed in section 8610?

Documentation to request from the taxpayer might include:

- Information showing an entity filed and/or paid the tax on the behalf of the taxpayer

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

2.

3. Did the taxpayer only report Idaho income on a nonresident or part-year return?

Documentation to request from the taxpayer might include:

- Schedule identifying what income was reported to each state

4.

5.

6. Did the taxpayer report income to the other state that should have only been reported to Idaho?

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INSTALLMENT PAYMENTS

SEC 8700

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**8705 INSTALLMENT PAYMENTS**

If you are asked how the taxpayer may make installment payments regarding an audit:

1. Don't discuss any specific payment arrangements regarding collections after the audit is posted with the taxpayer or their representative. Direct all specific questions to Collection staff at (800) 972-7660 ext 7633, or (208) 334-7633.
2. Encourage and accept any partial payments.
  - Taxpayers may make payments before the audit is posted. Instruct them to designate the payment as an Audit Payment, with the applicable year. Payment type is important because sometimes a general account payment will be refunded back to the taxpayer before the liability has been posted.
  - Interest stops accruing the date payment is made in full. Partial payments trigger a separate calculation for interest that may require manual interest calculation.
3. Have the taxpayer or their representative:
  - Contact Collections staff or TPS at (800) 972-7660 or (208) 334-7660.
  - Taxpayers can't complete a payment agreement request through TAP until the audit assessment has been posted in GenTax. However, they can begin making payments so long as they designate them as "Audit" payments in TAP.
4. See Audit Manual Section 2200 for Collections and Reductions in Liability for cases with collections in progress from posted audit liabilities.

See Audit Manual Section 15200 for general payments.

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ENERGY EFFICIENCY UPGRADES

SEC 8800

Idaho Code section 63-3022B allows taxpayers a deduction for qualifying expenses for energy efficient upgrades to an Idaho residence. The subtraction for individuals is claimed on Form 39R, Part B, line 4.

Code History of § 63-3022B:

- Originally established in 1976 as “Deduction for insulation of residences”
- 1995 – Code changed to remove the words “as defined in section 63 of the Internal Revenue Code”
- 2012 – Code revamped – “Deduction for Energy Efficiency Upgrades.” New definitions, additions, and deletions

Idaho Income Tax Administrative Rule 140 History:

- Changed in 1997 to add specific materials
- 2012 Revamped for energy efficient upgrades & clarification

### **8805 DEDUCTION FOR INSULATION OF RESIDENCES (TAX YEARS 1976 - 2011)**

1. Additions to a residence - Residence must be in Idaho – Includes vacation homes
  - a. Must be used as a residence of the taxpayer
  - b. Allocation if the taxpayer rents the residence for the part of the year the taxpayer resided in it
  - c. Structure must have existed prior to January 1, 1976
    - i. A structure with an outstanding building permit issued prior to 1/1/76 qualifies
2. Additional insulation
  - a. Improvements must be for ADDITIONAL insulation, not replacement
  - b. Rule 140.04: “Siding is not considered insulation. If a layer of insulation is placed beneath siding, the cost of the insulation is deductible if it otherwise qualifies. If the siding consists of an outer shell for protection against the weather and an inner layer of insulating material, the insulating material qualifies if the cost is separately identified by the seller.”

See § 63-3022B and Rule 140 for a list of more qualifying items

### **8810 ENERGY EFFICIENT UPGRADES (TAX YEARS 2012 AND FORWARD)**

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SEC 8800

1. Qualifying Date is **1/1/2002** for residences and additions (Idaho Code § 63-3022B(1))
  - a. Must be the taxpayer's **primary residence in Idaho (2013 and on)**
    - i. No vacation homes, no rentals
  - b. Payment must be cash basis, paid by the end of the calendar or fiscal year by the taxpayer.
2. Qualifying items: "energy efficiency upgrade measure":
  - a. Energy efficiency improvement to building envelope or duct systems (Idaho Code § 63-3022B(2)(a))
  - b. Insulation to walls, doors, ceilings, attics, roofs, floors, foundations, insulated sun rooms (2009 IECC 402.2 & Table 405.5.2(1))
  - c. Cavity insulation (blown insulation, fiberglass batts)
  - d. Duct sealing and insulation. "Duct sealing requires mechanical fastening of joints and mastic sealant" Idaho Code § 63-3022B(2)(b)(v)
  - e. Insulation in out buildings (garage, shop) *if* building is attached to house with a common wall
  - f. Renter-installed insulation, unless reimbursed by the landlord. There isn't a requirement for the taxpayer to own the house.
  - g. Insulation in 2nd residence, to the extent of personal use (2012 only)
  - h. Insulation of furnace ducts under house or trailer
  - i. Reflective coating on roof
  - j. Labor related to installation of qualifying energy efficiency upgrades
  - k. Windows – Windows that may replace less efficient existing windows (Idaho Code §63-3022B(2)(b)(ii))
    - i. Improving an exterior single pane window for a double pane window
  - l. Storm windows (§ 63-3022B(2)(b)(iii))
  - m. Weather stripping (§ 63-3022B(2)(b)(iv))
  - n. Adding insulation where there was no insulation before (unless it is in a new addition built after 2002)
  - o. Leaving the old fiberglass insulation in the wall, and putting additional insulation in the same wall
3. Not Allowable:
  - a. Landlord-installed insulation of rental property
  - b. Replacement insulation

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- i. Tearing out old fiber glass insulation and installing “blown-in” insulation does NOT qualify
- c. Insulation or upgrade installed in 2<sup>nd</sup> home or vacation home
- d. Trailer skirts
- e. Paint on siding
- f. Brick
- g. Insulating drapes
- h. Siding which covers or protects insulation, unless insulation is otherwise deductible **and** separately stated Rule 140.03
- i. Insulation in addition added to residence built after January 1, 2002



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SEC 8900

The investment tax credit (ITC) was originally a federal tax credit created by the Revenue Act of 1962, rearranged by the Tax Reform Act of 1984 and repealed by the Tax Reform Act of 1986. Idaho allows a maximum credit of 3% of qualified investments in IRC section 38 property that were placed into service after December 31, 1981. Idaho generally follows the definition of qualified property found in sections 46 and 48 of the IRC of 1986 as they existed prior to November 5, 1990.

**8905 TABLE OF CONTENTS**

<u>Section</u>	<u>Title</u>
8910	Qualified Investments
8915	Used Property Limitations for Member of Controlled Group
8920	Software (Computer)
8925	Investment Tax Credit Audit Issues
8930	Investment Tax Credit Audit Resources
8935	Investment Tax Credit Recapture
8940	Corporate Spin-off ITC Recapture & Carryover Investment
8945	Tax Credit Recapture Audit Issues Examples of Nonrecapture Events Examples of Recapture Events
8950	IRC section 46(c) as of 1989 and prior to Public Law 101-508
8955	IRC section 48 as of 1989 and prior to Public Law 101-508
8960	1975 List of Qualifying and Nonqualifying Property

**8910 QUALIFIED INVESTMENTS**

I. **Generally:**

- A. Qualified Investments include assets eligible for federal investment tax credit as defined in section 46(c) and section 48 of the IRC and meeting additional requirements in Idaho law.

All references to section 46 and section 48, IRC refer to the IRC as in effect prior to Public Law 101-508, or November 5, 1990. IRC section 46(c) is found in Section 8950. IRC section 48 is found in Section 8955. Section 8960, is a 1975 IRS list of qualifying and nonqualifying property. Caution is advised in using this list. An item shown as not qualifying may indeed qualify under sources of authority subsequent to 1975.

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- B. The ITC limitations contained in IRC section 46(e) do not apply. Idaho Code, section 63-3029B(3) specifically adopted the federal limitation in IRC section 46(f) but remained silent on IRC section 46(e) ([ITC - IRC 46\(e\) Limitation – Legal Opinion.](#))
- C. Property expensed under IRC section 179 is not a qualified investment. Similarly, any bonus depreciation allowed under IRC section 168(k) is subtracted from the otherwise qualifying investment for tax years beginning in 2008 and 2009.
- D. Property used by the taxpayer before the purchase of the asset does not qualify for the credit. For example, the taxpayer rents equipment for a period of time and later purchases the equipment.
- E. Must have situs in Idaho. In the case of property used both in and outside Idaho, the qualified investment must be computed in one of two ways:
  - separately computed based on the percentage of the actual use of the property in Idaho, or
  - multiplied by the Idaho property factor determined pursuant to section 63-3027, Idaho Code ([Burlington Northern v ISTC - Idaho Supreme Court Decision.](#))

**II. Motor Vehicles:**

A motor vehicle is a self-propelled vehicle that is registered or may be registered for highway use pursuant to the laws of Idaho. Gross vehicle weight is determined by the manufacturer's specified gross vehicle weight.

Investments in motor vehicles that are under 8,000 pounds gross weight do not qualify for the Idaho Investment Tax Credit.

**III. All-Terrain Vehicles (ATV):**

The Idaho ITC **will not** be allowed on an ATV if:

1. The ATV is registered to be operated on the public highways, or
2. The ATV is capable of being registered to be operated upon the public highways by virtue of meeting all the standards, rules, and

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specifications with regard to parts and equipment, even though it is not registered.

The Idaho ITC **will** be allowed on an ATV if:

1. The ATV is not registered to be operated on the public highways, and
2. The ATV is not capable of being registered due to the fact it does not meet all the standards, rules, and specifications required to be registered for highway use, and
3. The ATV meets all the other requirements to qualify for the Idaho ITC (used in Idaho, used for business purposes, etc.)

**8915 USED PROPERTY LIMITATION FOR MEMBER OF CONTROLLED GROUP**

The Idaho used property limitation rules follow federal law. IRS rules dictate an aggregate used property limitation for controlled group (defined in IRC section 48(c)(3)(C) and 1563(a)) of \$150,000. For corporate taxpayers, the limit for a controlled group is divided among the members based on the ratio of each corporation's used property to total used property of the controlled group (IRC section 48(c)(2)(C) and Treasury Regulation section 1.48-3(d)).

IRS regulations provide that the partnership limit is divided based on each partner's profit sharing percentage. Each partner is also subject to the \$150,000 limit.

**8920 COMPUTER SOFTWARE**

The Tax Commission will allow Idaho investment tax credit (ITC) on all software for all open cases and future audits.

**8925 POTENTIAL AUDIT ISSUES**

1. Buildings and building components
  - Generally, buildings do not qualify
  - Structural components of a building do not qualify:
    - doors
    - wiring

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- plumbing
- sprinkler systems
- parking lots
- air conditioning/heating units

The exception is a building component that is actually an integral part of a production process, such as electrical wiring for equipment, fish raceways at a trout farm, potato cellars as part of a farming operation, or an extra heavy concrete pad to support the weight of an industrial machine (IRC section 48(a)(1)).

2. Property not depreciated
  - Property not reported on the depreciation schedule.
  - Is it a phantom asset?
  - Was the asset expensed as a repair, a rental or a consumable?
3. Used property claimed in excess of the \$150,000 limitation.
4. The qualified investment should not include the basis of any trade-ins; unless ITC is recaptured on the traded-in property.
5. Property previously used by the same taxpayer or an affiliate of the taxpayer does not qualify as either a new or used asset for ITC purposes (IRC section 48(c)(1)). Examples:
  - a. Equipment acquired from an affiliate and transferred to a plant in Idaho.
  - b. Property previously subject to an operating lease where the taxpayer deducted lease payments and has now opted to buy out the lease.
  - c. Equipment rented by the taxpayer before purchase. The sales invoice may report "rent applied" in the sales calculation.
  - d. Property previously used by the taxpayer for personal purposes before conversion to business use (Treasury Regulation section 1.48-3(2), IRS Letter Ruling 8002126).
6. Leased property claimed by both the lessor and lessee, where the lessor treated the contract as an operating lease and the lessee treated it as a capital lease.

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7. Mobile property located outside of Idaho.
  - a. Taxpayers can choose one of two methods for calculating ITC per Idaho Code section 63-3029B(10).
  - b. If used property, the amount eligible for ITC is determined under the mobile property rules first and then the used property limitation is applied.
8. A farm structure does not fall within the narrow definition of what is a “single purpose agricultural or horticultural structure”. This does not include shop buildings (IRC section 48(p)).
9. Motor vehicles under 8,000 lbs gross vehicle weight don’t qualify.
10. The taxpayer did not compute ITC recapture on disposed assets. Check to see if Form 4797 reports dispositions. Review the depreciation schedules for assets that have been dropped.
11. The taxpayer did not account for expiration of carryover amounts.
12. The taxpayer did not reduce carryover amounts to reflect prior audit determinations.
13. The number of years held was overstated in the taxpayer’s recapture calculations, thereby reducing the recapture percentage. The holding period is from the first day of the month the asset was placed in service to the actual date of disposition.
14. The taxpayer ignored recapture on assets transferred out of Idaho but still owned.
15. ITC claimed on assets leased to tax-exempt organizations - including local governments. For example, a road grader leased to a city, or leased computer equipment (IRC section 48(a)(4)).
16. Reforestation expenditures qualifying for amortization under IRC section 194. Qualifying costs eligible for the credit are limited to \$10,000 whether or not the taxpayer elects amortization.

**8930 AUDIT RESOURCES**

ITC can be reported on either a business or individual return.

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

Structure the initial letter to mirror the records required by Idaho Income Tax Administrative Rule 716.

At various times, auditors ask questions of either the Auditor 4 or our legal department. Issue analyses and opinions can provide direction and guidance when conducting an ITC audit. These documents can be found on the ITA SharePoint site in the Issue Analysis folder.

On the ITA SharePoint site in the Issue Analysis folder are two documents entitled "ITC - Tax Management vol. 191" and "ITC - BNA Portfolio 583" that provide good background and information on the federal ITC before repeal.

Several ITC audits have also been protested and administrative decisions have been written. These decisions can be found on the [ISTC website](#) or in the Index of Administrative Decisions on the ITA SharePoint site.

**8935 RECAPTURE**

ITC recapture is required when property is disposed of or ceases to qualify. Idaho code specifies that recapture shall be determined according to the applicable recapture provisions of the IRC (see Idaho Code section 63-3029B(6)).

IRC section 50(a)(1) requires recapture when property is disposed of, or otherwise ceases to be investment credit property **with respect to the taxpayer**. IRC section 50(a)(1)(b) provides the following recapture periods and percentages:

Time Property Qualified	Recapture Percentage
Less than 1 full year	100%
More than 1 full year Less than 2 full years	80%
More than 2 full years Less than 3 full years	60%
More than 3 full years Less than 4 full years	40%

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More than 4 full years	
Less than 5 full years	20%

The following is a brief overview of ITC recapture.

- A. If property is disposed of or ceases to qualify within five full years from the date placed in service, a recapture computation must be made.
- If all or part of the original credit was claimed against tax on a return, then recapture needs to be reported as an addition to tax.
  - Otherwise, the recapture is reflected as a reduction in ITC carryforward.
- B. Recapture does not apply to the transfer of shares of stock of a shareholder of an electing small business corporation by reason of the death of the shareholder (Treasury Regulation section 1.47-3(b)).
- C. For property used both inside and outside of Idaho, no recapture will be required unless percentage use in Idaho drops to zero prior to the close of the estimated useful life of the property.
- D. Recapture period means the period consisting of the first full year after the property is placed in service and the four (4) succeeding full years.
- E. IRC section 38 property is treated as placed in service on the first day of the month in which such property is placed in service. If during the following tax years such property ceases to be section 38 property, the cessation is treated as having occurred on the actual date of such event (Treasury Regulation section 1.47-1(c)).
- F. If a shareholder in an S corporation or a partner in a partnership reduced his interest by more than one-third of his proportionate interest on the date an asset was placed in service, then recapture relative to that shareholder or partner is required on that asset to the extent of the actual reduction in proportionate interest (Treasury Regulation section 1.47-4(a)(2)).

Recapture is determined under the IRC and Treasury Regulations in effect in the year property ceases to qualify.

For some of the more common ITC recapture audit issues see Section 8945.

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**“Disposition” vs “Cessation”**

Dispositions

In general, ITC must be recaptured when property is sold, exchanged, transferred, distributed, involuntarily converted, or disposed of by gift.

Cessation

Property ceases to be qualified property if it ceases to satisfy one or more of the requirements of qualified property. The qualified property tests must be applied anew each year during the recapture period, as if the property were first placed in service in each year (Treasury Regulation section 1.47-2(a)).

IRC section 50(4) contains three exceptions to the general recapture rule including: (1) a transfer by reason of death, (2) mere changes in the form of doing business, and (3) a transaction to which section 381(a) applies (tax-free liquidations and reorganizations).

The “mere change in form of doing business” exception requires that: (1) the property transferred be retained in the trade or business as investment credit property; (2) substantially all of the assets necessary to operate the trade or business must be transferred (not just section 38 assets); (3) the transferor must retain a substantial interest in the trade or business; and (4) the basis of the section 38 property must be determined in whole or in part by reference to the basis of section 38 property in the hands of the transferor (Treasury Regulation section 1.47-3(f)).

“Substantial interest” means that the partner’s interest in the new business must be substantial in relation to the total interest of all persons, or equal to or greater than his interest prior to the change in form. Subsequent reductions can result in recapture.

**REPORTING**

ITC recapture is reported on Idaho Form 49R.

Lines 12 and 13 of the form distinguish between recapture of unused credit and used credit. Recapture of unused credit (not used to offset tax in any year) simply reduces ITC carryover. Recapture of used credit is reported as additional tax on Form 40 under “Other Taxes”.



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In determining whether the credit was used or unused, consider that credit earned first is used first.

**8940 CORPORATE SPIN-OFF ITC RECAPTURE & CARRYOVER**

Corporation A (A) had approximately \$32,000 in ITC carryover from 1984 to 1985. At the 1984 year-end, A spun off five corporations and distributed the assets among the five new corporations including the ITC carryover which was distributed among the five new corporations and A equally.

The following **questions** concerning Idaho ITC developed as a result of examining the spin off:

1. Should A recognize Idaho ITC recapture on assets distributed to the corporations which were spun-off?
2. Can the acquiring corporations claim Idaho ITC which had been earned by the distributor, A, but not previously allowed?

**Conclusions:**

1. Recapture on assets distributed should occur.
2. The acquiring corporations cannot claim ITC earned by the distributor and not previously allowed.

Analysis:

Refer to IRC section 47, section 368, and section 381 including related regulations as in effect prior to Public Law 101-508.

**8945 RECAPTURE AUDIT ISSUES**

Note: If no financial benefit was received from the use of ITC (i.e. ITC was forced to be used in a closed year) and then recapture is required in an open tax year, no tax is due from the recapture.

**EXAMPLES OF NONRECAPTURE EVENTS**

**1. Incorporation Transfers**

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No recapture as long as all of the “[mere change](#)” exception requirements are met (Treasury Regulation section 1.47-3(f)).

## **2. Election to be an S Corporation**

No recapture is required due to an S election; the election is treated as a mere change in the form of doing business (IRC section 1371(d)(1)).

Caution: An S corporation continues to be liable for any ITC recapture with respect to credits allowed during years the corporation was not an S corporation (IRC section 1371(d)(2)).

## **3. Termination of S Election**

Termination or revocation of an S election in and of itself is not a recapture event (Treasury Regulation section 1.47-4(d)).

## **4. Formation of a Partnership**

ITC recapture is not made upon the formation of a partnership as long as all of the “mere change” exception requirements are met (Treasury Regulation section 1.47-3(f)). There can't be a merger of existing businesses or creation of a new business under the “mere change” exception.

## **5. Death**

Recapture is not required as a result of death (IRC section 50(a)(4)(A)). However, any ITC applicable to a surviving spouse's original community property interest in the ITC property is subject to recapture if the surviving spouse disposes of the property during the recapture period.

## **6. Transfers Incident to Divorce**

A section 1041 transfer does not result in recapture. However, a later disposition by the transferee will result in recapture just the same as if the transferor had disposed of the property (IRC section 50(a)(5)(B)).

## **7. Individual Bankruptcies**

The transfer of assets between an individual debtor and bankruptcy estate in Title 11 cases is not treated as a disposition of the assets (IRC section 1398(f)).

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**RECAPTURE EVENTS**

**1. Sale of Property**

If property is sold within the recapture period, ITC recapture is required. If a Form 4797 is done, always consider whether ITC must be recaptured.

If ITC property is sold by an S corporation, partnership, estate, or trust, the entity should provide the shareholders, partners, and/or beneficiaries a schedule detailing the recapture information (See instructions, Idaho Form 49C).

The shareholder, partnership, or beneficiary interest at the time of sale is **not** determinative as to who is required to recapture ITC. The recapture determination is made with respect to the pro rata share of the qualified investment taken into account by the individual when the property was placed in service by the entity (Treasury Regulation sections 1.47-4(a)(1); 1.47-5(a)(1); and 1.47-6(a)(1)).

**2. Sale or Reduction of Partnership Interest**

If a partner's proportionate interest in the general profits of a partnership (or in the particular item of property) is reduced below  $\frac{2}{3}$  of what it was in the year ITC property was placed in service, a recapture determination is required (Treasury Regulation section 1.47-6(a)(2)).

This can result from a sale, a change in the partnership agreement, or the admission of a new partner.

Property of a partnership ceases to be investment credit property with respect to a particular partner to the extent of reduction in his interest, but recapture is triggered only if the reduction in the interest is more than  $\frac{1}{3}$  of his interest at the time the ITC property was placed in service. In these situations, a recapture determination is required for only the selling partner.

**Example:**

A partner claimed ITC on his \$10,000 share of a qualified investment of the partnership at a time when his interest in the general profits of the partnership was 60%. Two years later the partner's interest in profits is reduced to 30%. Since his interest has been reduced to less than  $\frac{2}{3}$  of what it was for the year the property was placed in service that partner must recapture ITC to the extent of the reduction in his interest.

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Once there has been a recapture due to a more-than-one-third reduction in interest, there will be no further recapture until the partner's interest is reduced to less than one-third of his interest at the time the property was placed in service (Treasury Regulation section 1.47-6(a)(2)(ii)).

### **3. Sale or Reduction of S Corporation Interest**

If a shareholder's proportionate stock interest is reduced below two-thirds of what it was for the year ITC property was placed in service, ITC recapture is required to the extent of the reduction in interest (Treasury Regulation section 1.47-4(a)(2)).

This can occur by sale, redemption or other disposition of the shareholder's stock (except by death), or by the corporation's issuance of more shares.

Once there has been a recapture due to a more-than-one-third reduction in interest, there will be no further recapture until the shareholder's interest is reduced to less than one-third of his interest at the time the property was placed in service (Treasury Regulation section 1.47-4(a)(2)(ii)).

### **4. Reduction of Beneficiary Interest in Estate or Trust**

If a beneficiary's proportionate interest in the income of an estate or trust is reduced below two-thirds of what it was for the year ITC property was placed in service, ITC recapture is required to the extent of the reduction in interest (Treasury Regulation section 1.47-5(a)(2)).

This can occur by sale or by the terms of the estate or trust instrument.

Once there has been a recapture due to a more-than-one-third reduction in interest, there will be no further recapture until the shareholder's interest is reduced to less than one-third of his interest at the time the property was placed in service (Treasury Regulation section 1.47-5(a)(2)(ii)).

### **5. Liquidating Partnership Distributions**

Partnership property distributed to a partner in a liquidating distribution ceases to qualify as investment credit property *even if the property continues to be used in the same business by the former partner.*

Always recapture ITC when partnership interests are liquidated by distributions. A partner's basis in assets received in a liquidating distribution is determined by

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reference to the basis of his partnership interest, not a carryover basis from the partnership. Since there is a substituted basis instead of a carryover basis, this does not qualify for the “mere change” exception.

### **6. Nonliquidating Partnership Distributions**

When a partnership distributes property in a nonliquidating distribution to a partner, ITC recapture is required of all partners if the property is still within the recapture period. Each partner is required to recapture based on the share of the basis of the property taken into account by the partner in computing his qualified investment. (Treasury Regulation section 1.47-6(a)(1)).

### **7. Corporate Distributions of ITC Property**

Corporate distributions of ITC property will result in ITC recapture even if the property continues to be used in the same business by the former shareholder. It does not qualify for the “mere change” exception because the shareholder’s basis in the assets distributed is not a carryover basis. The basis will be the fair market value of the property (IRC section 301(d)).

### **8. Partnership Terminations**

If any partnership section 38 property is disposed of or ceases to be section 38 property in the hands of the partnership within the ITC recapture period, each partner must make a recapture determination (Treasury Regulation section 1.47-6(a)(1)).

#### **a. Conversion to Sole Proprietorship**

##### **Example:**

A and B, each 20% partners in partnership ABC sell their interest to C, a 60% partner. Always recapture ITC in a situation like this at the time the partnership terminates. Due to the lack of a carryover basis for the partnership assets, this does not qualify for the “mere change” exception.

##### **Caution:**

As long as section 736 guaranteed payments are being made to a retired member of a partnership, the partnership is still considered to be conducting business. That is because the regulations provide that a partnership doesn’t end until “no part of any business, financial operation

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or venture of the partnership continues to be carried on” by any of its partners in a partnership. The partnership is not terminated until “all remaining assets, consisting only of cash, are distributed to the partners.” (Treasury Regulation section 1.708-1(b)(1)(I)).

**b. Incorporation of a Partnership**

There are three basic methods of incorporating a partnership by a transfer to a controlled corporation under IRC section 351.

**(1) Partnership Asset Transfer**

**Example 1:**

Partnership ABC has 10 partners who share profits equally. ABC transfers all of its assets to X Corporation, a newly-formed corporation, in exchange for all of the stock of X Corporation and immediately thereafter transfers 10 percent of the stock to each of the 10 partners. This qualifies as a “mere change” and no ITC is recaptured.

**Example 2:**

Same as above, except ABC transfers 10 percent of the stock in X Corporation to each of 8 partners, 20 percent to partner A, and cash to partner B. Recapture is required for partner B because he failed to retain a substantial interest in the trade or business (not equal to prior interest or substantial in relation to the total interest of all persons).

**(2) Partner Asset Transfer**

**Example:**

Partnership ABC distributes its assets to the partners. The partners then transfer the assets to a new corporation in exchange for stock. ITC recapture is required since the corporation’s basis in the assets is not determined by reference to the partnership’s basis in the assets. Each partner’s basis in the assets distributed is equal to the basis of his partnership interest.

**(3) Partnership Interest Transfer**

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**Example:**

The partners transfer their interests to a corporation in exchange for stock. ITC recapture is required since the basis in assets will be equal to the partner's basis in their partnership interests.

**9. Corporate Liquidations**

ITC recapture generally is required for corporate liquidations (other than S corporations). In order to qualify for the mere change in the form of doing business exception, the taxpayer must retain a substantial interest in the business. In the case of liquidation, the "taxpayer" ceases to exist. However, liquidation of an 80% owned subsidiary may qualify for the exception for tax-free transfers of assets under section 381(a). Transfers to which IRC section 381(a) applies are not considered dispositions of investment credit property.

**10. Like-Kind Exchanges and Trade-in's**

ITC property traded in on other property within the recapture period is subject to ITC recapture. However, the qualified investment in new property will include the adjusted basis of the property traded in. The qualified investment in used property will also include the adjusted basis of the trade-in if ITC was recaptured (Treasury Regulation section 1.48-3(b)(1) and (3)).

**11. Leased Property**

Generally ITC on leased property is allowed to the lessor. However, if an election was made to pass through the ITC to the lessee, then termination of the lease within the recapture period will result in recapture to the lessee. Entering into a conditional sales contract on property still within the recapture period will result in ITC recapture to the lessor.

**12. Casualty or Theft Losses**

When ITC property ceases to qualify because of destruction or theft, recapture applies if the property is still within the recapture period. However, if the property is replaced by qualified property, the replacement property is eligible for ITC.

**13. Personal Use of Property**

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Decrease in the business use of property that is used for both business and personal is an early disposition to the extent of the reduction in business use. This is a recapture event (Treasury Regulation section 1.47-2(e)).

**14. Abandonment or Retirement**

A retirement or abandonment within the recapture period results in recapture because depreciation will no longer be allowable on the retired items as required by IRC section 48(a)(1).

**15. Gifts of Property**

A gift of investment credit property within the recapture period is a recapture event due to “disposition” (Treasury Regulation section 1.47-2(a)).

**16. Corporate Spin-Offs**

A section 355 spin-off doesn’t qualify as a “mere change” because the transferor corporation doesn’t retain a substantial interest in the spun-off business (see Treasury Regulation section 1.47-3(f)).



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**8950 IRC SECTION 46(C) AS OF 1989 AND PRIOR TO PUBLIC LAW 101-508**

46(c)(1) IN GENERAL.--For purposes of this subpart, the term "qualified investment" means, with respect to any taxable year, the aggregate of--

46(c)(1)(A) the applicable percentage of the basis of each new section 38 property (as defined in section 48(b)) placed in service by the taxpayer during such taxable year, plus

46(c)(1)(B) the applicable percentage of the cost of each used section 38 property (as defined in section 48(c)(1)) placed in service by the taxpayer during such taxable year.

46(c)(2) APPLICABLE PERCENTAGE IN CERTAIN CASES.--Except as provided in paragraphs (3), (6), and (7), the applicable percentage for purposes of paragraph (1), for any property shall be determined under the following table:

If the useful life is--	The applicable percentage is--
3 years or more but less than 5 years	33 1/3
5 years or more but less than 7 years	66 2/3
7 years or more	100

For purposes of this subpart, the useful life of any property shall be the useful life used in computing the allowance for depreciation under section 167 for the taxable year in which the property is placed in service.

46(c)(3) PUBLIC UTILITY PROPERTY.--

46(c)(3)(A) To the extent that the credit allowed by section 38 with respect to any public utility property is determined at the rate of 7 percent, in the case of any property which is public utility property, the amount of the qualified investment shall be 4/7 of the amount determined under paragraph (1). The preceding sentence shall not apply for purposes of applying the energy percentage.

46(c)(3)(B) For purposes of subparagraph (A), the term "public utility property" means property used predominantly in the trade or business of the furnishing or sale of

46(c)(3)(B)(i) electrical energy, water, or sewage disposal services,

46(c)(3)(B)(ii) gas through a local distribution system, or

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46(c)(3)(B)(iii) telephone service, telegraph service by means of domestic telegraph operations (as defined in section 222(a)(5) of the Communications Act of 1934, as amended; 47 U.S.C. 222(a)(5)), or other communication services (other than international telegraph service), if the rates for such furnishing or sale, as the case may be, have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof. Such term also means communication property of the type used by persons engaged in providing telephone or microwave communication services to which clause (iii) applies, if such property is used predominantly for communication purposes.

46(c)(3)(C) In the case of any interest in a submarine cable circuit used to furnish telegraph service between the United States and a point outside the United States of a taxpayer engaged in furnishing international telegraph service (if the rates for such furnishing have been established or approved by a governmental unit, agency, instrumentality, commission, or similar body described in subparagraph (B)), the qualified investment shall not exceed the qualified investment attributable to so much of the interest of the taxpayer in the circuit as does not exceed 50 percent of all interests in the circuit.

46(c)(4) COORDINATION WITH SUBSECTION (d).--The amount which would (but for this paragraph) be treated as qualified investment under this subsection with respect to any property shall be reduced (but not below zero) by any amount treated by the taxpayer or a predecessor of the taxpayer (or, in the case of a sale and leaseback described in section 47(a)(3)(C), by the lessee) as qualified investment with respect to such property under subsection (d), to the extent the amount so treated has not been required to be recaptured by reason of section 47(a)(3).

46(c)(5) APPLICABLE PERCENTAGE IN THE CASE OF CERTAIN POLLUTION CONTROL FACILITIES.--

46(c)(5)(A) IN GENERAL.--Notwithstanding paragraph (2), in the case of property--

46(c)(5)(A)(i) with respect to which an election under section 169 applies, and

46(c)(5)(A)(ii) the useful life of which (determined without regard to section 169) is not less than 5 years,

100 percent shall be the applicable percentage for purposes of applying paragraph (1) with respect to so much of the adjusted basis of the property as

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(after the application of section 169(f)) constitutes the amortizable basis for purposes of section 169.

46(c)(5)(B) SPECIAL RULE WHERE PROPERTY IS FINANCED BY PRIVATE ACTIVITY BONDS.--To the extent that any property is financed by the proceeds of a private activity bond (within the meaning of section 141) the interest on which is exempt from tax under section 103, subparagraph (A) shall be applied by substituting "50 percent" for "100 percent." This subparagraph shall not apply for purposes of applying the energy percentage.

46(c)(6) SPECIAL RULE FOR COMMUTER HIGHWAY VEHICLES.--

46(c)(6)(A) IN GENERAL.--Notwithstanding paragraph (2) or (3), in the case of a commuter highway vehicle the useful life of which is 3 years or more, or which is recovery property (within the meaning of section 168), the applicable percentage for purposes of paragraph (1) shall be 100 percent.

46(c)(6)(B) DEFINITION OF COMMUTER HIGHWAY VEHICLE.--For purposes of subparagraph (A), the term "commuter highway vehicle" means a highway vehicle--

46(c)(6)(B)(i) the seating capacity of which is at least 8 adults (not including the driver),

46(c)(6)(B)(ii) at least 80 percent of the mileage use of which can reasonably be expected to be (I) for purposes of transporting the taxpayer's employees between their residences and their place of employment, and (II) on trips during which the number of employees transported for such purposes is at least one-half of the adult seating capacity of such vehicle (not including the driver),

46(c)(6)(B)(iii) which is acquired by the taxpayer on or after the date of the enactment of the Energy Tax Act of 1978, and placed in service by the taxpayer before January 1, 1986, and

46(c)(6)(B)(iv) with respect to which the taxpayer makes an election under this paragraph on his return for the taxable year in which such vehicle is placed in service.

46(c)(7) APPLICABLE PERCENTAGE FOR PROPERTY TO WHICH SECTION 168 APPLIES.--Notwithstanding paragraph (2), the applicable percentage for purposes of paragraph (1) shall be--

46(c)(7)(A) in the case of property to which section 168 applies other than 3-year property (within the meaning of section 168(e)), 100 percent, and

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46(c)(7)(B) in the case of 3-year property (within the meaning of section 168(e)), 60 percent.

For purposes of subparagraph (A), RRB replacement property (within the meaning of section 168 (f)(3)(B) (as in effect on the day before the date of enactment of the Tax Reform Act of 1986) shall be treated as property which is not 3-year property.

46(c)(8) CERTAIN NONRECOURSE FINANCING EXCLUDED FROM CREDIT BASE.--

46(c)(8)(A) LIMITATION.--The credit base of any property to which this paragraph applies shall be reduced by the nonqualified nonrecourse financing with respect to such property (as of the close of the taxable year in which placed in service).

46(c)(8)(B) PROPERTY TO WHICH PARAGRAPH APPLIES.--This paragraph applies to any property which--

46(c)(8)(B)(i) is placed in service during the taxable year by a taxpayer described in section 465(a)(1), and

46(c)(8)(B)(ii) is used in connection with an activity with respect to which any loss is subject to limitation under section 465.

46(c)(8)(C) CREDIT BASE DEFINED.--For purposes of this paragraph, the term "credit base" means--

46(c)(8)(C)(i) in the case of new section 38 property, the basis of the property, or

46(c)(8)(C)(ii) in the case of used section 38 property, the cost of such property.

46(c)(8)(D) NONQUALIFIED NONRECOURSE FINANCING.--

46(c)(8)(D)(i) IN GENERAL.--For purposes of this paragraph and paragraph (9), the term "nonqualified nonrecourse financing" means any nonrecourse financing which is not qualified commercial financing.

46(c)(8)(D)(ii) QUALIFIED COMMERCIAL FINANCING.--For purposes of this paragraph, the term "qualified commercial financing" means any financing with respect to any property if--

46(c)(8)(D)(ii)(I) such property is acquired by the taxpayer from a person who is not a related person,

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46(c)(8)(D)(ii)(II) the amount of the nonrecourse financing with respect to such property does not exceed 80 percent of the credit base of such property, and

46(c)(8)(D)(ii)(III) such financing is borrowed from a qualified person or represents a loan from any Federal, State, or local government or instrumentality thereof, or is guaranteed by any Federal, State, or local government.

Such term shall not include any convertible debt.

46(c)(8)(D)(iii) NONRECOURSE FINANCING.--For purposes of this subparagraph, the term "nonrecourse financing" includes--

46(c)(8)(D)(iii)(I) any amount with respect to which the taxpayer is protected against loss through guarantees, stop-loss agreements, or other similar arrangements, and

46(c)(8)(D)(iii)(II) except to the extent provided in regulations, any amount borrowed from a person who has an interest (other than as a creditor) in the activity in which the property is used or from a related person to a person (other than the taxpayer) having such an interest.

In the case of amounts borrowed by a corporation from a shareholder, subclause (II) shall not apply to an interest as a shareholder.

46(c)(8)(D)(iv) QUALIFIED PERSON.--For purposes of this paragraph, the term "qualified person" means any person which is actively and regularly engaged in the business of lending money and which is not--

46(c)(8)(D)(iv)(I) a related person with respect to the taxpayer,

46(c)(8)(D)(iv)(II) a person from which the taxpayer acquired the property (or a related person to such person), or

46(c)(8)(D)(iv)(III) a person who receives a fee with respect to the taxpayer's investment in the property (or a related person to such person).

46(c)(8)(D)(v) RELATED PERSON.--For purposes of this subparagraph, the term "related person" has the meaning given such term by section 465(b)(3)(C). Except as otherwise provided in regulations prescribed by the Secretary, the determination of whether a person is a related person shall be made as of the close of the taxable year in which the property is placed in service.

46(c)(8)(E) APPLICATION TO PARTNERSHIPS AND S CORPORATIONS.--For purposes of this paragraph and paragraph (9)--

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46(c)(8)(E)(i) IN GENERAL.--Except as otherwise provided in this subparagraph, in the case of any partnership or S corporation, the determination of whether a partner's or shareholder's allocable share of any financing is nonqualified nonrecourse financing shall be made at the partner or shareholder level.

46(c)(8)(E)(ii) SPECIAL RULE FOR CERTAIN RECOURSE FINANCING OF S CORPORATION.--A shareholder of an S corporation shall be treated as liable for his allocable share of any financing provided by a qualified person to such corporation if--

46(c)(8)(E)(ii)(I) such financing is recourse financing (determined at the corporate level), and

46(c)(8)(E)(ii)(II) such financing is provided with respect to qualified business property of such corporation.

46(c)(8)(E)(iii) QUALIFIED BUSINESS PROPERTY.--For purposes of clause (ii), the term "qualified business property" means any property if--

46(c)(8)(E)(iii)(I) such property is used by the corporation in the active conduct of a trade or business,

46(c)(8)(E)(iii)(II) during the entire 12-month period ending on the last day of the taxable year, such corporation had at least 3 full-time employees who were not owner-employees (as defined in section 465(c)(7)(E)(i)) and substantially all the services of whom were services directly related to such trade or business, and

46(c)(8)(E)(iii)(III) during the entire 12-month period ending on the last day of such taxable year, such corporation had at least 1 full-time employee substantially all of the services of whom were in the active management of the trade or business.

Such term shall not include any master sound recording or other tangible or intangible asset associated with literary, artistic, or musical properties.

46(c)(8)(E)(iv) DETERMINATION OF ALLOCABLE SHARE.--The determination of any partner's or shareholder's allocable share of any financing shall be made in the same manner as the credit allowable by section 38 with respect to such property.

46(c)(8)(F) SPECIAL RULE FOR CERTAIN ENERGY PROPERTY.--

46(c)(8)(F)(i) IN GENERAL.--Subparagraph (A) shall not apply with respect to qualified energy property.

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46(c)(8)(F)(ii) QUALIFIED ENERGY PROPERTY.--The term "qualified energy property" means energy property to which (but for this subparagraph) subparagraph (A) applies and--

46(c)(8)(F)(ii)(I) which is described in clause (iii),

46(c)(8)(F)(ii)(II) with respect to which the energy percentage determined under subsection (b)(2) at the time such property is placed in service is greater than zero,

46(c)(8)(F)(ii)(III) as of the close of the taxable year in which the property is placed in service, not more than 75 percent of the basis of such property is attributable to nonqualified nonrecourse financing, and

46(c)(8)(F)(ii)(IV) with respect to which any nonqualified nonrecourse financing in connection with such property consists of a level payment loan.

For purposes of subclass (II), the energy percentage for property described in clause (iii)(V) shall be treated as being greater than zero during any period the energy percentage for property described in section 48(l)(14) is greater than zero.

46(c)(8)(F)(iii) PROPERTY TO WHICH THIS SUBPARAGRAPH APPLIES.-- Energy property is described in this clause if such property is--

46(c)(8)(F)(iii)(I) described in clause (ii), (iv), or (vii) or [of] section 48(l)(2)[A],

46(c)(8)(F)(iii)(II) described in section 48(l)(15),

46(c)(8)(F)(iii)(III) described in section 48(l)(3)(A)(iii) (but only to the extent such property is used for converting an alternate substance into alcohol for fuel purposes),

46(c)(8)(F)(iii)(IV) described in clause (i) of section 48(l)(2)(A) (but only to the extent such property is also described in section 48(l)(3)(A)(viii) or (ix)), or

46(c)(8)(F)(iii)(V) property comprising a system for using the same energy source for the sequential generation of electrical power, mechanical shaft power, or both, in combination with steam, heat, or other forms of useful energy.

46(c)(8)(F)(iv) LEVEL PAYMENT LOAN DEFINED.--The term "level payment loan" means a loan in which each installment is substantially equal, a portion of each installment is attributable to the repayment of principal, and that portion is increased commensurate with decreases in the portion of the payment attributable to interest.

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46(c)(9) SUBSEQUENT DECREASES IN NONQUALIFIED NONRECOURSE FINANCING WITH RESPECT TO THE PROPERTY.--

46(c)(9)(A) IN GENERAL.--If, at the close of a taxable year following the taxable year in which the property was placed in service, there is a net decrease in the amount of nonqualified nonrecourse financing with respect to such property, such net decrease shall be taken into account as an increase in the credit base for such property in accordance with subparagraph (C).

46(c)(9)(B) CERTAIN TRANSACTIONS NOT TAKEN INTO ACCOUNT.--For purposes of this paragraph, nonqualified nonrecourse financing shall not be treated as decreased through the surrender or other use of property financed by nonqualified nonrecourse financing.

46(c)(9)(C) MANNER IN WHICH TAKEN INTO ACCOUNT.--

46(c)(9)(C)(i) CREDIT DETERMINED BY REFERENCE TO TAXABLE YEAR PROPERTY PLACED IN SERVICE.--For purposes of determining the amount of credit allowable under section 38 and the amount of credit subject to the early disposition or cessation rules under section 47, any increase in a taxpayer's credit base for any property by reason of this paragraph shall be taken into account as if it were property placed in service by the taxpayer in the taxable year in which the property referred to in subparagraph (A) was first placed in service.

46(c)(9)(C)(ii) CREDIT ALLOWED FOR YEAR OF DECREASE IN NONQUALIFIED NONRECOURSE FINANCING.--Any credit allowable under this subpart for any increase in qualified investment by reason of this paragraph shall be treated as earned during the taxable year of the decrease in the amount of nonqualified nonrecourse financing.



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**8955 IRC SECTION 48 AS OF 1989 AND PRIOR TO PUBLIC LAW 101-508**

SEC. 48. DEFINITIONS; SPECIAL RULES.

Subsec. (a) SECTION 38 PROPERTY.--

48(a)(1) IN GENERAL.--Except as provided in this subsection, the term "section 38 property" means--

48(a)(1)(A) tangible personal property (other than an air conditioning or heating unit), or

48(a)(1)(B) other tangible property (not including a building and its structural components) but only if such property--

48(a)(1)(B)(i) is used as an integral part of manufacturing, production, or extraction or of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services, or

48(a)(1)(B)(ii) constitutes a research facility used in connection with any of the activities referred to in clause (i), or

48(a)(1)(B)(iii) constitutes a facility used in connection with any of the activities referred to in clause (i) for the bulk storage of fungible commodities (including commodities in a liquid or gaseous state), or

48(a)(1)(C) elevators and escalators, but only if--

48(a)(1)(C)(i) the construction, reconstruction, or erection of the elevator or escalator is completed by the taxpayer after June 30, 1963, or

48(a)(1)(C)(ii) the elevator or escalator is acquired after June 30, 1963, and the original use of such elevator or escalator commences with the taxpayer and commences after such date, or

48(a)(1)(D) single purpose agricultural or horticultural structures; or

48(a)(1)(E) in the case of a qualified rehabilitated building, that portion of the basis which is attributable to qualified rehabilitation expenditures (within the meaning of subsection (g)), or

48(a)(1)(F) in the case of qualified timber property (within the meaning of section 194(c)(1)), that portion of the basis of such property constituting the amortizable basis acquired during the taxable year (other than that portion of such amortizable basis attributable to property which otherwise qualifies as section 38

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property) and taken into account under section 194 (after the application of section 194(b)(1)), or

48(a)(1)(G) a storage facility (not including a building and its structural components) used in connection with the distribution of petroleum or any primary product of petroleum.

Such term includes only property to which section 168 applies without regard to any useful life and any other property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life (determined as of the time such property is placed in service) of 3 years or more. The preceding sentence shall not apply to property described in subparagraph (F) and, for purposes of this subpart, the useful life of such property shall be treated as its normal growing period.

48(a)(2) PROPERTY USED OUTSIDE THE UNITED STATES.--

48(a)(2)(A) IN GENERAL.--Except as provided in subparagraph (B), the term "section 38 property" does not include property which is used predominantly outside the United States.

48(a)(2)(B) EXCEPTIONS.--Subparagraph (A) shall not apply to--

48(a)(2)(B)(i) any aircraft which is registered by the Administrator of the Federal Aviation Agency and which is operated to and from the United States or is operated under contract with the United States;

48(a)(2)(B)(ii) rolling stock which is used within and without the United States and which is--

48(a)(2)(B)(I) of a domestic railroad corporation providing transportation subject to subchapter I of chapter 105 of title 49, or

48(a)(2)(B)(II) of a United States person (other than a corporation described in subclause (I)) but only if the rolling stock is not leased to one or more foreign persons for periods aggregating more than 12 months in any 24-month period;

48(a)(2)(B)(iii) any vessel documented under the laws of the United States which is operated in the foreign or domestic commerce of the United States;

48(a)(2)(B)(iv) any motor vehicle of a United States person (as defined in section 7701(a)(30)) which is operated to and from the United States;

48(a)(2)(B)(v) any container of a United States person which is used in the transportation of property to and from the United States;

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48(a)(2)(B)(vi) any property (other than a vessel or an aircraft) of a United States person which is used for the purpose of exploring for, developing, removing, or transporting resources from the outer Continental Shelf (within the meaning of section 2 of the Outer Continental Shelf Lands Act, as amended and supplemented; (43 U.S.C. 1331));

48(a)(2)(B)(vii) any property which is owned by a domestic corporation (other than a corporation which has an election in effect under section 936) or by a United States citizen (other than a citizen entitled to the benefits of section 931 or 933) and which is used predominantly in a possession of the United States by such a corporation or such a citizen, or by a corporation created or organized in, or under the law of, a possession of the United States;

48(a)(2)(B)(viii) any communications satellite (as defined in section 103(3) of the Communications Satellite Act of 1962, 47 U. S. C. 702(3)), or any interest therein, of a United States person;

48(a)(2)(B)(ix) any cable, or any interest therein, of a domestic corporation engaged in furnishing telephone service to which section 46(c)(3)(B)(iii) applies (or of a wholly owned domestic subsidiary of such a corporation), if such cable is part of a submarine cable system which constitutes part of a communication link exclusively between the United States and one or more foreign countries;

48(a)(2)(B)(x) any property (other than a vessel or an aircraft) of a United States person which is used in international or territorial waters within the northern portion of the Western Hemisphere for the purpose of exploring for, developing, removing, or transporting resources from ocean waters or deposits under such waters; and

48(a)(2)(B)(xi) any property described in subsection (l)(3)(A)(ix) which is owned by a United States person and which is used in international or territorial waters to generate energy for use in the United States.

For purposes of clause (x), the term "northern portion of the Western Hemisphere" means the area lying west of the 30th meridian west of Greenwich, east of the international dateline, and north of the Equator, but not including any foreign country which is a country of South America.

48(a)(3) PROPERTY USED FOR LODGING.--Property which is used predominantly to furnish lodging or in connection with the furnishing of lodging shall not be treated as section 38 property. The preceding sentence shall not apply to--

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48(a)(3)(A) nonlodging commercial facilities which are available to persons not using the lodging facilities on the same basis as they are available to persons using the lodging facilities,

48(a)(3)(B) property used by a hotel or motel in connection with the trade or business of furnishing lodging where the predominant portion of the accommodations is used by transients,

48(a)(3)(C) coin-operated vending machines and coin-operated washing machines and dryers, and

48(a)(3)(D) a certified historic structure to the extent of that portion of the basis which is attributable to qualified rehabilitation expenditures.

48(a)(4) PROPERTY USED BY CERTAIN TAX-EXEMPT ORGANIZATIONS.-- Property used by an organization (other than a cooperative described in section 521) which is exempt from the tax imposed by this chapter shall be treated as section 38 property only if such property is used predominantly in an unrelated trade or business the income of which is subject to tax under section 511. If the property is debt-financed property (as defined in section 514(b)), the basis or cost of such property for purposes of computing qualified investment under section 46(c) shall include only that percentage of the basis or cost which is the same percentage as is used under section 514(a), for the year the property is placed in service, in computing the amount of gross income to be taken into account during such taxable year with respect to such property. If any qualified rehabilitated building is used by the tax-exempt organization pursuant to a lease, this paragraph shall not apply to that portion of the basis of such building which is attributable to qualified rehabilitation expenditures.

48(a)(5) PROPERTY USED BY GOVERNMENTAL UNITS OR FOREIGN PERSONS OR ENTITIES.--

48(a)(5)(A) IN GENERAL.--Property used--

48(a)(5)(A)(i) by the United States, any State or political subdivision thereof, any possession of the United States, or any agency or instrumentality of any of the foregoing, or

48(a)(5)(A)(ii) by any foreign person or entity (as defined in section 168(h)(2)(C)), but only with respect to property to which section 168(h)(2)(A)(iii) applies (determined after the application of section 168(h)(2)(B)--),

shall not be treated as section 38 property.

48(a)(5)(B) EXCEPTION FOR SHORT-TERM LEASES.--

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48(a)(5)(B)(i) IN GENERAL.--This paragraph and paragraph (4) shall not apply to any property by reason of use under a lease with a term of less than 6 months (determined under section 168(i)(3)--).

48(a)(5)(B)(ii) EXCEPTION FOR CERTAIN OIL DRILLING PROPERTY AND CERTAIN CONTAINERS.--For purposes of this paragraph and paragraph (4), clause (i) shall be applied by substituting the lease term limitation in section 168(h)(1)(C)(ii) for the lease term limitation in clause (i) in the case of property which is leased to a foreign person or entity and--

48(a)(5)(B)(ii)(I) which is used in offshore drilling for oil and gas (including drilling vessels, barges, platforms, and drilling equipment) and support vessels with respect to such property, or

48(a)(5)(B)(ii)(II) which is a container described in section 48(a)(2)(B)(v) (without regard to whether such container is used outside the United States) or container chassis or trailer but only if such container, chassis, or trailer has a present class life of not more than 6 years.

48(a)(5)(C) EXCEPTION FOR QUALIFIED REHABILITATED BUILDINGS LEASED TO GOVERNMENTS, ETC.--If any qualified rehabilitated building is leased to a governmental unit (or a foreign person or entity), this paragraph shall not apply to that portion of the basis of such building which is attributable to qualified rehabilitation expenditures.

48(a)(5)(D) SPECIAL RULES FOR PARTNERSHIPS, ETC.--For purposes of this paragraph and paragraph (4), rules similar to the rules of paragraphs (5) and (6) of section 168(h) shall apply.

48(a)(5)(E) CROSS REFERENCE.--

For provision providing special rules for the application of this paragraph and paragraph (4), see section 168(h).

48(a)(6) LIVESTOCK.--Livestock (other than horses) acquired by the taxpayer shall be treated as section 38 property, except that if substantially identical livestock is sold or otherwise disposed of by the taxpayer during the one-year period beginning 6 months before the date of such acquisition and if section 47(a) (relating to certain dispositions, etc., of section 38 property) does not apply to such sale or other disposition, then, unless such sale or other disposition constitutes an involuntary conversion (within the meaning of section 1033), the cost of the livestock acquired shall, for purposes of this subpart, be reduced by an amount equal to the amount realized on such sale or other disposition. Horses shall not be treated as section 38 property.

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48(a)(7) PROPERTY COMPLETED ABROAD OR PREDOMINANTLY OF FOREIGN ORIGIN.--

48(a)(7)(A) IN GENERAL.--Property shall not be treated as section 38 property if-

48(a)(7)(A)(i) such property was completed outside the United States, or

48(a)(7)(A)(ii) less than 50 percent of the basis of such property is attributable to value added within the United States.

For purposes of this subparagraph, the term "United States" includes the Commonwealth of Puerto Rico and the possessions of the United States.

48(a)(7)(B) PERIOD OF APPLICATION OF PARAGRAPH.--Except as provided in subparagraph (D), subparagraph (A) shall apply only with respect to property described in section 50 (as in effect before its repeal by the Revenue Act of 1978)--

48(a)(7)(B)(i) the construction, reconstruction, or erection of which by the taxpayer is begun after August 15, 1971, and on or before the date of termination of Proclamation 4074, or

48(a)(7)(B)(ii) which is acquired pursuant to an order placed on or before the date of termination of Proclamation 4074, unless acquired pursuant to an order which the taxpayer establishes was placed before August 16, 1971.

48(a)(7)(C) PRESIDENT MAY EXEMPT ARTICLES.--If the President of the United States shall at any time determine that the application of subparagraph (A) to any article or class of articles is not in the public interest, he may by Executive order specify that subparagraph (A) shall not apply to such article or class of articles. Subparagraph (A) shall not apply to an article or class of articles for the period specified in such Executive order. Any period specified under the preceding sentence shall not apply to property ordered before (or to property the construction, reconstruction, or erection of which began before) the date of the Executive order specifying such period, except that, if the President determines it to be in the public interest, such period shall apply to property ordered (or property the construction, reconstruction, or erection of which began) after a date (before the date of the Executive order) specified in the Executive order.

48(a)(7)(D) COUNTRIES MAINTAINING TRADE RESTRICTIONS OR ENGAGING IN DISCRIMINATORY ACTS.--If, on or after the date of the termination of Proclamation 4074, the President determines that a foreign country--

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48(a)(7)(D)(i) maintains nontariff trade restrictions, including variable import fees, which substantially burden United States commerce in a manner inconsistent with provisions of trade agreements, or

48(a)(7)(D)(ii) engages in discriminatory or other acts (including tolerance of international cartels) or policies unjustifiably restricting United States commerce,

he may provide by Executive order for the application of subparagraph (A) to any article or class of articles manufactured or produced in such foreign country for such period as may be provided by Executive order.

48(a)(8) AMORTIZED PROPERTY.--Any property with respect to which an election under section 167(k), 184, or 188 applies shall not be treated as section 38 property.

48(a)(9)[Repealed]

48(a)(10) BOILERS FUELED BY OIL OR GAS.--

48(a)(10)(A) IN GENERAL.--The term "section 38 property" does not include any boiler primarily fueled by petroleum or petroleum products (including natural gas) unless the use of coal is precluded by Federal air pollution regulations (or by State air pollution regulations in effect on October 1, 1978) or unless the use of such boiler will be an exempt use within the meaning of subparagraph (B). For purposes of the preceding sentence, the term "petroleum or petroleum products" does not include petroleum coke or petroleum pitch.

48(a)(10)(B) EXEMPT USE DEFINED.--For purposes of subparagraph (A), the term "exempt use" means--

48(a)(10)(B)(i) use in an apartment, hotel, motel, or other residential facility,

48(a)(10)(B)(ii) use in a vehicle, aircraft, or vessel, or in transportation by pipeline,

48(a)(10)(B)(iii) use on a farm for farming purposes (within the meaning of section 6420(c)),

48(a)(10)(B)(iv) use in--

48(a)(10)(B)(I) a shopping center,

48(a)(10)(B)(II) an office building,

48(a)(10)(B)(III) a wholesale or retail establishment,

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48(a)(10)(B)(IV) any other facility which is not an integral part of manufacturing, processing, or mining, or

48(a)(10)(B)(V) any facility for the production of electric power having a heat rate of less than 9,500 Btu's per kilowatt hour and which is capable of converting to synthetic fuels (as certified by the Secretary),

48(a)(10)(B)(v) use in the exploration for, or the development, extraction, transmission, or storage of, crude oil, natural gas, or natural gas liquids, and

48(a)(10)(B)(vi) use in Hawaii.

Except as provided in clauses (iv) (V) and (vi) of the preceding sentence, the term "exempt use" does not include use of a boiler which is public utility property (within the meaning of section 46(f)(5)).

Subsec. (b) NEW SECTION 38 PROPERTY.--

For purposes of this subpart--

48(b)(1) IN GENERAL.--The term "new section 38 property" means section 38 property the original use of which commences with the taxpayer. Such term includes any section 38 property the reconstruction of which is completed by the taxpayer, but only with respect to that portion of the basis which is properly attributable to such reconstruction.

48(b)(2) SPECIAL RULE FOR SALE-LEASEBACKS.--For purposes of the first sentence of paragraph (1), in the case of any section 38 property which--

48(b)(2)(A) is originally placed in service by a person, and

48(b)(2)(B) is sold and leased back by such person, or is leased to such person, within 3 months after the date such property was originally placed in service,

such property shall be treated as originally placed in service not earlier than the date on which such property is used under the leaseback (or lease) referred to in subparagraph (B). The preceding sentence shall not apply to any property if the lessee and lessor of such property make an election under this sentence. Such an election, once made, may be revoked only with the consent of the Secretary.

48(b)(3) SPECIAL RULE FOR ENERGY PROPERTY.--The principles of paragraph (2) shall be applicable in determining whether the original use of property commences with the taxpayer for purposes of section 48(1)(2)(B)(ii).

Subsec. (c) USED SECTION 38 PROPERTY.--

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48(c)(1) IN GENERAL.--For purposes of this subpart, the term "used section 38 property" means section 38 property acquired by purchase after December 31, 1961, which is not new section 38 property. Property shall not be treated as "used section 38 property" if, after its acquisition by the taxpayer, it is used by a person who used such property before such acquisition (or by a person who bears a relationship described in section 179(d)(2)(A) or (B) to a person who used such property before such acquisition).

48(c)(2) DOLLAR LIMITATION.--

48(c)(2)(A) IN GENERAL.--The cost of used section 38 property taken into account under section 46(c)(1)(B) for any taxable year shall not exceed \$125,000 (\$150,000 for taxable years beginning after 1987). If such cost exceeds \$125,000 (or \$150,000 as the case may be), the taxpayer shall select (at such time and in such manner as the Secretary shall by regulations prescribe) the items to be taken into account, but only to the extent of an aggregate cost of \$125,000 (or \$150,000). Such a selection, once made, may be changed only in the manner, and to the extent, provided by such regulations.

48(c)(2)(B) MARRIED INDIVIDUALS.--In the case of a husband or wife who files a separate return, the limitation under subparagraph (A) shall be \$62,500 (\$75,000 for taxable years beginning after 1987). This subparagraph shall not apply if the spouse of the taxpayer has no used section 38 property which may be taken into account as qualified investment for the taxable year of such spouse which ends within or with the taxpayer's taxable year.

48(c)(2)(C) CONTROLLED GROUPS.--In the case of a controlled group, the amount specified under subparagraph (A) shall be reduced for each component member of the group by apportioning such amount among the component members of such group in accordance with their respective amounts of used section 38 property which may be taken into account.

48(c)(2)(D) PARTNERSHIPS AND S CORPORATIONS.--In the case of a partnership, the limitation contained in subparagraph (A) shall apply with respect to the partnership and with respect to each partner. A similar rule shall apply in the case of an S corporation and its shareholders.

48(c)(3) DEFINITIONS.--For purposes of this subsection--

48(c)(3)(A) PURCHASE.--The term "purchase" has the meaning assigned to such term by section 179(d)(2).

48(c)(3)(B) COST.--The cost of used section 38 property does not include so much of the basis of such property as is determined by reference to the adjusted

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basis of other property held at any time by the person acquiring such property. If property is disposed of (other than by reason of its destruction or damage by fire, storm, shipwreck, or other casualty, or its theft) and used section 38 property similar or related in service or use is acquired as a replacement therefore in a transaction to which the preceding sentence does not apply, the cost of the used section 38 property acquired shall be its basis reduced by the adjusted basis of the property replaced. The cost of used section 38 property shall not be reduced with respect to the adjusted basis of any property disposed of if, by reason of section 47, such disposition involved an increase of tax or a reduction of the unused credit carrybacks or carryovers described in section 39.

48(c)(3)(C) CONTROLLED GROUP.--The term "controlled group" has the meaning assigned to such term by section 1563(a), except that the phrase "more than 50 percent" shall be substituted for the phrase "at least 80 percent" each place it appears in section 1563(a)(1).

Subsec. (d) CERTAIN LEASED PROPERTY.--

48(d)(1) GENERAL RULE.--A person (other than a person referred to in section 46(e)(1)) who is a lessor of property may (at such time, in such manner, and subject to such conditions as are provided by regulations prescribed by the Secretary) elect with respect to any new section 38 property (other than property described in paragraph (4)) to treat the lessee as having acquired such property for an amount equal to--

48(d)(1)(A) except as provided in subparagraph (B), the fair market value of such property, or

48(d)(1)(B) if the property is leased by a corporation which is a component member of a controlled group (within the meaning of section 38(c)(3)(B)) to another corporation which is a component member of the same controlled group, the basis of such property to the lessor.

48(d)(2) SPECIAL RULE FOR CERTAIN SHORT TERM LEASES.--

48(d)(2)(A) IN GENERAL.--A person (other than a person referred to in section 46(e)(1)) who is a lessor of property described in paragraph (4) may (at such time, in such manner, and subject to such conditions as are provided by regulations prescribed by the Secretary) elect with respect to such property to treat the lessee as having acquired a portion of such property for the amount determined under subparagraph (B).

48(d)(2)(B) DETERMINATION OF LESSEE'S INVESTMENT.--The amount for which a lessee of property described in paragraph (4) shall be treated as having

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acquired a portion of such property is an amount equal to a fraction, the numerator of which is the term of the lease and the denominator of which is the class life of the property leased (determined under section 167(m)), of the amount for which the lessee would be treated as having acquired the property under paragraph (1).

48(d)(2)(C) DETERMINATION OF LESSOR'S QUALIFIED INVESTMENT.--The qualified investment of a lessor of property described in paragraph (4) in any such property with respect to which he has made an election under this paragraph is an amount equal to his qualified investment in such property (as determined under section 46(c)) multiplied by a fraction equal to the excess of one over the fraction used under subparagraph (B) to determine the lessee's investment in such property.

48(d)(3) LIMITATIONS.--The elections provided by paragraphs (1) and (2) may be made with respect to property which would be new section 38 property if acquired by the lessee. For purposes of the preceding sentence and section 46(c), the useful life of property in the hands of the lessee is the useful life of such property in the hands of the lessor. If a lessor makes the election provided by paragraph (1) with respect to any property, the lessee shall be treated for all purposes of this subpart as having acquired such property. If a lessor makes the election provided by paragraph (2) with respect to any property, the lessee shall be treated for all purposes of this subpart as having acquired a fractional portion of such property equal to the fraction determined under paragraph (2)(B) with respect to such property.

48(d)(4) PROPERTY TO WHICH PARAGRAPH (2) APPLIES.--Paragraph (2) shall apply only to property which--

48(d)(4)(A) is new section 38 property,

48(d)(4)(B) has a class life (determined under section 167(m)) in excess of 14 years,

48(d)(4)(C) is leased for a period which is less than 80 percent of its class life, and

48(d)(4)(D) is not leased subject to a net lease (within the meaning of section 57(c)(1)(B) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1986)).

48(d)(5) COORDINATION WITH BASIS ADJUSTMENT.--In the case of any property with respect to which an election is made under this subsection--

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48(d)(5)(A) subsection (q) (other than paragraph (4)) shall not apply with respect to such property,

48(d)(5)(B) the lessee of such property shall include ratably in gross income over the shortest recovery period which could be applicable under section 168 with respect to such property an amount equal to 50 percent of the amount of the credit allowable under section 38 to the lessee with respect to such property, and

48(d)(5)(C) in the case of a disposition of such property to which section 47 applies, this paragraph shall be applied in accordance with regulations prescribed by the Secretary.

48(d)(6) COORDINATION WITH AT-RISK RULES.--

48(d)(6)(A) EXTENSION OF AT-RISK RULES TO CERTAIN LESSORS.--

48(d)(6)(A)(i) IN GENERAL.--If--

48(d)(6)(A)(I) a lessor makes an election under this subsection with respect to any at-risk property leased to an at-risk lessee, and

48(d)(6)(A)(II) but for this clause, section 46(c)(8) would not apply to such property in the hands of the lessor,

section 46(c)(8) shall apply to the lessor with respect to such property.

48(d)(6)(A)(ii) EXCEPTIONS.--Clause (i) shall not apply--

48(d)(6)(A)(I) if the lessor manufactured or produced the property,

48(d)(6)(A)(II) if the property has a readily ascertainable fair market value, or

48(d)(6)(A)(III) in circumstances which the Secretary determines by regulations to be circumstances where the application of clause (i) is not necessary to carry out the purposes of section 46(c)(8).

48(d)(6)(B) REQUIREMENT THAT LESSOR BE AT RISK.--In the case of any property which, in the hands of the lessor, is property to which section 46(c)(8) applies, the amount of the credit allowable to the lessee under section 38 with respect to such property by reason of an election under this subsection shall at no time exceed the credit which would have been allowable to the lessor with respect to such property (determined without regard to section 46(e)(3) if--

48(d)(6)(B)(i) the lessor's basis in such property were equal to the lessee acquisition amount, and

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48(d)(6)(B)(ii) no election had been made under this subsection.

48(d)(6)(C) LESSEE SUBJECT TO AT-RISK LIMITATIONS.--

48(d)(6)(C)(i) IN GENERAL.--In the case of any lease where--

48(d)(6)(C)(I) the lessee is an at-risk lessee,

48(d)(6)(C)(II) the property is at-risk property, and

48(d)(6)(C)(III) the at-risk percentage is less than the required percentage,

any credit allowable under section 38 to the lessee by reason of an election under this subsection (hereinafter in this paragraph referred to as the "total credit") shall be allowable only as provided in subparagraph (D).

48(d)(6)(C)(ii) AT-RISK PERCENTAGE.--For purposes of this paragraph, the term "at-risk percentage" means the percentage obtained by dividing--

48(d)(6)(C)(I) the present value (as of the time the lease is entered into) of the aggregate lease at-risk payments, by

48(d)(6)(C)(II) the lessee acquisition amount.

For purposes of subclause (I), the present value shall be determined by using a discount rate equal to the underpayment rate in effect under section 6621 as of the time the lease is entered into.

48(d)(6)(C)(iii) REQUIRED PERCENTAGE.--For purposes of clause (i)(III), the term "required percentage" means the sum of--

48(d)(6)(C)(I) 2 times the sum of the percentages applicable to the property under section 46(a), plus

48(d)(6)(C)(II) 10 percent.

In the case of 3-year property, such term means 60 percent of the required percentage determined under the preceding sentence.

48(d)(6)(C)(iv) LESSEE ACQUISITION AMOUNT.--For purposes of this paragraph, the term "lessee acquisition amount" means the amount for which the lessee is treated as having acquired the property by reason of an election under this subsection.

48(d)(6)(C)(v) LEASE AT-RISK PAYMENT.--For purposes of this paragraph, the term "lease at-risk payment" means any rental payment--

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48(d)(6)(C)(I) which the lessee is required to make under the lease in all events, and

48(d)(6)(C)(II) with respect to which the lessee is not protected against loss through nonrecourse financing, guarantees, stop-loss agreements, or other similar arrangements.

48(d)(6)(D) YEAR FOR WHICH CREDIT ALLOWABLE.--

48(d)(6)(D)(i) IN GENERAL.--Except as provided in clause (ii), in any case to which subparagraph (C)(i) applies, the portion of the total credit allowable for any taxable year shall be an amount which bears the same ratio to such total credit as--

48(d)(6)(D)(I) the aggregate rental payments made by the lessee under the lease during such taxable year, bears to

48(d)(6)(D)(II) the lessee acquisition amount.

48(d)(6)(D)(ii) REMAINING AMOUNT ALLOWABLE FOR YEAR IN WHICH AGGREGATE RENTAL PAYMENTS EXCEED REQUIRED PERCENTAGE OF ACQUISITION AMOUNT.--The total credit (to the extent not allowable for a preceding taxable year) shall be allowable for the first taxable year as of the close of which the aggregate rental payments made by the lessee under the lease equal or exceed the required percentage (as defined in subparagraph (C)(iii)) of the lessee acquisition amount.

48(d)(6)(E) DEFINITION OF AT-RISK LESSEE AND AT-RISK PROPERTY.--For purposes of this paragraph--

48(d)(6)(E)(i) AT-RISK LESSEE.--The term "at-risk lessee" means any lessee who is a taxpayer described in section 465(a)(1).

48(d)(6)(E)(ii) AT-RISK PROPERTY.--The term "at-risk property" means any property used by an at-risk lessee in connection with an activity with respect to which any loss is subject to limitation under section 465.

48(d)(6)(F) SPECIAL RULES FOR SUBPARAGRAPHS (C) AND (D).--

48(d)(6)(F)(i) SUBPARAGRAPHS (C) AND (D) APPLY IN LIEU OF OTHER AT-RISK RULES.--In the case of any election under this subsection, paragraphs (8) and (9) of section 46(c) and subsection (d) of section 47 shall only apply with respect to the lessor.

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48(d)(6)(F)(ii) APPLICATION TO PARTNERSHIPS AND S CORPORATIONS.--  
For purposes of subparagraphs (C) and (D), rules similar to the rules of  
subparagraph (E) of section 46(c)(8) shall apply.

48(d)(6)(F)(iii) SUBSEQUENT REDUCTIONS IN AT-RISK AMOUNT.--Under  
regulations prescribed by the Secretary, the principles of subsection (d) of  
section 47 shall apply for purposes of subparagraphs (C) and (D).

48(d)(6)(G) REGULATIONS.--The Secretary shall prescribe such regulations as  
may be necessary to carry out the purposes of this paragraph, including  
regulations--

48(d)(6)(G)(i) providing for such adjustments as may be appropriate where  
expenses connected with the lease are borne by the lessor, and

48(d)(6)(G)(ii) providing the extent to which contingencies in the lease will be  
disregarded.

Subsec. (f) ESTATES AND TRUSTS.--

In the case of an estate or trust--

48(f)(1) the qualified investment for any taxable year shall be apportioned  
between the estate or trust and the beneficiaries on the basis of the income of  
the estate or trust allocable to each, and

48(f)(2) any beneficiary to whom any investment has been apportioned under  
paragraph (1) shall be treated (for purposes of this subpart) as the taxpayer with  
respect to such investment, and such investment shall not (by reason of such  
apportionment) lose its character as an investment in new section 38 property or  
used section 38 property, as the case may be.

Subsec. (g) SPECIAL RULES FOR QUALIFIED REHABILITATED BUILDINGS.--

For purposes of this subpart--

48(g)(1) QUALIFIED REHABILITATED BUILDING.--For purposes of this  
subsection--

48(g)(1)(A) IN GENERAL.--The term "qualified rehabilitated building" means any  
building (and its structural components) if--

48(g)(1)(A)(i) such building has been substantially rehabilitated,

48(g)(1)(A)(ii) such building was placed in service before the beginning of the  
rehabilitation, and

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48(g)(1)(A)(iii) in the case of any building other than a certified historic structure, in the rehabilitation process--

48(g)(1)(A)(iii)(I) 50 percent or more of the existing external walls of such building are retained in place as external walls,

48(g)(1)(A)(iii)(II) 75 percent or more of the existing external walls of such building are retained in place as internal or external walls, and

48(g)(1)(A)(iii)(III) 75 percent or more of the existing internal structural framework of such building is retained in place.

48(g)(1)(B) BUILDING MUST BE FIRST PLACED IN SERVICE BEFORE 1936.--  
In the case of a building other than a certified historic structure, a building shall not be a qualified rehabilitated building unless the building was first placed in service before 1936.

48(g)(1)(C) SUBSTANTIALLY REHABILITATED DEFINED.--

48(g)(1)(C)(i) IN GENERAL.--For purposes of subparagraph (A)(i), a building shall be treated as having been substantially rehabilitated only if the qualified rehabilitation expenditures during the 24-month period selected by the taxpayer (at the time and in the manner prescribed by regulations) and ending with or within the taxable year exceed the greater of--

48(g)(1)(C)(i)(I) the adjusted basis of such building (and its structural components), or

48(g)(1)(C)(i)(II) \$5,000.

The adjusted basis of the building (and its structural components) shall be determined as of the beginning of the 1st day of such 24-month period, or of the holding period of the building, whichever is later. For purposes of the preceding sentence, the determination of the beginning of the holding period shall be made without regard to any reconstruction by the taxpayer in connection with the rehabilitation.

48(g)(1)(C)(ii) SPECIAL RULE FOR PHASED REHABILITATION.--In the case of any rehabilitation which may reasonably be expected to be completed in phases set forth in architectural plans and specifications completed before the rehabilitation begins, clause (i) shall be applied by substituting "60-month period" for "24-month period".

48(g)(1)(C)(iii) LESSEES.--The Secretary shall prescribe by regulation rules for applying this subparagraph to lessees.

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48(g)(1)(D) RECONSTRUCTION.--Rehabilitation includes reconstruction.

48(g)(2) QUALIFIED REHABILITATION EXPENDITURE DEFINED.--For purposes of this section--

48(g)(2)(A) IN GENERAL.--The term "qualified rehabilitation expenditure" means any amount properly chargeable to capital account--

48(g)(2)(A)(i) for property for which depreciation is allowable under section 168 and which is--

48(g)(2)(A)(i)(I) nonresidential real property,

48(g)(2)(A)(i)(II) residential rental property,

48(g)(2)(A)(i)(III) real property which has a class life of more than 12.5 years, or

48(g)(2)(A)(i)(IV) an addition or improvement to property or housing described in subclause (I), (II), or (III), and

48(g)(2)(A)(ii) in connection with the rehabilitation of a qualified rehabilitated building.

48(g)(2)(B) CERTAIN EXPENDITURES NOT INCLUDED.--The term "qualified rehabilitation expenditure" does not include--

48(g)(2)(B)(i) STRAIGHT LINE DEPRECIATION MUST BE USED.--Any expenditure with respect to which the taxpayer does not use the straight line method over a recovery period determined under subsection (c) or (g) of section 168. The preceding sentence shall not apply to any expenditure to the extent the alternative depreciation system of section 168(g) applies to such expenditure by reason of subparagraph (B) or (C) of section 168(g)(1).

48(g)(2)(B)(ii) COST OF ACQUISITION.--The cost of acquiring any building or interest therein.

48(g)(2)(B)(iii) ENLARGEMENTS.--Any expenditure attributable to the enlargement of an existing building.

48(g)(2)(B)(iv) CERTIFIED HISTORIC STRUCTURE, ETC.--Any expenditure attributable to the rehabilitation of a certified historic structure or a building in a registered historic district, unless the rehabilitation is a certified rehabilitation (within the meaning of subparagraph (C)). The preceding sentence shall not apply to a building in a registered historic district if--

48(g)(2)(B)(iv)(I) such building was not a certified historic structure.

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48(g)(2)(B)(iv)(II) the Secretary of the Interior certified to the Secretary that such building is not of historic significance to the district, and

48(g)(2)(B)(iv)(III) if the certification referred to in subclause (II) occurs after the beginning of the rehabilitation of such building, the taxpayer certifies to the Secretary that, at the beginning of such rehabilitation, he in good faith was not aware of the requirement of subclause (II).

48(g)(2)(B)(v) TAX-EXEMPT USE PROPERTY.--

48(g)(2)(B)(v)(I) IN GENERAL.--Any expenditure in connection with the rehabilitation of a building which is allocable to that portion of such building which is (or may reasonably be expected to be) tax-exempt use property (within the meaning of section 168(h)).

48(g)(2)(B)(v)(II) CLAUSE NOT TO APPLY FOR PURPOSES OF PARAGRAPH (1)(C).--This clause shall not apply for purposes of determining under paragraph (1)(C) whether a building has been substantially rehabilitated.

48(g)(2)(B)(vi) EXPENDITURES OF LESSEE.--Any expenditure of a lessee of a building if, on the date the rehabilitation is completed, the remaining term of the lease (determined without regard to any renewal periods) is less than the recovery period determined under section 168(c).

48(g)(2)(C) CERTIFIED REHABILITATION.--For purposes of subparagraph (B), the term "certified rehabilitation" means any rehabilitation of a certified historic structure which the Secretary of the Interior has certified to the Secretary as being consistent with the historic character of such property or the district in which such property is located.

48(g)(2)(D) NONRESIDENTIAL REAL PROPERTY; RESIDENTIAL RENTAL PROPERTY; CLASS LIFE.--For purposes of subparagraph (A), the terms "nonresidential real property," "residential rental property," and "class life" have the respective meanings given such terms by section 168.

48(g)(3) CERTIFIED HISTORIC STRUCTURE DEFINED.--For purposes of this subsection--

48(g)(3)(A) IN GENERAL.--The term "certified historic structure" means any building (and its structural components) which--

48(g)(3)(A)(i) is listed in the National Register, or

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48(g)(3)(A)(ii) is located in a registered historic district and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

48(g)(3)(B) REGISTERED HISTORIC DISTRICT.--The term "registered historic district" means--

48(g)(3)(B)(i) any district listed in the National Register, and

48(g)(3)(B)(ii) any district--

48(g)(3)(B)(ii)(I) which is designated under a statute of the appropriate State or local government, if such statute is certified by the Secretary of the Interior to the Secretary as containing criteria which will substantially achieve the purpose of preserving and rehabilitating buildings of historic significance to the district, and

48(g)(3)(B)(ii)(II) which is certified by the Secretary of the Interior to the Secretary as meeting substantially all of the requirements for the listing of districts in the National Register.

48(g)(4)PROPERTY TREATED AS NEW SECTION 38 PROPERTY.--Property which is treated as section 38 property by reason of subsection (a)(1)(E) shall be treated as new section 38 property.

Subsec. (k) MOVIE AND TELEVISION FILMS.--

48(k)(1) ENTITLEMENT TO CREDIT.--

48(k)(1)(A) IN GENERAL.--A credit shall be allowable under section 38 to a taxpayer with respect to any motion picture film or video tape--

48(k)(1)(A)(i) only if such film or tape is new section 38 property (determined without regard to useful life) which is a qualified film, and

48(k)(1)(A)(ii) only to the extent that the taxpayer has an ownership interest in such film or tape.

48(k)(1)(B) QUALIFIED FILM DEFINED.--For purposes of this subsection, the term "qualified film" means any motion picture film or video tape created primarily for use as public entertainment or for educational purposes. Such term does not include any film or tape the market for which is primarily topical or is otherwise essentially transitory in nature.

48(k)(1)(C) OWNERSHIP INTEREST.--For purposes of this subsection, a person's "ownership interest" in a qualified film shall be determined on the basis

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of his proportionate share of any loss which may be incurred with respect to the production costs of such film.

48(k)(2) APPLICABLE PERCENTAGE TO BE 662/3.--Except as provided in paragraph (3), the applicable percentage under section 46(c)(2) for any qualified film shall be 662/3 percent.

48(k)(3) ELECTION OF 90--PERCENT RULE.--

48(k)(3)(A) IN GENERAL.--If the taxpayer makes an election under this paragraph, the applicable percentage under section 46(c)(2) shall be determined as if the useful life of the film would have expired at the close of the first taxable year by the close of which the aggregate amount allowable as a deduction under section 167 would equal or exceed 90 percent of the basis of the film.

48(k)(3)(B) MAKING OF ELECTION.--An election under this paragraph shall be made at such time and in such manner as the Secretary may by regulations prescribe. Such an election shall apply for the taxable year for which it is made and for all subsequent taxable years and may be revoked only with the consent of the Secretary.

48(k)(3)(C) WHO MAY ELECT.--If for any prior taxable year paragraph (2) of this subsection applied to the taxpayer or any related business entity, or if for the taxable year paragraph (2) applies to any related business entity, an election under this paragraph may be made by the taxpayer only with the consent of the Secretary.

48(k)(3)(D) RELATED BUSINESS ENTITY.--Two or more corporations, partnerships, trusts, estates, proprietorships, or other entities shall be treated as related business entities if 50 percent or more of the beneficial interest in each of such entities is owned by the same or related persons (taking into account only persons who own at least 10 percent of such beneficial interest). For purposes of this subparagraph, a person is a related person to another person if--

48(k)(3)(D)(i) such persons are component members of a controlled group of corporations (within the meaning of section 1563(a), except that section 1563(b)(2) shall not apply and except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears in section 1563(a)), or

48(k)(3)(D)(ii) the relationship between such persons would result in a disallowance of losses under section 267 or 707(b), except that for these purposes a family of an individual includes only his spouse and minor children.

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For purposes of this subparagraph, the term "beneficial interest" means voting stock in the case of a corporation, profits interest or capital interest in the case of a partnership, or beneficial interest in the case of a trust or estate.

48(k)(4) PREDOMINANT USE TEST OR AT-RISK RULES; QUALIFIED INVESTMENT.--In the case of any qualified film--

48(k)(4)(A) section 48(a)(2), section 46(c)(8), or section 46(c)(9) shall not apply, and

48(k)(4)(B) in determining qualified investment under section 46(c)(1), there shall be used (in lieu of the basis of the property) an amount equal to the qualified United States production costs (as defined in paragraph (5)).

48(k)(5) QUALIFIED UNITED STATES PRODUCTION COSTS.-

48(k)(5)(A) IN GENERAL.--For purposes of this subsection, the term "qualified United States production costs" means with respect to any film--

48(k)(5)(A)(i) direct production costs allocable to the United States, plus

48(k)(5)(A)(ii) if 80 percent or more of the direct production costs are allocable to the United States, all other production costs other than direct production costs allocable outside the United States.

48(k)(5)(B) PRODUCTION COSTS.--For purposes of this subsection, the term "production costs" includes--

48(k)(5)(B)(i) a reasonable allocation of general overhead costs,

48(k)(5)(B)(ii) compensation (other than participations described in clause (vi)) for services performed by actors, production personnel, directors, and producers,

48(k)(5)(B)(iii) costs of "first" distribution of prints,

48(k)(5)(B)(iv) the cost of the screen rights and other material being filmed,

48(k)(5)(B)(v) "residuals" payable under contracts with labor organizations, and

48(k)(5)(B)(vi) participations payable as compensation to actors, production personnel, directors, and producers.

Participations on all qualified films placed in service by a taxpayer during a taxable year shall be taken into account under clause (vi) only to the extent of the lesser of 25 percent of each such participation or 12 1/2 percent of the aggregate qualified United States production costs (other than costs described in clauses

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(v) and (vi) of this subparagraph) for such films, but taking into account for both the 25 percent limit and 12 1/2 percent limit no more than \$1,000,000 in participations for any one individual with respect to any one film. For purposes of this subparagraph (other than clauses (v) and (vi) and the preceding sentence), costs shall be taken into account only if they are capitalized.

48(k)(5)(C) DIRECT PRODUCTION COSTS.--For purposes of this paragraph, the term "direct production costs" does not include items referred to in clause (i), (iv), (v), or (vi) of subparagraph (B). The term also does not include advertising and promotional costs and such other costs as may be provided in regulations prescribed by the Secretary.

48(k)(5)(D) ALLOCATION OF DIRECT PRODUCTION COSTS.--For purposes of this paragraph--

48(k)(5)(D)(i) Compensation for services performed shall be allocated to the country in which the services are performed, except that payments to United States persons for services performed outside the United States shall be allocated to the United States. For purposes of the preceding sentence, payments to an S corporation or a partnership shall be considered payments to a United States person only to the extent that such payments are included in the gross income of a United States person other than an S corporation or partnership.

48(k)(5)(D)(ii) Amounts for equipment and supplies shall be allocated to the country in which, with respect to the production of the film, the predominant use occurs.

48(k)(5)(D)(iii) All other items shall be allocated under regulations prescribed by the Secretary which are consistent with the allocation principle set forth in clause (ii).

48(k)(6) UNITED STATES.--For purposes of this subsection, the term "United States" includes the possessions of the United States.

Subsec. (l) ENERGY PROPERTY.--

For purposes of this subpart--

48(l)(1) TREATMENT AS SECTION 38 PROPERTY.--For any period for which the energy percentage determined under section 46(b)(2) for any energy property is greater than zero--

48(l)(1)(A) such energy property shall be treated as meeting the requirements of paragraph (1) of subsection (a), and

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48(l)(1)(B) paragraph (3) of subsection (a) shall not apply to such property.

48(l)(2) ENERGY PROPERTY DEFINED.--The term "energy property" means property--

48(l)(2)(A) which is--

48(l)(2)(A)(i) alternative energy property,

48(l)(2)(A)(ii) solar or wind energy property,

48(l)(2)(A)(iii) specially defined energy property,

48(l)(2)(A)(iv) recycling equipment,

48(l)(2)(A)(v) shale oil equipment,

48(l)(2)(A)(vi) equipment for producing natural gas from geopressured brine,

48(l)(2)(A)(vii) qualified hydroelectric generating property,

(viii) cogeneration equipment, or

48(l)(2)(A)(ix) qualified intercity buses,

48(l)(2)(B)(i) the construction, reconstruction, or erection of which is completed by the taxpayer after September 30, 1978, or

48(l)(2)(B)(ii) which is acquired after September 30, 1978, if the original use of such property commences with the taxpayer and commences after such date, and

48(l)(2)(C) with respect to which depreciation (or amortization in lieu of depreciation) is allowable, and which has a useful life (determined as of the time such property is placed in service) of 3 years or more or to which section 168 applies.

48(l)(3) ALTERNATIVE ENERGY PROPERTY.--

48(l)(3)(A) IN GENERAL.--The term "alternative energy property" means--

48(l)(3)(A)(i) a boiler the primary fuel for which will be an alternate substance,

48(l)(3)(A)(ii) a burner (including necessary on-site equipment to bring the alternate substance to the burner) for a combustor other than a boiler if the primary fuel for such burner will be an alternate substance,

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48(l)(3)(A)(iii) equipment for converting an alternate substance into a synthetic liquid, gaseous, or solid fuel,

48(l)(3)(A)(iv) equipment designed to modify existing equipment which uses oil or natural gas as a fuel or as feedstock so that such equipment will use either a substance other than oil and natural gas, or oil mixed with a substance other than oil and natural gas (where such other substance will provide not less than 25 percent of the fuel or feedstock),

48(l)(3)(A)(v) equipment to convert--

48(l)(3)(A)(I) coal (including lignite), or any nonmarketable substance derived therefrom, into a substitute for a petroleum or natural gas derived feedstock for the manufacture of chemicals or other products, or

48(l)(3)(A)(II) coal (including lignite), or any substance derived therefrom, into methanol, ammonia, or a hydroprocessed coal liquid or solid,

48(l)(3)(A)(vi) pollution control equipment required (by Federal, State, or local regulations) to be installed on or in connection with equipment described in clause (i), (ii), (iii), (iv), or (v),

48(l)(3)(A)(vii) equipment used for the unloading, transfer, storage, reclaiming from storage, and preparation (including, but not limited to, washing, crushing, drying, and weighing) at the point of use of an alternate substance for use in equipment described in clause (i), (ii), (iii), (iv), (v), or (vi),

(viii) equipment used to produce, distribute, or use energy derived from a geothermal deposit (within the meaning of section 613(e)(3)), but only, in the case of electricity generated by geothermal power, up to (but not including) the electrical transmission stage, and

48(l)(3)(A)(ix) equipment, placed in service at either of 2 locations designated by the Secretary after consultation with the Secretary of Energy, which converts ocean thermal energy to usable energy.

The equipment described in clause (vii) includes equipment used for the storage of fuel derived from garbage at the site at which such fuel was produced from garbage.

48(l)(3)(B) ALTERNATE SUBSTANCE.--The term "alternate substance" means any substance other than--

48(l)(3)(B)(i) oil and natural gas, and

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48(l)(3)(B)(ii) any product of oil and natural gas.

48(l)(3)(C) SPECIAL RULE FOR CERTAIN POLLUTION CONTROL EQUIPMENT.--The term "pollution control equipment" does not include any equipment which--

48(l)(3)(C)(i) is installed on or in connection with property which, as of October 1, 1978, was using coal (including lignite), and

48(l)(3)(C)(ii) was required to be installed by Federal, State, or local regulations in effect on such date.

For purposes of the preceding sentence, in the case of property which is alternative energy property solely by reason of the amendments made by section 222(b) of the Crude Oil Windfall Profit Tax Act of 1980, "January 1, 1980" shall be substituted for "October 1, 1978".

48(l)(4) SOLAR OR WIND ENERGY PROPERTY.--The term "solar or wind energy property" means any equipment which uses solar or wind energy--

48(l)(4)(A) to generate electricity,

48(l)(4)(B) to heat or cool (or provide hot water for use in) a structure, or

48(l)(4)(C) to provide solar process heat.

48(l)(5) SPECIALLY DEFINED ENERGY PROPERTY.--The term "specially defined energy property" means--

48(l)(5)(A) a recuperator,

48(l)(5)(B) a heat wheel,

48(l)(5)(C) a regenerator,

48(l)(5)(D) a heat exchanger,

48(l)(5)(E) a waste heat boiler,

48(l)(5)(F) a heat pipe,

48(l)(5)(G) an automatic energy control system,

48(l)(5)(H) a turbulator,

48(l)(5)(I) a preheater,

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48(l)(5)(J) a combustible gas recovery system,

48(l)(5)(K) an economizer,

48(l)(5)(L) modifications to alumina electrolytic cells,

48(l)(5)(M) modifications to chlor-alkali electrolytic cells, or

48(l)(5)(N) any other property of a kind specified by the Secretary by regulations, the principal purpose of which is reducing the amount of energy consumed in any existing industrial or commercial process and which is installed in connection with an existing industrial or commercial facility. The Secretary shall not specify any property under subparagraph (N) unless he determines that such specification meets the requirements of paragraph (9) of section 23(c) for specification of items under section 23(c)(4)(A)(viii).

48(l)(6) RECYCLING EQUIPMENT.--

48(l)(6)(A) IN GENERAL.--The term "recycling equipment" means any equipment which is used exclusively--

48(l)(6)(A)(i) to sort and prepare solid waste for recycling, or

48(l)(6)(A)(ii) in the recycling of solid waste.

48(l)(6)(B) CERTAIN EQUIPMENT NOT INCLUDED.--The term "recycling equipment" does not include--

48(l)(6)(B)(i) any equipment used in a process after the first marketable product is produced, or

48(l)(6)(B)(ii) in the case of recycling iron or steel, any equipment used to reduce the waste to a molten state and in any process thereafter.

48(l)(6)(C) 10 PERCENT VIRGIN MATERIAL ALLOWED.--Any equipment used in the recycling of material which includes some virgin materials shall not be treated as failing to meet the exclusive use requirements of subparagraph (A) if the amount of such virgin materials is 10 percent or less.

48(l)(6)(D) CERTAIN EQUIPMENT INCLUDED.--The term "recycling equipment" includes any equipment which is used in the conversion of solid waste into a fuel or into useful energy such as steam, electricity, or hot water.

48(l)(7) SHALE OIL EQUIPMENT.--The term "shale oil equipment" means equipment for producing or extracting oil from oil-bearing shale rock but does not

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include equipment for hydrogenation, refining, or other process subsequent to retorting.

48(l)(7) SHALE OIL EQUIPMENT.--The term "shale oil equipment" means equipment for producing or extracting oil from oil-bearing shale rock; except that such term does not include equipment for hydrogenation, refining, or other process subsequent to retorting other than hydrogenation or other process which is applied in the vicinity of the property from which the shale was extracted and which is applied to bring the shale oil to a grade and quality suitable for transportation to and processing in a refinery.

48(l)(8) EQUIPMENT FOR PRODUCING NATURAL GAS FROM GEOPRESSURED BRINE.-- The term "equipment for producing natural gas from geopressured brine" means equipment which is used exclusively to extract natural gas described in section 613A(b)(3)(C)(i).

48(l)(9) EQUIPMENT MUST MEET CERTAIN STANDARDS TO QUALIFY.-- Equipment qualifies under paragraph (3), (4), (5), (6), (7), or (8) only if it meets the performance and quality standards (if any) which--

48(l)(9)(A) have been prescribed by the Secretary by regulations (after consultation with the Secretary of Energy), and

48(l)(9)(B) are in effect at the time of the acquisition of the property.

48(l)(10) EXISTING.--For purposes of this subsection, the term "existing" means--

48(l)(10)(A) when used in connection with a facility, 50 percent or more of the basis of such facility is attributable to construction, reconstruction, or erection before October 1, 1978, or

48(l)(10)(B) when used in connection with an industrial or commercial process, such process was carried on in the facility as of October 1, 1978.

48(l)(11) SPECIAL RULE FOR PROPERTY FINANCED BY SUBSIDIZED ENERGY FINANCING OR INDUSTRIAL DEVELOPMENT BONDS.--

48(l)(11)(A) REDUCTION OF QUALIFIED INVESTMENT.--For purposes of applying the energy percentage to any property, if such property is financed in whole or in part by--

48(l)(11)(A)(i) subsidized energy financing, or

48(l)(11)(A)(ii) the proceeds of a private activity bond (within the meaning of section 141) the interest on which is exempt from tax under section 103,

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the amount taken into account as qualified investment shall not exceed the amount which (but for this subparagraph) would be the qualified investment multiplied by the fraction determined under subparagraph (B).

48(l)(11)(B) DETERMINATION OF FRACTION.--For purposes of subparagraph (A), the fraction determined under this subparagraph is 1 reduced by a fraction--

48(l)(11)(B)(i) the numerator of which is that portion of the qualified investment in the property which is allocable to such financing or proceeds, and

48(l)(11)(B)(ii) the denominator of which is the qualified investment in the property.

48(l)(11)(C) SUBSIDIZED ENERGY FINANCING.--For purposes of subparagraph (A), the term "subsidized energy financing" means financing provided under a Federal, State, or local program a principal purpose of which is to provide subsidized financing for projects designed to conserve or produce energy.

48(l)(12) INDUSTRIAL INCLUDES AGRICULTURAL.--The term "industrial" includes agricultural.

48(l)(13) QUALIFIED HYDROELECTRIC GENERATING PROPERTY.--

48(l)(13)(A) IN GENERAL.--The term "qualified hydroelectric generating property" means property installed at a qualified hydroelectric site which is--

48(l)(13)(A)(i) equipment for increased capacity to generate electricity by water (up to, but not including, the electrical transmission stage), and

48(l)(13)(A)(ii) structures for housing such generating equipment, fish passageways, and dam rehabilitation property, required by reason of the installation of equipment described in clause (i).

48(l)(13)(B) QUALIFIED HYDROELECTRIC SITE.--The term "qualified hydroelectric site" means any site--

48(l)(13)(B)(i) at which--

48(l)(13)(B)(I) there is a dam the construction of which was completed before October 18, 1979, and which was not significantly enlarged after such date, or

48(l)(13)(B)(II) electricity is to be generated without any dam or other impoundment of water, and

48(l)(13)(B)(ii) the installed capacity of which is less than 125 megawatts.

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48(l)(13)(C) LIMITATION ON CREDIT WHEN INSTALLED CAPACITY EXCEEDS 25 MEGAWATTS.--For purposes of applying the energy percentage to any qualified hydroelectric generating property placed in service in connection with a site the installed capacity of which exceeds 25 megawatts, the amount taken into account as qualified investment shall not exceed the amount which (but for this subparagraph) would be the qualified investment multiplied by a fraction--

48(l)(13)(C)(i) the numerator of which is 25 reduced by 1 for each whole megawatt by which such installed capacity exceeds 100 megawatts, and

48(l)(13)(C)(ii) the denominator of which is the number of megawatts of such installed capacity but not in excess of 100.

48(l)(13)(D) DAM REHABILITATION PROPERTY.--For purposes of this paragraph, the term "dam rehabilitation property" means any amount properly chargeable to capital account for property (or additions or improvements to property) in connection with the rehabilitation of a dam.

48(l)(13)(E) INSTALLED CAPACITY.--The term "installed capacity" means, with respect to any site, the installed capacity of all electrical generating equipment placed in service at such site. Such term includes the capacity of equipment installed during the 3 taxable years following the taxable year in which the equipment is placed in service.

48(l)(14) COGENERATION EQUIPMENT.--

48(l)(14)(A) IN GENERAL.--The term "cogeneration equipment" means property which is an integral part of a system for using the same fuel to produce both qualified energy and electricity at an industrial or commercial facility at which, as of January 1, 1980, electricity or qualified energy was produced.

48(l)(14)(B) ONLY COGENERATION INCREASES TAKEN INTO ACCOUNT.--The term "cogeneration equipment" includes property only to the extent that such property increases the capacity of the system to produce qualified energy or electricity, whichever is the secondary energy product of the system.

48(l)(14)(C) LIMITATION ON USE OF OIL OR GAS.--The term "cogeneration equipment" does not include any property which is part of a system if--

48(l)(14)(C)(i) such system uses oil or natural gas (or a product of oil or natural gas) as a fuel for any purpose other than--

48(l)(14)(C)(I) start-up,

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48(l)(14)(C)(II) flame control, or

48(l)(14)(C)(III) back-up, or

48(l)(14)(C)(ii) more than 20 percent (determined on a Btu basis) of the fuel for such system for any taxable year consists of oil or natural gas (or a product of oil or natural gas).

48(l)(14)(D) QUALIFIED ENERGY.--The term "qualified energy" means steam, heat, or other forms of useful energy (other than electric energy) to be used for industrial, commercial, or space-heating purposes (other than in the production of electricity).

48(l)(14)(E) INDUSTRIAL INCLUDES PURIFICATION AND DESALINIZATION OF WATER.--The term "industrial" includes the purification of water and the desalinization of water.

48(l)(15) BIOMASS PROPERTY.--

48(l)(15)(A) IN GENERAL.--The term "biomass property" means--

48(l)(15)(A)(i) any property described in clause (i), (ii), or (iii) of paragraph (3)(A), as modified by the last sentence of paragraph (3)(A) and by subparagraph (B) of this paragraph, and

48(l)(15)(A)(ii) any equipment described in so much of clause (vi) or (vii) of paragraph (3)(A) as relates to property described in clause (i) of this subparagraph.

48(l)(15)(B) MODIFICATIONS.--For purposes of subparagraph (A)--

48(l)(15)(B)(i) the term "alternate substance" has the meaning given to such term by paragraph (3)(B), except that such term does not include any inorganic substance and does not include coal (including lignite) or any product of such coal, and

48(l)(15)(B)(ii) clause (iii) of paragraph (3)(A) shall be applied by substituting "a qualified fuel" for "a synthetic liquid, gaseous, or solid fuel."

48(l)(15)(C) QUALIFIED FUEL.--For purposes of subparagraph (B), the term "qualified fuel" means--

48(l)(15)(C)(i) any synthetic solid fuel, and

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48(l)(15)(C)(ii) alcohol for fuel purposes if the primary source of energy for the facility producing the alcohol is not oil or natural gas or a product of oil or natural gas.

48(l)(16) QUALIFIED INTERCITY BUSES.--

48(l)(16)(A) IN GENERAL.--Paragraph (2)(A)(ix) shall apply only with respect to the qualified investment in qualified intercity buses of a taxpayer--

48(l)(16)(A)(i) which is a common carrier regulated by the Interstate Commerce Commission or an appropriate State agency (as determined by the Secretary), and

48(l)(16)(A)(ii) which is engaged in the trade or business of furnishing intercity passenger transportation or intercity charter service by bus.

48(l)(16)(B) QUALIFIED INTERCITY BUS.--The term "qualified intercity bus" means an automobile bus--

48(l)(16)(B)(i) the chassis of which is an automobile bus chassis and the body of which is an automobile bus body,

48(l)(16)(B)(ii) which has--

48(l)(16)(B)(I) a seating capacity of more than 35 passengers (in addition to the driver), and

48(l)(16)(B)(II) 1 or more baggage compartments, separated from the passenger area, with a capacity of at least 200 cubic feet, and

48(l)(16)(B)(iii) which is used predominantly by the taxpayer in the trade or business of furnishing intercity passenger transportation or intercity charter service.

48(l)(16)(C) OPERATING CAPACITY MUST INCREASE.--Under regulations prescribed by the Secretary--

48(l)(16)(C)(i) IN GENERAL.--The amount of qualified investment taken into account under paragraph (2)(A)(ix) for any taxable year shall not exceed the amount of the qualified investment which is attributable to an increase in the taxpayer's total operating seating capacity for the taxable year over such capacity as of the close of the preceding taxable year.

48(l)(16)(C)(ii) SPECIAL RULES.--The regulations prescribed under this subparagraph--

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48(l)(16)(C)(I) shall provide that only buses used predominantly on a full-time basis in the trade or business of furnishing intercity passenger or intercity charter service shall be taken into account in determining the taxpayer's total operating seating capacity, and

48(l)(16)(C)(II) shall provide rules treating related taxpayers as 1 person.

48(l)(17) EXCLUSION FOR PUBLIC UTILITY PROPERTY.--The terms "alternative energy property", "biomass property", "solar or wind energy property", "recycling equipment", and "cogeneration property" do not include property which is public utility property (within the meaning of 46(f)(5)).

Subsec. (m) APPLICATION OF CERTAIN TRANSITIONAL RULES.--

Where the application of any provision of subsection (l) of this section or subsection (b) or (c)(3) of section 46 is expressed in terms of a period, such provision shall apply only to--

48(m)(1) property to which section 46(d) does not apply, the construction, reconstruction, or erection of which is completed by the taxpayer on or after the first day of such period, but only to the extent of the basis thereof attributable to the construction, reconstruction, or erection during such period,

48(m)(2) property to which section 46(d) does not apply, acquired by the taxpayer during such period and placed in service by the taxpayer during such period, and

48(m)(3) property to which section 46(d) applies, but only to the extent of the qualified investment (as determined under subsections (c) and (d) of section 46) with respect to qualified progress expenditures made during such period.

Subsec. (o) CERTAIN CREDITS DEFINED.--

For purposes of this title--

48(o)(1) REGULAR INVESTMENT CREDIT.--The term "regular investment credit" means that portion of the credit allowable by section 38 which is attributable to the regular percentage.

48(o)(2) ENERGY INVESTMENT CREDIT.--The term "energy investment credit" means that portion of the credit allowable by section 38 which is attributable to the energy percentage.



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48(o)(3) REHABILITATION INVESTMENT CREDIT.--The term "rehabilitation investment credit" means that portion of the credit allowable by section 38 which is attributable to the rehabilitation percentage.

Subsec. (p) SINGLE PURPOSE AGRICULTURAL OR HORTICULTURAL STRUCTURE DEFINED.--

For purposes of this section--

48(p)(1) IN GENERAL.--The term "single purpose agricultural or horticultural structure" means--

48(p)(1)(A) a single purpose livestock structure, and

48(p)(1)(B) a single purpose horticultural structure.

48(p)(2) SINGLE PURPOSE LIVESTOCK STRUCTURE.--The term "single purpose livestock structure" means any enclosure or structure specifically designed, constructed, and used--

48(p)(2)(A) for housing, raising, and feeding a particular type of livestock and their produce, and

48(p)(2)(B) for housing the equipment (including any replacements) necessary for the housing, raising, and feeding referred to in subparagraph (A).

48(p)(3) SINGLE PURPOSE HORTICULTURAL STRUCTURE.--The term "single purpose horticultural structure" means--

48(p)(3)(A) a greenhouse specifically designed, constructed, and used for the commercial production of plants, and

48(p)(3)(B) a structure specifically designed, constructed and used for the commercial production of mushrooms.

48(p)(4) STRUCTURES WHICH INCLUDE WORK SPACE.--An enclosure or structure which provides work space shall be treated as a single purpose agricultural or horticultural structure only if such work space is solely for--

48(p)(4)(A) the stocking, caring for, or collecting of livestock or plants (as the case may be) or their produce,

48(p)(4)(B) the maintenance of the enclosure or structure, and

48(p)(4)(C) the maintenance or replacement of the equipment or stock enclosed or housed therein.

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48(p)(5) SPECIAL RULE FOR APPLYING SECTION 47.--For purposes of section 47, any single purpose agricultural or horticultural structure shall be treated as meeting the requirements of this subsection for any period during which such structure is held for the use under which it qualified under this subsection.

48(p)(6) LIVESTOCK.--The term "livestock" includes poultry.

Subsec. (q) BASIS ADJUSTMENT TO SECTION 38 PROPERTY.--

48(q)(1) IN GENERAL.--For purposes of this subtitle, if a credit is determined under section 46(a) with respect to section 38 property, the basis of such property shall be reduced by 50 percent of the amount of the credit so determined.

48(q)(2) CERTAIN DISPOSITIONS.--If during any taxable year there is a recapture amount determined with respect to any section 38 property the basis of which was reduced under paragraph (1), the basis of such property (immediately before the event resulting in such recapture) shall be increased by an amount equal to 50 percent of such recapture amount. For purposes of the preceding sentence, the term "recapture amount" means any increase in tax (or adjustment in carrybacks or carryovers) determined under section 47.

48(q)(3) SPECIAL RULE FOR QUALIFIED REHABILITATED BUILDINGS.--In the case of any credit determined under section 46(a) for any qualified rehabilitation expenditure in connection with a qualified rehabilitated building, paragraphs (1) and (2) of this subsection and paragraph (5) of subsection (d) shall be applied without regard to the phrase "50 percent of".

48(q)(4) ELECTION OF REDUCED CREDIT IN LIEU OF BASIS ADJUSTMENT FOR REGULAR PERCENTAGE.--

48(q)(4)(A) IN GENERAL.--If the taxpayer elects to have this paragraph apply with respect to any recovery property--

48(q)(4)(A)(i) paragraphs (1) and (2) shall not apply to so much of the credit determined under section 46(a) with respect to such property as is attributable to the regular percentage set forth in section 46(b)(1); and

48(q)(4)(A)(ii) the amount of the credit allowable under section 38 with respect to such property shall be determined under subparagraph (B).

48(q)(4)(B) REDUCTION IN CREDIT.--In the case of any recovery property to which an election under subparagraph (A) applies--

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48(q)(4)(B)(i) solely for the purposes of applying the regular percentage, the applicable percentage under subsection (c) or (d) of section 46 shall be deemed to be 100 percent, and

48(q)(4)(B)(ii) notwithstanding section 46(b)(1), the regular percentage shall be--

48(q)(4)(B)(ii)(I) 8 percent in the case of recovery property other than 3-year property, or

48(q)(4)(B)(ii)(II) 4 percent in the case of recovery property which is 3-year property.

For purposes of the preceding sentence, RRB replacement property (within the meaning of section 168(f)(3)(B)) shall be treated as property which is not 3-year property.

48(q)(4)(C) TIME AND MANNER OF MAKING ELECTION.--

48(q)(4)(C)(i) IN GENERAL.--An election under this subsection with respect to any property shall be made on the taxpayer's return of the tax imposed by this chapter for the taxpayer's taxable year in which such property is placed in service (or in the case of property to which an election under section 46(d) applies, for the first taxable year for which qualified progress expenditures were taken into account with respect to such property).

48(q)(4)(C)(ii) REVOCABLE ONLY WITH CONSENT.--An election under this subsection with respect to any property, once made, may be revoked only with the consent of the Secretary.

48(q)(5) RECAPTURE OF REDUCTIONS.--

48(q)(5)(A) IN GENERAL.--For purposes of sections 1245 and 1250, any reduction under this subsection shall be treated as a deduction allowed for depreciation.

48(q)(5)(B) SPECIAL RULE FOR SECTION 1250.--For purposes of section 1250(b), the determination of what would have been the depreciation adjustments under the straight line method shall be made as if there had been no reduction under this section.

48(q)(6) ADJUSTMENT IN BASIS OF INTEREST IN PARTNERSHIP OR S CORPORATION.--The adjusted basis of--

48(q)(6)(A) a partner's interest in a partnership, and

48(q)(6)(B) stock in an S corporation,

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shall be appropriately adjusted to take into account adjustments made under this subsection in the basis of property held by the partnership or S corporation (as the case may be).

48(q)(7) SPECIAL RULE FOR QUALIFIED FILMS.--If a credit is allowed under section 38 with respect to any qualified film (within the meaning of subsection (k)(1)(B)) then, in lieu of any reduction under paragraph (1)--

48(q)(7)(A) to the extent that the credit is determined with respect to any amount described in clause (v) or (vi) of subsection (k)(5)(B), any deduction allowable under this chapter with respect to such amount shall be reduced by 50 percent of the amount of the credit so determined, and

48(q)(7)(B) the basis of the taxpayer's ownership interest (within the meaning of subsection (k)(1)(C)) shall be reduced by the excess of--

48(q)(7)(B)(i) 50 percent of the amount of the credit determined under subsection (k), over

48(q)(7)(B)(ii) the amount of the reduction under subparagraph (A).

Subsec. (r) CERTAIN SECTION 501(d) ORGANIZATIONS.--

48(r)(1) IN GENERAL.--In the case of eligible section 501(d) organizations--

48(r)(1)(A) any business engaged in by such organization for the common benefit of its members and the taxable income from which is included in the gross income of its members shall be treated as an unrelated business for purposes of paragraph (4) of subsection (a),

48(r)(1)(B) The qualified investment for each taxable year with respect to such business shall be apportioned pro rata among such members in the same manner as the taxable income of such organization, and

48(r)(1)(C) any individual to whom any investment has been apportioned under subparagraph (B) shall be treated for purposes of this subpart (other than section 47) as the taxpayer with respect to such investment, and such investment shall not (by reason of such apportionment) lose its character as an investment in new section 38 property or used section 38 property, as the case may be.

48(r)(2) LIMITATION ON USED SECTION 38 PROPERTY APPLIED AT ORGANIZATION LEVEL.--The limitation under subparagraph (A) of subsection (c)(2) shall apply with respect to the section 501(d) organization.

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48(r)(3) RECAPTURE.--For purposes of applying section 47 to any property for which credit was allowed under section 38 by reason of this subsection--

48(r)(3)(A) the section 501(d) organization shall be treated as the taxpayer to which the credit under section 38 was allowed,

48(r)(3)(B) the amount of such credit allowed with respect to the property shall be treated as the amount which would have been allowed to the section 501(d) organization were such credit allowable to such organization,

48(r)(3)(C) subparagraph (D) of section 47(a)(5) shall not apply, and

48(r)(3)(D) the amount of the increase in tax under section 47 for any taxable year with respect to property to which this subsection applies shall be allocated pro rata among the members of such organization in the same manner as such organization's taxable income for such year is allocated among such members.

48(r)(4) NO INVESTMENT CREDIT ALLOWED TO MEMBER IF MEMBER CLAIMS OTHER INVESTMENT CREDIT.--No credit shall be allowed to an individual by reason of this subsection if such individual claims a credit under section 38 without regard to this subsection. The amount of the credit not allowed by reason of the preceding sentence shall not be allowed to any other person.

48(r)(5) ELIGIBLE SECTION 501(d) ORGANIZATION.--For purposes of this subsection, the term "eligible section 501(d) organization" means any organization--

48(r)(5)(A) which elects to be treated as an organization described in section 501(d) and which is exempt from tax under section 501(a), and

48(r)(5)(B) which does not provide a substantially higher standard of living for any person or persons than it does for the majority of the members of the community. Subsec.

(s) SPECIAL RULES RELATING TO SOUND RECORDINGS.--

48(s)(1) IN GENERAL.--For purposes of this title, in the case of any sound recording, the original use of which commences with the taxpayer, the taxpayer may elect to treat such recording as recovery property which is 3-year property to the extent that the taxpayer has an ownership interest in such recording.

48(s)(2) FAILURE TO MAKE ELECTION.--If a taxpayer does not make an election under paragraph (1) with respect to any sound recording--

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48(s)(2)(A) no credit shall be allowed under section 38 with respect to such recording, and

48(s)(2)(B) such recording shall not be treated as recovery property.

48(s)(3) PREDOMINANT USE TEST AND AT RISK RULES NOT TO APPLY; QUALIFIED INVESTMENT.--In the case of any sound recording--

48(s)(3)(A) sections 46(c)(8), 46(c)(9), and 48(a)(2) shall not apply, and

48(s)(3)(B) in determining the qualified investment under section 46(c)(1), there shall be used (in lieu of the basis of the property) an amount equal to the production costs which are allocable to the United States (as determined under rules similar to the rules of section 48(k)(5)(D)).

48(s)(4) OWNERSHIP INTEREST.--For purposes of determining the credit allowable under section 38, the ownership interest of any person in a sound recording shall be determined on the basis of his proportionate share of any loss which may be incurred with respect to the production costs of such sound recording.

48(s)(5) SOUND RECORDING.--For purposes of this subsection, the term "sound recording" means works which result from the fixation of a series of musical, spoken, or other sounds, regardless of the nature of the material objects (such as discs, tapes, or other phonorecordings) in which such sounds are embodied.

48(s)(6) PRODUCTION COSTS.--

48(s)(6)(A) IN GENERAL.--For purposes of this subsection, the term "production costs" includes--

48(s)(6)(A)(i) a reasonable allocation of general overhead costs,

48(s)(6)(A)(ii) compensation for services performed by song writers, artists, production personnel, directors, producers, and similar personnel,

48(s)(6)(A)(iii) costs of "first" distribution of records or tapes, and

48(s)(6)(A)(iv) the cost of the material being recorded.

48(s)(6)(B) CERTAIN COSTS NOT TAKEN INTO ACCOUNT.--Except as provided in subparagraph (C), the term "production costs" shall not include--

48(s)(6)(B)(i) "residuals" payable under contracts with labor organizations, or

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48(s)(6)(B)(ii) participations or royalties payable as compensation to song writers, artists, production personnel, directors, producers, and similar personnel, or

48(s)(6)(B)(iii) any other contingent amounts.

48(s)(6)(C) CERTAIN CONTINGENT AMOUNTS TAKEN INTO ACCOUNT.--In the case of any amount which is described in subparagraph (B) and which is incurred in the taxable year in which the sound recording is placed in service or the next taxable year--

48(s)(6)(C)(i) subparagraph (B) shall not apply, and

48(s)(6)(C)(ii) for purposes of sections 38 and 168, the taxpayer shall be treated as having placed in service in each such taxable year 3-year recovery property with a basis equal to the amount so incurred in such taxable year.

48(s)(7) ELECTION MADE SEPARATELY.--An election under paragraph (1) shall be made separately with respect to each sound recording and must be made by all persons having an ownership interest in such recording.

48(s)(8) UNITED STATES.--For purposes of this subsection, the term "United States" includes the possessions of the United States.

48(s)(9) TERMINATION.--This subsection shall not apply to any property placed in service after December 31, 1985, unless such property is transition property (as defined in section 49(e)(1)). Subsec. (t) CROSS REFERENCE.--

For application of this subpart to certain acquiring corporations, see section 381(c)(26).

**8960 1975 LIST OF QUALIFYING AND NONQUALIFY PROPERTY**

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

# IDAHO STATE TAX COMMISSION

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SEC 11200

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The following procedures should be followed when a taxpayer brings a lawsuit in state or federal district court, or in another trial court against either the Tax Commission, or the Tax Commission's employees.

### **11205 EMPLOYEE RESPONSIBILITIES DURING LITIGATION**

1. When served with a summons and complaint by a taxpayer, all documents should be forwarded immediately to the Tax Commission's Legal Section.
2. No further communication should be made to any parties affiliated with the taxpayer or his representatives by the auditor, and any communication should be made only through a lawyer who represents the Tax Commission.

### **11210 SERVICE OF COURT RELATED DOCUMENTS ON THE STATE TAX COMMISSION OR ITS STAFF**

Auditors receiving personally or by mail or other means, court documents relating to a case in which the State of Idaho, the State Tax Commission, or a Commission employee or agent, for actions in the course of his or her employment, is named as a party should proceed as outlined below.

#### **General Rule:**

Tax Commission employees are not delegated authority to accept service of process or to sign acknowledgements of service for the State of Idaho or the State Tax Commission.

If a taxpayer, attorney, or process server wants to serve a summons or complaint in a case naming the State or the Tax Commission as a defendant, you should advise the individual that the service on the Tax Commission or the employee is not effective as to the Commission or the State. The person serving the process will likely leave the documents anyway.

If you are asked to sign an acknowledgement of service for the State of Idaho or the Tax Commission, politely advise them that you are not authorized to do so. Only a Deputy Attorney General or the AG himself can sign an acknowledgement.



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Immediately deliver all the documents to the Legal section. If you are in a field office, fax them, then call the Legal section to let them know they are coming and send the originals as soon as possible.

### **Special Situations:**

#### Auditor named as a defendant:

If you are served with a legal process in which you are named as a party and it relates to actions taken in the course of your duties as an employee or agent of the Tax Commission, immediately contact one of the Deputy Attorneys General assigned to the Tax Commission. If asked to sign acknowledgement of service, politely decline to do so. You may say you are declining on advice of counsel, or that you do not have the authority to represent the state in this manner.

Many cases naming a Commission employee individually as a party will also name the State or the Tax Commission or both as parties. Service on the individual may be effective as to that person but not as to the State or the Commission. In this case, both the instructions under the "general rule" above and the preceding paragraph apply.

#### Subpoenas:

A subpoena to testify in court can be effectively served on the person who is sought to be a witness. Do not decline to accept service of a subpoena. If you are subpoenaed, immediately contact one of the Deputy Attorneys General assigned to the Tax Commission. The information you are asked to provide may or may not be subject to the tax confidentiality laws. The Deputy Attorneys General will advise you about how to proceed.

#### Federal Grand Jury Subpoenas:

If the subpoena is only for records or documents for the State Tax Commission, send it directly to the Tax Discovery Bureau Chief. If the subpoena asks for a personal appearance and testimony to the Grand Jury, proceed as in the preceding paragraph.

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Bankruptcy Cases:

If you receive any documents relating to a case in a U.S. Bankruptcy court (in or out of Idaho) send them to the Bankruptcy Section Supervisor.

Other Judicial Documents:

If you receive any other court documents relating to the State Tax Commission that are not described above, immediately contact a Deputy Attorney General for advice.

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MILITARY INFORMATION

SEC 12300

There are special rules for servicemembers and servicemember spouses who serve in active branches of the U.S. armed services. It is important to understand these rules in order to properly calculate taxable income.

**12305 GENERAL INFORMATION**

IDAHO RESIDENT MILITARY PERSONNEL:

- File Form 40 if single, head of household, married filing separately, or filing jointly with an Idaho resident spouse.
- File Form 43 if filing jointly with a spouse who is a part-year resident, nonresident, or military nonresident or if the servicemember is a part-year resident of Idaho.
- Idaho residents on active duty stationed in Idaho are taxed on all income, military and nonmilitary, regardless of source.
- Idaho residents on active duty outside Idaho for at least one hundred and twenty consecutive days are not taxed on military pay received for that duty.
  - Those filing Form 40 must report all income to Idaho, but are allowed a deduction for qualifying military pay on Form 39, Part B, Line 11.
  - Those filing Form 43 with a nonresident spouse do not include the qualifying military pay in wages reported on Form 43, Line 7.
  - Those filing Form 43 as part-year residents must report all income (including military pay) during the period of residency, but are allowed a deduction on Form 39NR, Part B, Line 7 for qualifying military pay reported on Form 43, Line 7.
- Members of the Armed Forces of the U.S., and their spouses, who have designated Idaho as their state of residence, employed by an Unappropriated Fund Activity at a U.S. military installation are subject to Idaho income tax. Unappropriated Fund Activities include officer's clubs, military stores (PX's, BX's, etc.).

NONRESIDENT MILITARY PERSONNEL STATIONED IN IDAHO:

- File Form 43.

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MILITARY INFORMATION

SEC 12300

- Under the Servicemembers Civil Relief Act, a servicemember does not acquire a domicile in, or become a resident of, Idaho solely by reason of being present in Idaho on military orders. This rule also applies to a servicemember's spouse if both have the same domicile.
- Military income of a nonresident servicemember stationed in Idaho is not taxed by Idaho. Nonmilitary compensation and business income from Idaho sources is considered Idaho source income subject to the Idaho income tax.
- As a result of the Military Spouses Residency Relief Act of 2009, **service income** earned by the nonresident spouse of a servicemember stationed in Idaho is not subject to Idaho income tax if the spouse has the same domicile as the servicemember.

The following table provides a few examples of income taxable in Idaho for non-resident servicemembers and their spouses:

Examples	Nonresident service-member	Spouse
	Income taxable to Idaho?	
Idaho nonmilitary salaries, wages, and commissions	Yes	No*
Distributive share of income or loss from a partnership or S corporation transacting business in Idaho	Yes	Yes
Rents and royalties from real and tangible personal property located in Idaho	Yes	Yes
Sale or exchange of Idaho real property	Yes	Yes
Winnings from lottery tickets purchased in Idaho	Yes	Yes

\*If the spouse has the same domicile as the non-resident service-member

**12310 NON-QUALIFYING SERVICES**

- The commissioned corps of the National Oceanic and Atmospheric Administration and the Public Health Service are uniformed services of the United States, but they are not considered **armed forces** unless they have been militarized by Presidential Executive Order; therefore individuals who are part of these two branches of the uniformed services are treated the same as any other ordinary citizen for tax purposes.
- The Servicemembers Civil Relief Act does not include members of the Merchant Marine in the definition of persons in the military service of the United States.

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SEC 12300

- Income earned by nonresident servicemembers while participating in Idaho National Guard or Reserve Unit drills is Idaho source income. Because the drills do not meet the 120 day active duty requirement, the servicemember will be required to file if he or she meets the filing requirements.

**12315 GROCERY CREDIT**

- A member of the United States Armed Forces who is required to file an Idaho income tax return and who is domiciled in Idaho is entitled to this credit even if not stationed in Idaho.
- A nonresident military servicemember stationed in Idaho is not entitled to the credit. However, the credit may be claimed for dependents who are residents. If the individual files a joint return with a resident spouse, the credit may also be claimed for the spouse.
- A nonresident military servicemember's spouse who claims relief under the "Military Spouses Residency Relief Act" is not eligible for the grocery credit because the spouse is also considered a nonresident.

**12320 EXTENSION OF TIME**

- Servicemembers residing outside any of the United States and Puerto Rico have an automatic extension of time to file until the fifteenth day of the sixth month following the close of their taxable year.
- Servicemembers serving in a combat zone, or who are hospitalized as a result of serving in a combat zone, are granted an extension of 180 days after the period of qualified service or hospitalization, whichever occurs last.

**12325 SEPARATION PAY**

Military separation pay is included in Idaho taxable income only if the recipient is domiciled or residing in Idaho when it is received. A former active duty service member with a home of record outside Idaho is not deemed to be residing in Idaho if he moves from Idaho within 30 days from the date of separation from active duty.

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**12330 GENERAL AUDIT TECHNIQUES**

*Verifying state of domicile for the servicemember*

To verify the servicemember's state of domicile, you may request their State of Legal Resident Certificate. This document would have been filled out at the beginning of their service. See next page for an example of the certificate.

**12335 RELEVANT AUTHORITIES**

50 U.S.C App. Section 571 – Residence for tax purposes

50 U.S.C App. Section 595 – Guarantee of residency for military personnel and spouses...

Public Law 111-97 – Military Spouses Residency Relief Act

Idaho Code section 63-3022(h) – Compensation for service performed outside Idaho

Idaho Income Tax Administrative Rule 032 – Members of the armed forces

Idaho Income Tax Administrative Rule 815 – Extension of time for filing

Idaho Income Tax Administrative Rule 771-07 – Spouse or Dependents of...

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STATE OF LEGAL RESIDENCE CERTIFICATE		
<b>DATA REQUIRED BY THE PRIVACY ACT OF 1974</b>		
<b>AUTHORITY:</b>	Tax Reform Act of 1976, Public Law 94-455.	
<b>PURPOSE:</b>	Information is required for determining the correct State of legal residence for purposes of withholding State income taxes from military pay.	
<b>ROUTINE USES:</b>	Information herein will be furnished State authorities and to Members of Congress.	
<b>MANDATORY OR VOLUNTARY DISCLOSURE:</b>	Disclosure is voluntary. If not provided, State income taxes will be withheld based on the tax laws of the State previously certified as your legal residence, or in the absence of a prior certification, the tax laws of the applicable State based on your home of record.	
<b>NAME</b> (Last, first, middle initial)		<b>SOCIAL SECURITY NUMBER</b> (SSN)
<b>LEGAL RESIDENCE/DOMICILE</b> (City or county and State)		
<b>INSTRUCTIONS FOR CERTIFICATION OF STATE OF LEGAL RESIDENCE</b>		
<p>The purpose of this certificate is to obtain information with respect to your legal residence/domicile for the purpose of determining the State for which income taxes are to be withheld from your "wages" as defined by Section 3401(a) of the Internal Revenue Code of 1954. PLEASE READ INSTRUCTIONS CAREFULLY BEFORE SIGNING.</p> <p>The terms "legal residence" and "domicile" are essentially interchangeable. In brief, they are used to denote that place where you have your permanent home and to which, whenever you are absent, you have the intention of returning. The Soldiers' and Sailors' Civil Relief Act protects your military pay from the income taxes of the State in which you reside by reason of military orders unless that is also your legal residence/domicile. The Act further provides that no change in your State of legal residence/domicile will occur solely as a result of your being ordered to a new duty station.</p> <p>You should not confuse the State which is your "home of record" with your State of legal residence/domicile. Your "home of record" is used for fixing travel and transportation allowances. A "home of record" must be changed if it was erroneously or fraudulently recorded initially.</p> <p>Enlisted members may change their "home of record" at the time they sign a new enlistment contract. Officers may not change their "home of record" except to correct an error, or after a break in service. The State which is your "home of record" may be your State of legal residence/domicile only if it meets certain criteria.</p> <p>The formula for changing your State of legal residence/domicile is simply stated as follows: <u>physical presence in the new State with the simultaneous intent of making it your permanent home and abandonment of the old State of legal residence/domicile.</u> In most cases, you must actually reside in the new State at the time you form the intent to make it your permanent home. Such intent must be clearly indicated. Your intent to make the new State your permanent home may be indicated by certain actions such as: (1) registering to vote; (2) purchasing residential property or an unimproved residential lot; (3) titling and registering your automobile(s); (4) notifying the State of your previous legal residence/domicile of the change in your State of legal residence/domicile; and (5) preparing a new last will and testament which indicates your new State of legal residence/domicile. Finally, you must comply with the applicable tax laws of the State which is your new legal residence/domicile.</p> <p>Generally, unless these steps have been taken, it is doubtful that your State of legal residence/domicile has changed. Failure to resolve any doubts as to your State of legal residence/domicile may adversely impact on certain legal privileges which depend on legal residence/domicile including among others, eligibility for resident tuition rates at State universities, eligibility to vote or be a candidate for public office, and eligibility for various welfare benefits. If you have any doubt with regard to your State of legal residence/domicile, you are advised to see your Legal Assistance Officer (JAG Representative) for advice prior to completing this form.</p>		
<p>I certify that to the best of my knowledge and belief, I have met all the requirements for legal residence/domicile in the State claimed above and that the information provided is correct.</p> <p>I understand that the tax authorities of my former State of legal residence/domicile will be notified of this certificate.</p>		
<b>SIGNATURE</b>	<b>CURRENT MAILING ADDRESS</b> (Include ZIP Code)	<b>DATE</b>

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### **12805 TAX COMPUTATION**

Corporations in Idaho are subject to either the Corporation Income Tax (Idaho Code section 63-3025) or Corporation Franchise Tax (Idaho Code, Section 63-3925A) on the net income of the corporation allocated or apportioned to Idaho. An additional tax (Permanent Building Fund Tax, Idaho Code section 63-3082) is imposed on most corporations required to file an income tax return.

The income tax (minimum \$20) and the Permanent Building Fund Tax (\$10) are levied against each taxpayer (corporation) that is required to file an Idaho tax return. Corporations are required to file returns if they transact or are authorized to transact business in Idaho or have income attributable to this state. The tax rate is 8% for tax years beginning on or after January 1, 1987. For tax years beginning on or after January 1, 2001 to December 31, 2011, the tax rate is 7.6%. For tax years beginning on or after January 1, 2012, the tax rate is 7.4%.

### **12810 INCOME AND DEDUCTIONS**

Idaho has adopted the IRC provisions for the definitions of income and deductions with the following exception:

- 1) Net Operating Loss (NOL): For affiliated corporations filing combined returns the Idaho NOL carryover or carryback is limited to that share of the combined NOL apportioned to Idaho for each taxable year for each separate member of the combine group (Idaho Income Tax Administrative Rule 365).
- 2) Taxes on or Measured by Income: Not deductible (Idaho Code section 63-3022(a)).
- 3) State and Municipal Bond Interest: Only interest from obligations of the State of Idaho and its political subdivisions is not taxable.
- 4) Federal Capital Loss Carryover: Same as federal except that capital losses incurred in a year in which the corporation did not have an Idaho business situs are not deductible, unless the corporation was part of a unitary group with at least one (1) member of the group taxable by Idaho for that taxable year.
- 5) Federal Dividends Received Deduction: For tax years beginning prior to 1/1/90, Idaho taxed the amount deducted under the provisions of section 243(a) of the IRC (relating to dividends received by corporations) as limited

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by section 246(b)(1) of said code. For tax years beginning on or after 1/1/90 but prior to 1/1/93, Idaho taxed the amount deducted under the provisions of sections 243(a), 243(c), and 244, IRC. For tax years beginning on or after 1/1/93, Idaho taxes the amounts under 243(a), 243(c), 244, 245, and 256A, IRC. (Idaho Code section 63-3022(d)).

- 6) Idaho Dividends Received Deduction: For tax years beginning prior to 1/1/93, Idaho allowed as a deduction an amount equal to the percentage determined under IRC 246(b)(3) of the IRC, as limited by section 246(b)(1), from any corporation whose Idaho taxable income in the preceding year exceeded 50% of total taxable income (Idaho Code section 63-3022(f) 1992 Ed.).
- 7) Section 78 Dividend Gross-up: not taxable (Idaho Code section 63-3022(e)).
- 8) Technological Equipment Donation: Idaho allows as a deduction the fair market value of certain technological equipment donated to public schools or libraries (Idaho Code section 63-3022J).
- 9) U.S. Interest: Idaho does not tax interest received from U.S. obligations. Idaho employs an interest expense offset against this nontaxable income. (Idaho Code section 63-3022M).

For years beginning prior to 1/1/93, a domestic unitary combination was required unless the taxpayer elected to compute its income using the water's edge filing method or made a retroactive worldwide election. The water's edge filing method is available only for years beginning on or after 1/1/88. A retroactive worldwide election was available for all pre-1993 years for which the statute of limitations had not expired. This election was required to be made by October 15, 1994.

The pre-1993 domestic unitary combined return must include all domestic and foreign affiliates with a federal taxable income. This includes FSCs, DISCs, and CFCs filing an 1120F. Federal taxable income of a FSC does not include the exempt foreign trade income provided for in IRC Sec. 921. DISC deemed dividends are eliminated if the DISC income was previously included in apportionable income. FSC dividends are eliminated.

For years beginning on or after 1/1/93, worldwide unitary combination is required unless the taxpayer has elected the revised water's edge filing method. Due to extensive revisions, a new election to file using the water's edge method was required even though the taxpayer may have been filing a water's edge return prior to 1993. Pretax book income of an FSC is included and the intercompany dividend is eliminated. DISC deemed dividends are eliminated if the DISC

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income was previously included in apportionable income. If a foreign corporation is included in the federal consolidated return, federal taxable income is included. If the foreign corporation is not included in the federal consolidated return, include financial net income before income taxes as reported to the SEC or as reported to shareholders if not reported to the SEC. The taxpayer may elect to make book to tax adjustments. If elected, all such adjustments must be made consistently by all affiliates for all years that a worldwide method applies.

### **12815 APPORTIONMENT FORMULA**

UDITPA three-factor. For tax years beginning prior to 1/1/94, all three factors are evenly weighted. For tax years beginning on and after 1/1/94, the three factors are evenly weighted only for electrical and telephone corporations. For all other corporations the sales factor is double weighted (Idaho Code section 63-3027(i)). Idaho Income Tax Administrative Rule 580 incorporates by reference the MTC Special Industry Regulations in providing several exceptions to the apportionment formula:

- 1) Trucking Companies,
- 2) Railroads,
- 3) Construction Contractors,
- 4) Airlines,
- 5) Publishing (years beginning on or after 1/1/95),
- 6) Television and Radio Broadcasting (years beginning on or after 1/1/95)  
and
- 7) Financial Institutions (years beginning on or after 1/1/98).

With respect to throwback sales, taxability in a state is determined on a taxpayer basis, with each corporation constituting a separate taxpayer.

### **12820 MISCELLANEOUS INCOME PROVISIONS**

- A. Interest on U.S. Obligations - adjusted by interest expense not deductible to purchase tax exempt bonds (Idaho Code section 63-3022M(4)).

No deduction shall be allowed for interest on indebtedness incurred or continued to purchase obligations the interest of which is not subject to the taxes imposed under this chapter. The amount of interest on indebtedness thus incurred or continued shall be an amount which bears the same ratio to the aggregate amount allowable to the taxpayer as a deduction for interest for

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the taxable year as the taxpayer's interest income from the obligations mentioned in the preceding sentence bears to the taxpayer's total income for the taxable year.

The interest expense offset is computed using the combined income and interest expense amounts of all companies in a combined report after elimination of intercompany transactions.

- B. Deduction of value for technological equipment. Effective for tax years beginning on and after January 1, 1985. (Idaho Code section 63-3022J).
- (1) . . . corporation may deduct from taxable income an amount equal to the fair market value of technological equipment donated to public elementary or public secondary schools, public universities, private universities, public colleges, private colleges, public community colleges, private community colleges, public technical colleges or private technical colleges, or public libraries and library districts located within the state of Idaho, except that the amount of the deduction shall not reduce Idaho taxable income to less than zero. The deduction allowed pursuant to this section shall be in addition to any other deduction allowed pursuant to this chapter. In order to take the deduction pursuant to this section, the taxpayer must receive a written statement from the donee in which the donee agrees to accept the technological equipment donated.
  - (2) For purposes of this section, "technological equipment" means a computer, computer software, scientific equipment or apparatus to be used by the university, college, community college, technical college, school or library directly or indirectly in the education program of the university, college, community college, technical college, school or library and which is donated to the university, college, community college, technical college, school or library no later than five (5) years after its manufacture has been substantially completed.
  - (3) For the purposes of this section, a public elementary or public secondary school means one that is located within this state and receives funding pursuant to Chapter 10, Title 33, Idaho Code.
  - (4) For purposes of this section, a public library or library district means one that is located within this state and receives funding pursuant to Chapters 26 and 27, Title 33, Idaho Code.

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- C. Attributing income of corporations which are members of partnerships: "If the income or loss of a partnership is business income or loss to a corporate partner, its share of this net business income or loss shall be apportioned together with all other net business income or loss of the corporation." See Idaho Income Tax Administrative Rule 620.04.a. The partner's share of the partnership property, payroll and sales shall be included within the numerators and denominators of the corporation. Nonbusiness partnership income shall be allocated to the state in which it was earned.
- D. Interest expense offset relating to tax exempt income: Idaho does not allow a deduction for interest on indebtedness incurred or continued to purchase or to carry obligations the interest of which is not subject to income taxes. The ratio of the taxpayer's total interest income to its total income will be applied to the taxpayer's interest expense to determine the expense related to tax exempt income. This is the offset. See Section 5330. (Idaho Code section 63-3022M).
- E. Related expense offset: All deductions relating to the production of nonbusiness income must be allocated together with the income produced. Any allowable deduction that is applicable both to business and nonbusiness income is prorated to those classes of income in determining Idaho taxable income. The taxpayer must be consistent in the proration of the deductions in filing its state income tax returns. (Idaho Code section 63-3027(d)).

### **12825 MISCELLANEOUS FACTOR PROVISIONS**

#### A. Safe Harbor Leases:

- 1) A taxpayer whose only contact with Idaho is as a lessor under a safe harbor lease of property within Idaho will not, without more, have nexus or situs for Idaho income tax purposes.
- 2) Property subject to the safe harbor lease should be reported in the property factor of the actual user (the lessee) of the property, and not in the property factor of the safe harbor lessor. The value of the property should be reported at original cost of acquisition, normally the cost to the lessee. The lessee should not include the rent expense in computing the property factor.
- 3) Because Idaho views the safe harbor lease transaction as merely the transfer of intangibles between the lessee and lessor, neither party should

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include any receipts (rental income of the lessor or interest income of the lessee) related to the safe harbor lease in the sales factor.

- 4) The taxpayer should report depreciation in the same manner as it is reported on the federal tax return. In addition, Idaho income tax rules provide the Internal Revenue Code Section 168(f)(8) does not apply for purposes of determining who is entitled to claim the Idaho investment tax credit.

B. Intangible Drilling Costs: Idaho includes intangible drilling costs of producing oil properties in the property factor. Intangible drilling costs applicable to wells being drilled are to be considered construction in progress and excluded from the property factor. Similarly, intangible drilling costs applicable to dry holes are to be excluded on the basis that they constitute property which is neither used nor capable of being used in the taxpayer's business.

C. Capitalized Royalties: Idaho does not include capitalized royalties in the property factor. Per Idaho Income Tax Administrative Rule 485, annual rent does not include royalties based on extraction of natural resources, whether represented by delivery or purchase. For this purpose, a royalty includes any consideration conveyed or credited to a holder of an interest in property which constitutes a sharing of current or future production of natural resources from such property, whether denominated as royalty, advance royalty, rental, or otherwise.

**12830 IDAHO TAX EXEMPT INTEREST EXPENSE OFFSET**

- 1. a. Interest expense. Total interest expense deducted in determining federal taxable income..... \_\_\_\_\_
- b. Interest expense disallowed under IRC Sections 265 and 291. .... \_\_\_\_\_
- c. Interest expense from a pass-through entity ..... \_\_\_\_\_
- d. Interest expense of foreign corporations included in the combined report ..... \_\_\_\_\_
- e. Subtotal. Add lines a through d. .... \_\_\_\_\_
- f. Interest expense of corporations included in the consolidated federal return but not part of the combined report filed with Idaho ..... \_\_\_\_\_

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- g. Intercompany interest expense ..... \_\_\_\_\_
- h. Total interest expense. Subtract lines f and g from line e..... \_\_\_\_\_
- 2. Total tax-exempt income (interest on qualifying obligations of the United States and interest on qualifying obligations of the state of Idaho, its cities, and political subdivisions) ..... \_\_\_\_\_
- 3. Total income. Refer to Rule 115, Idaho Income Tax Administrative Rules. .... \_\_\_\_\_
- 4. Divide line 2 by line 3 ..... \_\_\_\_\_%
- 5. Multiply line 1 h by line 4. .... \_\_\_\_\_

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SEC 13100

Members of Indian tribes are subject to federal income tax. Membership in an Indian tribe does not affect that individual's Idaho residency status (Idaho Income Tax Administrative Rule 033.02). However, due to federal treaties and Idaho law, they may not have an Idaho filing requirement or may be entitled to an Idaho subtraction from income.

**13105 INCOME EARNED ON A RESERVATION BY AN AMERICAN INDIAN**

**Filing requirement**

If the only income of an enrolled member of a federally recognized tribe living on an Idaho reservation is earned on the reservation of the Coeur d'Alene tribe, the Kootenai tribe of Idaho, the Nez Perce tribe, the Shoshone-Bannock tribes of the Fort Hall reservation, or the Shoshone-Paiute tribes of the Duck Valley reservation, he is not required to file an Idaho income tax return.

If he has sufficient income from sources other than one or more of these reservations to meet the federal filing requirement, he must file an Idaho income tax return. All income earned on one of these reservations received while living on one of these reservations is exempt from Idaho taxation.

**Idaho subtraction**

In order to subtract reservation-sourced income, the taxpayer must be

- an enrolled member of a federally recognized Indian tribe and
- live and work on the reservation of the
  - Coeur d'Alene tribe,
  - Kootenai tribe of Idaho,
  - Nez Perce tribe,
  - Shoshone-Bannock tribes of the Fort Hall reservation, or
  - Shoshone-Paiute tribes of the Duck Valley reservation (Idaho Code section 63-3022S).

The following income of an Idaho resident American Indian is subject to Idaho tax:

- Income earned outside one of the reservations mentioned above
- Income earned within a federally recognized Indian reservation by an individual who is not an enrolled member of a federally recognized tribe
- Income earned by an individual living off the reservation

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**13110 GAMBLING WINNINGS AND PER CAPITA DISTRIBUTIONS (RULES 033.03 & 033.04)**

Gambling winnings on an Idaho Indian reservation and per capita distributions received by an enrolled member who lives on an Idaho Indian reservation are not taxable by Idaho.

Gaming proceeds and per capita distributions paid by an Indian tribe to an enrolled member who lives off the Indian reservation are subject to Idaho tax.

**13115 GROCERY CREDIT**

American Indians are eligible for the grocery credit, whether or not they have an Idaho filing requirement.

**13120 AUDIT ISSUES**

**Corporations**

Indian tribes and wholly owned tribal corporations chartered under federal law or the Oklahoma Indian Welfare Act generally are exempt from federal and state income tax. In contrast, a corporation organized under Idaho state law and owned by a tribe or tribal members may be subject to income tax (Revenue Ruling 94-16; [Idaho Docket No 17308](#)).

**13125 AUDIT TECHNIQUES**

**Enrolled member of a federally recognized Indian tribe (Rule 033.01.a)**

A list of federally recognized Indian tribes can be found on the [Bureau of Indian Affairs website](#). The Tribal Leaders Directory lists the BIA servicing offices that can be contacted to verify its enrolled members. You can also request a copy of the taxpayer's tribal identification card in your initial audit letter.

**Federally recognized Indian reservation (Rule 033.01.b)**

The boundaries of four of the five qualifying reservations are easily found on Google maps by clicking on the name of the reservation after locating the taxpayer's home and work addresses.

Conversely, the Kootenai tribe's lands include several parcels. The areas of the Kootenai reservation where people work include the Kootenai River Inn, Casino



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and Spa property (located within the exterior boundaries of the City of Bonners Ferry along the south bank of the Kootenai River and adjacent to Highway 95), the Mission, a.k.a. Tribal Headquarters (identified below) and Twin Rivers (identified below). The areas of the reservation with residents include the Mission (12.5-acre area northwest of Bonners Ferry where tribal government operations and the primary housing area are located), Frontier Village (south of Bonners Ferry a little ways off Highway 95 on Frontier Village Road), Twin Rivers (at the confluence of the Moyie and Kootenai Rivers) and a lot in Bonners Ferry (Comanche Street Lot). The remaining areas of the reservation (scattered throughout Bonners Ferry) are agricultural and forest allotments, Kootenai Tribe Fish and Wildlife Department conservation properties, and economic development properties that do not have long-term residents. Therefore, the best source to confirm that a taxpayer's employment and residence are both within the confines of Kootenai tribal lands is to contact the [Kootenai Tribe of Idaho](#) finance department.

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NET OPERATING LOSS

SEC 13300

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An Idaho net operating loss (NOL) is not the same as a federal NOL. An Idaho NOL is the amount that Idaho taxable income, after making modifications, is less than zero. The modifications are to add back: any net operating losses from other years; any net capital loss deduction; any Idaho capital gains deduction; any deduction for personal exemptions; and any standard or itemized deductions other than casualty losses on property physically located in Idaho.

Individuals, C corporations, trusts, and estates are allowed a deduction in computing Idaho taxable income for Idaho NOL. S corporations and partnerships aren't allowed an NOL deduction. Instead, any losses are passed through to the shareholders and partners.

**13305 IN GENERAL**

An NOL is created when the taxpayer has sustained:

1. A loss in the operation of his business or profession during the year, and/or
2. A casualty loss of property physically located in Idaho in excess of his income for the year. Note: a theft loss of money resulting from embezzlement or other malfeasance is not a loss resulting from physical damage to property and Idaho law does not include them in NOL's. Ponzi scheme losses are treated as theft losses and likewise will not create an NOL for Idaho purposes. See analysis: Tax Commission Offers Guidance on Ponzi Schemes.

The NOL deduction is provided for by Idaho Code section 63-3021 and related rules.

A claim for refund due to an NOL carryback must be filed by the fifteenth (15th) day of the fortieth (40th) month following the end of the loss year. (Idaho Code section 63-3072)

A taxpayer who has an NOL deduction should keep all records pertaining to the loss year and the years to which the loss is carried. The individual has the burden of proof to verify the correctness of any year audited.

Refer to the Income Tax Audit Cheat Sheet for NOL guidelines: Cheat Sheet

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**13310 CALCULATING IDAHO NET OPERATING LOSSES - INDIVIDUALS**

Each year to which an NOL is applied is referred to as an absorption year. Certain adjustments must be made to taxable income or loss to calculate the NOL and how much income is available for absorption in the year to which the NOL is carried back or carried forward. Those adjustments are the same as the modifications identified in the introduction to this section. The NOL calculation is on Idaho Form 56 which can be found at [tax.idaho.gov](http://tax.idaho.gov).

**13320 ID NOL CARRYBACKS & CARRYOVERS – INDIVIDUAL & CORPORATIONS**

Any Idaho NOL carryback is limited to \$100,000 per loss year. NOL's from multiple loss years are absorbed in the order the losses were incurred.

Carryback and carryforward provisions are:

**From 2000 - 2012**

Taxpayers can choose between:

- a. Automatic 2 year carryback (limited to \$100,000 per loss year). Any remaining balance is carried forward 20 years. The taxpayers have until the 15<sup>th</sup> day of the 40<sup>th</sup> month following the end of the loss year to file the amended return for the absorption year(s) to claim a refund, or
- b. A binding election to forego the carryback period. The election must be made on a return filed by the due date of the loss year return, including extensions. Once the return is filed, the extension period expires. An election made on an amended return filed after the due date is considered untimely. Once an election is made, it cannot be revoked. The carryforward period is 20 years.
  - For a loss year beginning in 2000, the election must be made by checking a box on the Idaho return or by attaching a statement to the Idaho return electing to forego carryback of the Idaho NOL.
  - For a loss year beginning after 2000, but before 2010, the election may be made by checking a box on the Idaho return, attaching a statement to the Idaho return electing to forego carryback of the Idaho NOL, or by attaching to the Idaho return a copy of the federal election to forego carryback of the federal NOL.

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For a loss year beginning after 2009, but before 2013, the election must be made by checking a box on the Idaho return or by attaching a statement to the Idaho return electing to forego carryback of the Idaho NOL. Attaching to the Idaho return a copy of the federal election to forego carryback of the federal NOL was *not* a valid election.

**From 2013 forward**

An NOL from a loss year beginning on or after January 1, 2013 must be carried forward unless an amended return carrying back the NOL is filed no later than one year after the end of the loss year. If no amended return to carryback the NOL is filed, the loss must be carried forward. The carryforward period is 20 years.

**13325 ID NOLS & AUDIT REPORTS – INDIVIDUAL & CORPORATIONS**

When preparing audit reports keep the following in mind:

- The loss year need not be shown on the audit report unless it is being adjusted by an amended return or by audit.
- Interest on refunds resulting from an NOL carryback is computed from the last day of the loss year. Section 63-3073 Idaho Code.
- Any remaining NOL available to carry forward to subsequent years should be stated in the audit report.
- If the auditor is reducing the NOL, it may be beneficial to provide the taxpayer with a corrected Form 56 so they may see the proper NOL calculation and carryforward available.

**13330 SPECIAL SITUATIONS**

**A. NOL Carried to Wrong Year:**

If the taxpayer files an amended return claiming an NOL carryback to the wrong year, the auditor:

- Completes an audit report making the correction for the year amended.

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SEC 13300

- The explanation pages in the audit report should explain that the taxpayer should review the NOL carryback and carryover provisions and they can amend the correct years as needed.

**B. Part-Year and Nonresidents:**

- a. Only Idaho source losses reportable to Idaho may be included in an Idaho NOL carried to Idaho income in another year.
- b. The percentage that Idaho income bears to total income may change as a result of a carryback. The percentage should be recomputed using AGI after the carryback for both Idaho and federal income. The following rules will apply:
  - i. Both Idaho and Federal A.G.I. are positive amounts - divide Idaho A.G.I. by Federal A.G.I. for new percentage.
  - ii. Idaho A.G.I. positive - Federal A.G.I. negative - Idaho percentage is 100%.
  - iii. Idaho A.G.I. negative - Federal A.G.I. positive - Idaho percentage is 0%.
  - iv. Both Idaho and Federal A.G.I. are negative:
    1. If Idaho negative is greater than Federal, percentage is 100%.
    2. If Idaho negative is less than Federal, divide Idaho A.G.I. by Federal A.G.I. for new percentage.

**C. More Than One Loss Year:**

When two different net operating losses are carried into the same year, apply the loss from the earliest year first. This rule provides each loss with the greatest chance to be absorbed within the overall limitation period.

**13335 NOL LIMITATIONS WHEN INDIVIDUAL FILING STATUS CHANGES**

The following chart is for most taxpayers who generally follow Idaho community property laws and split their income equally.

An exception to the calculations in the table would result if there was separate income in the married filing joint year and if the tax was not paid with community

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funds. If both criteria occurred, and evidence was provided to verify this, the calculations would be modified accordingly.

Status In The Loss Year	Status In Absorption Or Intervening Year	Carryback Year	Carry Forward Year
Married filing joint	Single; Head of Household; Married filing separate	Allowed 1/2 of the NOL deduction	Allowed 1/2 of the NOL deduction
Single; Head of Household; Married filing separate  (See Docket #16382 from 2002)	Married filing joint	Allowed 100% of the NOL deduction against the NOL spouse's 50% of the community property income.  Refund generally cannot be greater than 1/2 the original tax.	Allowed 100% of the NOL deduction against the NOL spouse's 50% of the community property income.
Married filing joint  (See Docket #16382 from 2002)	Married filing joint (spouses are not the same)	Allowed 1/2 of the NOL deduction against the NOL spouse's 50% of the community property income.  Refund generally cannot be greater than 1/2 the original tax.	Allowed 1/2 of the NOL deduction against the NOL spouse's 50% of the community property income.

**13340 MULTISTATE CORPORATIONS**

**A. Computation**

Each corporation that is a member of a unitary group must separately compute its share of an NOL. The corporation's NOL is computed as follows:

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1. Multiply the corporation's Idaho apportionment factor for the year of the loss by the group's apportionable income/loss.
2. Add its nonbusiness income allocated to Idaho
3. Subtract its nonbusiness loss allocated to Idaho.

**B. Application of NOL**

A corporation's NOL may only be applied against the income apportioned and allocated to that member in the carryback or carryover years.

If a corporation leaves the unitary group, whether as a result of a disposition or a change in the filing method, the corporation takes its Idaho NOL with it. The group can't use it against other member's income.

For example, if the taxpayer makes a valid water's edge election, the taxpayer may have NOL carryovers that were created in years filed using the worldwide filing method. To the extent that the NOL carryover was attributed to a corporation that isn't included in the water's edge group, the carryover for that member can't be included in the amount reported by the water's edge group.

**C. Change in Filing Method**

Although a taxpayer may have changed its filing method, NOLs and absorption year income are not restated as long as the taxpayer used a valid filing method for all applicable years. Filing method changes include:

- Changes to and from worldwide and water's edge filing methods.
  - Check for valid water's edge election.
  - A taxpayer must receive permission from the Tax Commission to convert to a worldwide filing method from the water's edge method.
- Changes to and from combined reporting.
  - Verify that all applicable years were filed using combined reporting if so required. Don't restate a loss computed on a separate company basis if the corporation was not required to be combined in the year of its loss. If the taxpayer was unitary with other corporations but failed to file that way, separate company losses

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can be restated to a combined basis for correcting the loss carried forward, even though the year may be closed.

**13345 PASS-THROUGH ENTITIES**

Partnerships and S corporations are not allowed to claim an NOL deduction, even if the entity is paying the tax for electing individual owners.

An NOL carryback or carryover from a tax year when a corporation was a C corporation can't be carried to a tax year when the corporation is an S corporation. However, if an S corporation is subject to tax on net recognized built-in gains or excess net passive income, it can deduct an NOL carryover from a tax year when the corporation was a C corporation against that income.

**13350 CORRECTIONS TO NOLS**

Although the statute of limitations for a tax year may be closed for assessment or refund, corrections should be made to the NOL year and absorption years using the law applicable to that year. This will result in the correct NOL amount being carried over to open years. Review items of income, deductions and credits for correctness and adjust if necessary.

**13355 APPLICABLE AUTHORITY**

- Idaho Code section 63-3002 is the declaration of intent that Idaho taxable income will be the same as federal taxable income except for items that are specifically adjusted in Idaho law.
- Idaho Code section 63-3021 defines Idaho NOL.
- Idaho Code section 63-3022(b) requires add back of any federal NOL deducted.
- Idaho Code section 63-3022(c) provides subtraction for Idaho NOL.
- Idaho Income Tax Administrative Rule 201 provides additional detail on treatment of carryback and carryover years.



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This section covers audit procedures when an auditor determines that no changes should be made to tax returns reviewed in an audit case that has been assigned or opened.

The procedures to follow depend on whether the auditor informed the taxpayers that their tax returns were being reviewed.

If the taxpayers aren't aware that you're reviewing their tax returns, and you're recommending that no changes be made, the case should be  **canceled** in GenTax without sending a no-change letter to the taxpayers.

If you or other Tax Commission staff have informed the taxpayers that you're reviewing their tax returns, and you subsequently recommend that no changes be made to those returns, the case must be  **closed** in GenTax and a no-change letter explaining the determination should be sent to the taxpayers.

### **13505 CANCELLATION OF AN AUDIT**

The steps of canceling an audit are as follows:

1. Copy the audit case folder, with any useful records and worksheets you have prepared, into the intrastate managers' review folder on IAPUB.

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

### **13510 COMPLETION OF A NO-CHANGE AUDIT**

**(See Section 6100 (Section 6120) for additional information)**

The following are reasons a no-change result should be recommended:

- The tax returns were correctly filed with no adjustments identified.

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

- The audit covered multiple years, but you decide to close the audit when your review of the first year indicated there were no adjustments to be made and your time would be more productively spent on other cases.

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The steps of completing an audit when you recommend no changes are as follows:

1. Complete the audit narrative.
2. Finish any worksheets that provide support for your determination. Describe their purpose in the audit narrative.
3. Don't finish an NODD, billing letter, or explanation page unless requested by your supervisor.
4. Complete a closing letter to the taxpayer and place a copy of it in the review folder with the audit narrative and other records. Make sure to include your electronic signature.

There are three no-change letter templates on the Income Tax Audit SharePoint page. Select the 'Audit Letters and Templates' page, then choose the appropriate letter from the following:

- No change recommended  
Use this template when there are no adjustments to be made for the years and issues reviewed.
  - No change recommended after only one year was reviewed  
Use this template if you review one of the years under audit and determine there are no adjustments to be made for any of the years and issues audited. This letter advises the taxpayer of the limited issues reviewed, that the returns are accepted, and that the same issues won't be reviewed for the other years included in the audit letter. You can review the other years if you identify different issues at a later date.
  - No change with recommendation  
Use this template when an issue was incorrectly reported by the taxpayer, but an adjustment would result in an immaterial change to their taxes due.
5. Create an audit case folder in the reviewer's folder on . If federal tax information was used to make your determination, include "FTI" at the end of the case folder's name.
    - Audits of complexity level A or B go into the intrastate managers' review folder.
    - Audits of level C, D, or E go into the auditor 4's review folder.

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6. Place copies of the audit narrative, worksheets, and closing letter in the audit case folder.

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

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A nonfiler audit case occurs when the taxpayer is unwilling or unable to provide a complete and correct tax return. If it's a single year audit and you have no other issues with the taxpayer, refer the case to Tax Discovery Bureau (TDB). If it's a multi-year audit and only one year is a nonfiler, you may keep the case in Income Tax Audit and ask for the return. If you keep the nonfiler year, create an audit for the nonfiler year and an audit for the other year(s).

### **13605 SETTLEMENT OFFERS (NONAUDIT SITUATIONS)**

If you receive an anonymous request for settlement of potential past income, sales or other state tax liabilities:

1. Collect as much background information as possible.
2. Forward all information to TDB.

### **13610 NONFILER PROVIDES TAX RETURNS AT AUDITOR'S REQUEST**

Once the initial contact is made with the individual nonfiler, the taxpayer may provide a tax return for the missing year. The auditor should review the return for correctness.

#### **Auditor Accepts the Tax Return**

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

1. If the return is acceptable, scan the return and place a copy in your electronic folder. You may also attach a copy to the Audit in GenTax.
2. If you want GenTax to calculate the interest and the 25% late filing penalty, leave these items blank on the tax return. If the auditor makes changes to the filed return, the penalty and interest must be calculated.
- 3.
- 4.
5. Create a Narrative and place it in your electronic folder.
6. Create a Close Letter accepting the return and place it in your electronic folder. The manager will place the letter in the mail when the review is completed.
- 7.
8. Place a copy of your electronic folder in the Intrastate Managers – Review folder on IAPUB. You may keep the hard copy folder or place it in the Intrastate Audit Review file cabinet.
- 9.

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10. If the manager agrees, they'll forward the task and electronic folder to Admin support to close the case. If the manager doesn't agree, they'll return the case for further work.
11. Admin Support will attach the return (if not already done) to the audit and close the case according to their procedures.

### **Auditor Does Not Accept the Tax Return**

1. Prepare an NODD based on the amounts presented on the submitted tax return. For the nonfilers, use the TC68ind. In the audit report, address the fact that the return was received, but not accepted by the Tax Commission. Discuss all changes made to the submitted return. Once the NODD has hardened, follow the procedures listed in Section 13615.

### **13615 PREPARING INDIVIDUAL NONFILER DOCUMENTS**

The TC68 is used for Idaho residents and nonresidents.

For part-year and nonresident returns, the TC68 template doesn't provide a schedule to show the adjustment to Federal Adjusted Gross Income or the apportionment calculation of the standard deduction and personal exemptions. The Taxpayer Information and Income entry screens must be attached so the NODD can be properly posted when it hardens.

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The image shows two overlapping software windows. The 'TP Info' window on the left has a green title bar and contains fields for Year 1, Year 2, and Year 3. It includes dropdown menus for 'Click On Date' and 'Click Status', and radio button options for 'Filing Status' (MJ, S, MS, HH, W). The 'Income' window on the right also has a green title bar and contains a table with columns for Year 1, Year 2, and Year 3. The table is titled 'Idaho Adjusted Income >>>' and 'Adjustment Name'. It lists adjustments a through e, 'Withholding', and 'Tentative/Form 51 Paymer'. Below the table are fields for 'Total Federal Adjusted Income W/Idaho Adjustments' and 'Penalties, Enter only if differant'.

A separate schedule may also be created and included in the audit to show the following:

1. Beginning adjusted gross income for both Federal and Idaho.
2. Adjustments to both Federal and Idaho adjusted gross income.
3. The calculation of the percentage allowed for Idaho standard/itemized deductions and personal exemptions.
4. The allowed standard/itemized deductions and personal exemption amounts for Idaho.

### **13620 NONFILER – BUSINESS RETURNS**

Refer the non-filing business to the TDB Business Unit.

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NONPROFIT ORGANIZATIONS

SEC 13700

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Idaho does not have many income tax provisions that address nonprofit organizations.

**13705 NONPROFIT ORGANIZATIONS – MINIMUM TAX**

Nonprofit organizations are generally exempt from the minimum tax imposed by Idaho Code section 63-3025 *unless* they have unrelated business income subject to federal tax under IRC Section 511.

**13710 RELEVANT AUTHORITIES**

Idaho Code section 63-3025C – Corporations exempt from minimum tax.

*[Redacted a Deputy Attorney General memo included in section]*

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03-01 HOMEOWNERS ASSOCIATION SEC 2500 PAGE 1

2505 PERMANENT BUILDING FUND TAX

Are homeowners associations required to pay the \$10 permanent building fund tax?

Homeowners associations are required to file corporation income tax returns if they are authorized to do business or conducting business in Idaho. They are required to file corporation returns even if they are not incorporated.

The word "corporation" is defined in the Idaho Income Tax Act very broadly and expressly includes more than just those entities incorporated under state or federal law. Idaho Code Section 63-3006 provides:

The term "corporation" includes any corporation formed under the laws of any government, any common law trust and any association of whatever kind other than a partnership.  
(Emphasis added)

Therefore, unless the association qualifies as a partnership (and therefore is required to file a partnership return), the association is subject to the same rules for filing an Idaho tax return as is a corporation. Idaho Code Section 63-3030 provides:

- (a) Returns with respect to taxes measured by income in this act shall be made by the following:
- \* \* \*
- (3) Every corporation which is transacting business in this state, authorized to transact business in this state or having income attributable to this state, unless exempt from the tax imposed in this chapter;...

The permanent building fund tax is required to be paid by "every person required to file an income tax return". Idaho Code Section 63-3082. The term "person" specifically includes any corporation (see Section 63-3083) and, as we have seen, the term "corporation" includes any association which is not a partnership.

It therefore follows that any homeowners association receiving any amount of gross income is required to file an income tax return and pay the \$10 permanent building fund tax.

Reference: Memo issued by Ted Spangler dated May 22, 1981.  
Subject Homeowners Associations.



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03-01 HOMEOWNERS ASSOCIATION SEC 2500 PAGE 2

2510 MINIMUM TAX

Are homeowners associations, as defined under Section 528 of the Internal Revenue Code, and political organizations, as defined under Internal Revenue Code Section 527, required to pay the minimum \$20 income tax required by Idaho Code Section 63-3025?

For tax years beginning on or after January 1, 1986:

During the 1986 Legislative Session, Section 63-3025C was added to the Idaho Code. This section generally exempts nonprofit corporations from the \$20 minimum tax for tax years beginning on or after January 1, 1986. Those nonprofit corporations subject to federal tax on unrelated business income under Section 511, Internal Revenue Code, are subject to Idaho corporate income tax and will pay at least the minimum of \$20.

Reference: Section 63-3025C, Idaho Code.

EPB00754

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5-2010      NONRESIDENTS/PART-YEAR RESIDENTS      SEC 13800

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Part-year residents and nonresidents have different filing requirements than residents. As a result of filing with Idaho on Form 43, there are occasions where interesting situations are created.

**13805 PASSIVE INCOME/LOSSES**

Nonresidents and part-year residents should be reporting in Column B of Idaho Form 43 the loss for each Idaho activity that is allowed on federal Form 8582 and the corresponding worksheets. The suspended passive activity losses for both federal and Idaho should be the same.

In some cases, this will create a net operating loss for Idaho. If the taxpayer has passive income from sources outside of Idaho and losses from activities within Idaho, the amount reportable in column B will be the loss allowable for federal purposes.

Example:

Taxpayer has a \$5,000 loss from an Idaho partnership that is a passive activity for this individual; he also has \$3,000 of income from a passive activity located in Oregon.

Federal Treatment: Taxpayer is allowed to absorb \$3,000 of the loss from the partnership, and suspend the remaining \$2,000.

Idaho Treatment: On Form 43, column B, he will report a \$3,000 loss. The remaining \$2,000 will be suspended until he disposes of his interest in the partnership or has passive income in a future year. The \$3,000 loss reported to Idaho can be carried forward as a net operating loss.

If the passive income or loss is flowing through from a pass-through entity that apportions its income, the amount of the loss allowed for federal purposes for that entity must be apportioned after the computations for passive losses are made. If this apportionment creates a substantial distortion due to using the current year's apportionment factor on suspended losses from prior years, the auditor may want to consider using the factor from the loss year or separate accounting.

When auditing passive losses, the auditor should request copies of the federal Form 8582 worksheets to verify Idaho activities and the appropriate gains and losses.

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MAY-10                      PARTNERSHIPS/ S CORPORATIONS                      SEC 15000 PG 1

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**15005 TAXATION OF NONFILING PARTNERS AND SHAREHOLDERS Caution – Doesn't reflect 2012 and 2014 legislative changes**

When checking for individual nonfiling partners and shareholders, use the following guideline:

1. Did the Partners or Shareholders file Idaho Returns?
  - If no, go to Step 2.
  - If yes, they're done. The auditor may choose to verify correctness of return.
  
2. Are the Partners of a Partnership or Shareholders in an S Corporation Nonresidents?
  - If yes, go to Step 3.
  - If no, they are residents and must file an Idaho resident return.
  
3. Are the Nonresident Partners or Shareholders required to file?
  - What is the Idaho Gross Income?
    - Idaho Gross Income = (Business's Gross Income X Apportionment Factor X Ownership Percentage)
  - Does the Idaho Gross Income exceed the filing requirement? (See Idaho Code section 63-3030 for the filing requirements of nonresidents)
    - If yes, is there additional Idaho source income from other sources?
      - If no, go to Step 4.
      - If yes, the individual taxpayer must file his own Idaho nonresident return.
    - If no, a return is not required.
  
4. The partnership or S corporation is assessed tax on the Idaho source income of the nonfiling nonresident taxpayers as follows (See Idaho Code section 63-3022L and Rule 290):
  - Include the Idaho source income as taxable income.

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- The tax is computed at the corporate tax rate.
- The permanent building fund tax is assessed for each nonresident partner/shareholder not filing returns.
- No deductions are allowed:
  - For separately stated items and/or
  - NOL carryback or carryover.

Note: The law is changing (See Idaho Code section 63-3022L or House Bill 382 from 2010 Legislative Session) effective on 1/1/2011 which will require nonresident partners or shareholders to:

- Elect to pay tax at entity level or
- Withholding taxes will be required to be collected on behalf of the partner or shareholder by the entity.

**15010 DISCLOSURE OF NONFILING PARTNERS & SHAREHOLDERS**

We are obligated to inform the business of the reasons for any tax we determine it owes. This requires us to tell them:

- The name of the nonresident partner or shareholder whose income from the business is not reported in an Idaho income tax return.
- The specific types and amounts of income not reported.
- Do not include tax identification numbers (TIN) in the audit report for disclosure and security purposes.

**15015 TAXABILITY OF S CORPORATIONS IN IDAHO**

Reporting to Idaho as an S Corporation may include paying corporate level taxes.

When the corporation is subject to tax for nonfiling shareholders, the S corporation is subject to the following taxes:

- The \$20 minimum tax - unless another tax exceeds the \$20 and is required to be paid by the corporation,

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MAY-10                      PARTNERSHIPS/ S CORPORATIONS                      SEC 15000 PG 3

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- The tax assessed on behalf of any shareholder, and
- The Permanent Building Fund Tax of \$10 for each shareholder for whom they are paying taxes.

**15020 IDAHO REQUIREMENTS FOR ELECTING S CORPORATION STATUS**

For Idaho purposes:

- The Tax Commission relies on IRS' acceptance of an S corporation election. We do not require Federal Form 2553, Election by a Small Business Corporation.
- A copy of the notification that the taxpayer receives from the IRS accepting the election is requested and should be attached to the first "S" return that the taxpayer is allowed to file.

**15025 TRANSFER OF IDAHO PARTNERSHIP INTEREST – BEFORE 1/1/05**

**A partnership interest is an intangible capital asset separate and distinct from the underlying assets of the partnership.** The gain on the transfer of the partnership interest should be sourced to the state of domicile of the partner selling his interest.

The result would be different if the partnership was dissolving or liquidating. In that case, any gain would be properly sourced to Idaho if it were an Idaho partnership with out-of-state partners.

**15030 TRANSFER OF PARTNERSHIP INTEREST OR S CORP STOCK - AFTER 1/1/05**  
**Caution – not updated for 2018 legislation**

Gains or losses on the sale or other disposition of a partnership interest or stock in an S Corporation will be sourced to Idaho based on the apportionment factor reported on the prior year's tax return. (See Idaho Code section 63-3026A(3)(a)(vii)).

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**15205 PAYMENT RECEIVED PRIOR TO ISSUANCE OF REPORT**

Payments received prior to issuing the audit report are not to be reflected on the audit report but are to be shown on the NODD as a reduction in the net amount due.

When the taxpayer remits the balance due, all payments will be applied to the total deficiency on the audit report.

**15210 CORPORATE QUARTERLY PAYMENTS**

Following is a quick reference guide in regard to quarterly estimates for business returns:

- For the first year of existence or operation in Idaho, no estimated payments are required. This also applies to zero tax due S corporation returns that are changing to C corporations.
- A corporation is required to file a return in order to get an estimated payment refunded.
- Taxpayer can elect to have overpayment applied to the next year's estimated payments.
- Estimated payments are required if the corporation is required to make federal estimated tax payments and the Idaho tax liability is estimated to be \$500 or more.
- If payments are based on annualized income for federal purposes, the same method may be used for making Idaho estimated payments.

**15215 S CORPORATE QUARTERLY PAYMENTS**

An S corporation **is required** to make estimated tax payments on the Idaho tax due to:

- Net recognized built-in gains tax, and/or
- Excess net passive income tax.

Estimated tax payments are **not required** on the tax due on income being reported for nonresident shareholders.

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**15220 ELECTRONIC TRANSFERS**

All business payments of \$100,000 or more payable to the state must be paid by electronic funds transfer. Funds can be electronically transferred by one of the three following methods:

- Inter-bank transfer
- Federal Reserve Wire Transfer
- Automated Clearing House System

The taxpayer must initiate the transfer so that the money is deposited as collected funds to the State Treasurer's account on the day that the tax is due. Taxpayer questions should be referred to the Tax Commission's toll-free number.

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Penalties may be applied to a deficiency, or a return for various reasons. The specific reason that a penalty is being applied to a case must be stated on the audit report. If a penalty is being applied to an audit report, the minimum amount of penalty required is \$10. The negligence, late, substantial understatement, and extension penalties are limited to a total of 25% of the tax due on the return.

**15405 NEGLIGENCE PENALTY**

The negligence penalty is applied if the deficiency results from negligence or disregard by the taxpayer or his agent of state or federal tax laws, rules of the Tax Commission, or Treasury Regulations. The negligence penalty is 5%. The relevant code for the negligence penalty is Idaho Code section 63-3046(a) and Idaho Tax Commission Administration and Enforcement Rule 410. Some examples of when the penalty is applicable:

- Taxpayer continues to make errors in reporting income, sales or assets, or claims erroneous deductions, exemptions, or credits even though these mistakes have been called to his attention in previous audit reports.
- Taxpayer fails to maintain proper records and files returns containing unsubstantiated claims or substantial errors.
- Taxpayer makes unsubstantiated or exaggerated claims of deductions or exemptions.
- Taxpayer fails to offer any explanation for understating taxes.
- Unreported taxable income is a material amount as compared with the reported income.
- Taxpayer exhibits a careless disregard of his tax obligations.
- Failure to make the required estimated payment when requesting an extension of time for filing a return.
- Taxpayer fails to respond to requests to produce records substantiating items shown on the return.

**Negligence Penalty as a Result of Federal Audits**

- The negligence penalty should be assessed if:
  1. More than 120 days have passed without receiving taxpayer notification of a final federal audit determination, or
  2. We have asked the taxpayer to provide a final federal audit determination without his having first reported it.
- The 120-day period starts at the later of:



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1. The date the taxpayer signed off on the income tax examination change report, or
  2. The date the taxpayer receives the final notification and acceptance from the IRS District Director.
- Do *not* impose the negligence penalty if the taxpayer voluntarily provides a copy of the federal audit without first being prompted by us (even if more than 60 days have passed since the IRS issued its report).

**15410 SUBSTANTIAL UNDERSTATEMENT**

The substantial understatement penalty is 10%. The understatement penalty will be applied if the amount of tax understatement for the taxable year exceeds the greater of:

1. 10% of the tax required to be shown on the return for the taxable year, or
2. \$5,000 (\$10,000 for a corporation)

The amount the penalty is applied to must be reduced by the understatement attributable to any item for which there was substantial authority or if the relevant facts affecting the item's treatment were adequately disclosed on the return.

The penalty may be waived if the taxpayers have shown that there was reasonable cause for the understatement and that the taxpayer acted in good faith.

**15415 FRAUD PENALTY**

If any part of a deficiency is due to fraud with the intent to evade taxes, a 50% penalty will be assessed.

Fraud is defined as the actual intentional wrongdoing on the part of the taxpayer with the specific intent to avoid taxes known to be owed. Fraud is never presumed and must be proven by the Tax Commission.

All facts and circumstances of the case must be reviewed with the Audit Supervisor prior to the assessment of the fraud penalty.

Examples of actions that may justify imposition of the fraud penalty:

- A continued pattern of not reporting large amounts of income
- Keeping two sets of books

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- Falsifying documents
- Destruction of books and records
- Concealment of assets
- Covering up sources of income (illicit income)
- Conduct that misleads or conceals
- Failure to file tax returns
- Understatement of income

**15420 EXTENSION, LATE FILING OR LATE PAYMENT PENALTIES**

Penalties may be imposed if a return is delinquent or payment is delinquent. Penalties may be imposed on the tax due as follows:

- 0.5% per month or fraction of a month to a maximum of 25% for failure to pay the tax due (if return is filed)
- 2% per month or fraction of a month for failure to meet the extension criteria (the return must be filed by the extended due date, and the taxes paid by the earlier of the date the return is filed or the extended due date)
- 5% per month or fraction of a month to a maximum of 25% for failure to file the return on time

Note: for the purposes of determining whether or not these penalties are applicable, tax due includes subsequent adjustments. Idaho Tax Commission Administration and Enforcement Rule 430.01.f . However, as a matter of fairness, auditors should not assess the .5% or 2% penalties on additional tax due unless the penalties already applied based on the tax shown on the original return. It would be unreasonable to penalize a taxpayer for not paying tax they didn't know they owed.

See the Penalty Table on ITA's SharePoint work group site, for a breakdown of delinquent penalty situations.

**15425 WAIVER OF PENALTIES**

Penalties are not required on every NODD like interest is. The auditor must exercise judgment on whether or not to assess a penalty. Negligence, fraud, and substantial understatement penalties should be assessed when the penalty criteria is met because the statute states that when the criteria for those penalties if met, those penalties "shall be" assessed. The judgment for these penalties is based on whether or not the penalty criteria was met, i.e; Was the taxpayer

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negligent? Was fraud committed? Was their reasonable authority or sufficient disclosure of a position resulting in an understatement?

For late penalties, the statute states they “may be” assessed when penalty criteria was met. The auditor should first determine whether the penalty criteria was met, and then exercise discretion on whether or not to assess the penalty.

- **Pre – Audit Report:** Auditors have the discretion of whether or not to assess penalties.
- **Post – Audit Report:** As long as the NODD has not hardened or otherwise become a final assessment, an auditor can modify the NODD. Auditors may want to discuss this with their supervisor. If approved, a modified report is required.
- **Protested – Audit Report:** Tax and interest must be paid and a protest withdrawal form signed by the taxpayer *before* waiving any penalties approved by the Audit Supervisor. If approved, a modified report is required.

**15430 APPLICABLE AUTHORITY**

- Idaho Code section 63-3046 provides guidelines for the penalties that can be applied.
- Idaho Income Tax Administrative Rules 890 provides that the negligence penalty may be applied to a federal determination.
- Idaho Tax Commission Administration and Enforcement Rule 400 discuss the application of penalties in general.
- Idaho Tax Commission Administration and Enforcement Rule 410 discuss guidelines for the negligence penalty.
- Idaho Tax Commission Administration and Enforcement Rule 420 pertain to the fraud penalty.
- Idaho Tax Commission Administration and Enforcement Rule 430 provide the guidance for a penalty for failure to file, failure to pay, or delinquent filing.

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### **15505 GENERAL**

*Objective* – This is a guideline that establishes performance standards for two areas of performance – Complexity and Quality. While these performance standards and the quantity of audits performed are a part of your performance plan and management, it is not meant to replace or to be the only performance measure of your work. The core objectives along with other intangible objectives will also need to be evaluated and included in the performance plan.

#### **Performance Measures:**

**Complexity** – Each auditor class will be assigned leads or cases depending upon the complexity of the audit and the level of the auditor. Complexity is determined based upon a number of factors including, nature and number of issues, amount of time and research/analysis needed, type of taxpayer, and availability and nature of records needed to conduct the audit. During the course of the audit, the complexity may change due to nature of the records, identification of additional issues, or expansion of the scope of the audit, for example: an individual audit that now needs to have pass-through entities examined.

**Quality** – The quality of each audit is based upon the work you performed. The audit work will comply with established standards; clearly and accurately address all issues examined with legal support of the facts; effectively use time; and demonstrate ability to provide good taxpayer service.

While it is necessary to set standards for the unit and bureau, these measures should be discussed frequently and confidentially between you and your supervisor. As with other evaluative measures, these are not intended to be discussed broadly with staff other than to clarify the definitions and modify as needed.

### **15510 COMPLEXITY**

**Financial Technician** – These audits involve issues that are very limited in scope (see the Financial Technician Desk Audit Manual, Real Property Procedures Manual, and CP2000 Manual for more information on the specific issues worked by this position). They may require correspondence with the taxpayer to resolve the issue. You are only responsible for reviewing the assigned issues on the return. Because the issues in these audits are often very

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similar and limited in scope, you will use standardized explanations and schedules in most situations when issuing BLs or NODDs.

**Auditor 1** – These audits typically involve a wide variety of single issues that are fairly straight forward or nonfiler work that may lead to an audit of the return once it is received. You are responsible for independently reviewing and addressing all material issues on both the Idaho and federal income tax returns. They may require correspondence with the taxpayer to resolve the issue. The audit reports will be comprised of simple computations and explanations. While in some instances you may be able to use standardized explanations, in general, the issues in each audit are unique requiring that the explanation in the BL or NODD be written to address the taxpayer’s specific situation. The audits will generally be on individual taxpayers and would include Idaho additions, subtractions, and credits.

**Auditor 2** – These audits would involve multiple issues and may be either individual taxpayers or basic issues of business entities. They will require involved research of both the facts and the law. In addition to Idaho issues, the audit may include federal issues such as sole proprietorships, farms, rentals, and pass-through entities. The decision making and judgment required are much more involved than at the Auditor 1 level in that they require researching law to apply to facts gathered from a variety of sources.

**Auditor 3** – While these audits may include individual returns that have a multitude of issues or may be on the cutting edge of an issue, the majority of audits will be business entities including partnerships, LLCs, S corporations, C corporations, and fiduciary returns. The work on these audits is generally done at the taxpayer’s or representative’s offices and the report will include involved work-papers presenting complex financial data. The explanation and audit narratives are in-depth explanations of analysis of facts and law.

**A** = Single issue that requires a minimum of research. Information necessary to make decisions on the audit is easy to obtain.

**B** = Multiple issues that are basic in nature. Information necessary to make decisions on the audit is relatively easy to obtain. For example, a Schedule A or C.

**C** = Multiple issues that are a mixture of basic and more complex items. Information necessary to make decisions on the audit is more difficult to obtain, and may require gathering information from third parties in addition to what the taxpayer provides.

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**D** = A single very complex issue that requires in-depth research. Information necessary to make decisions on the audit is difficult to obtain, either due to the number of factors / transactions involved or due to the uncooperativeness of the taxpayer.

**E** = Multiple very complex issues that require in-depth research. Information necessary to make decisions on the audit is difficult to obtain, either due to the number of factors / transactions involved or due to the uncooperativeness of the taxpayer.

**15515 QUALITY** – For each standard a description of what is considered unacceptable, needs improvement, good, very good, and excellent work has been provided.

**Research & Analytical Review** – This area includes pre-audit analysis; conducting research using resources such as state and federal statutes, court cases, RIA/BNA, GenTax, etc.; analyzing financial records, conducting interviews, and applying the audit standards in section 0520 of the audit manual or sections 300, 400, 500, and 600 of the multistate income tax audit manual (MITAM). The level of review will be determined based upon the thoroughness and relevance of the work performed.

**Unacceptable** - Activity was not performed, was not relevant to the issue, was so poorly performed that the issue was not adequately supported, and may include substantial amounts of unnecessary or prolonged research.

**Needs Improvement** – Research and/or analytical review was performed but was either incomplete or did not address the appropriate issues. Issues may have been overlooked by inadequate analysis.

**Good** - Basic research and analytical review has been performed. The issue is supported by law and the facts are developed sufficiently.

**Very Good** - This includes research and analytical activities that were thoroughly conducted and relevant to the issues or facts of the case. Extra steps were taken to verify such things as other tax permits, related returns, related taxpayers, etc.

**Excellent** - Research was outstanding and demonstrated in-depth understanding of difficult issues and correct application of law. The research and analytical review achieves results that are highly productive

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due to either materiality or their ability to identify other issues not previously identified.

**Audit Workpapers and Narratives** – The workpapers should thoroughly document the issues addressed in the audit. Narratives should comply with section 0745 of the audit manual or section 700 of the MITAM. Section 800 of the MITAM provides a standardized format to be used in scheduling for multistate audits. Criteria used to rate the workpapers will be based upon completeness, if the issue is sufficiently documented, and if the supporting schedules can be followed easily; i.e., do they make sense.

**Unacceptable** - Material errors are found in the workpapers and findings. Audit documents are sloppy and contain numerous spelling and grammatical errors. Little attempt is made to correct errors or review work. The workpapers do not support the findings or adequately record the audit work performed.

**Needs Improvement** – Errors are numerous, but are not material in nature. Guidance on the workpaper file or narratives was not followed. Narratives are incomplete or not provided when required.

**Good** – Minimal to no errors are found in the workpapers and findings. The workpapers adequately support the findings of fact and law. They are clear as to the audit work performed and follow the guidelines in the audit manual.

**Very Good** – The audit workpapers are well organized and readily support the findings of fact and law. Issues of law are fully documented with proper research and issues of fact are fully developed. They meet or exceed all of the criteria set forth in the audit manual. The narrative supports and augments the audit explanation.

**Excellent** - The workpapers and narrative were outstanding and demonstrated in-depth understanding of difficult issues and correct application of law. The workpapers are complete and very thoroughly address each issue in the audit, whether adjusted or not. The narrative is complete and provides a clear history and discussion of the taxpayer's business activities, records, development of audit issues, penalties, and closing conference.

**Audit Report** – The final audit report including the explanation and schedules should thoroughly address each issue. The explanation should be written clearly

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and concisely. The criteria used to rate this area will be: What adjustments were made? Why were these adjustments made? What is the authority for making these adjustments?

**Unacceptable** – Material errors are found in the audit explanation and/or schedules. Schedules do not tie to the adjustments on the audit report. Authority for making the adjustment is absent from the report.

**Needs Improvement** - A few minor errors such as spelling or computational may be made occasionally. The audit explanation and schedules support the adjustments, but may not be thorough, may not cite the appropriate authority, or may be written to the incorrect audience.

**Good** – While there may be no errors in the report, the explanation may not be thorough or may need further clarification. The schedules are supportable and tie to the adjustments made.

**Very Good** – The explanation meets all of the criteria identified above with no errors. The schedules are complete and easy to understand. The audit explanation is thorough and relevant to the taxpayer.

**Excellent** – The audit report was outstanding and demonstrated in-depth understanding of difficult issues and correct application of law. The explanation and schedules fully support and tie to all adjustments. The explanation is exceptionally well written in such a clear and concise manner.

**Correspondence/Communication** – Requests for information should be complete and follow up contact should be timely and regular. Effort should be taken to contact the taxpayer in person whenever possible if the taxpayer has not responded to requests. Criteria used to evaluate the quality of communication, both written and verbal, will include the timeliness, accuracy and thoroughness.

You should develop a positive, honest relationship with the taxpayer and present a professional demeanor. This is accomplished by thoroughly discussing the audit issues from the beginning to the end of the audit, including post audit conferences as needed. Be prepared with information the taxpayer requests and make suggestions as needed on how the taxpayer can improve their processes to comply with the law.

**Unacceptable** – You did not timely or accurately communicate with the taxpayer. Communication during the audit was minimal or non-existent.

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**Needs Improvement** – Communications were unclear and unnecessarily numerous. Often the taxpayer did not understand the requests or the audit issues.

**Good** – Written and verbal communications were generally timely, thorough and accurate. You followed the 45 day contact policy. Audit issues were disclosed to the taxpayer or representative.

**Very Good** – Communications were always timely, thorough and accurate. The taxpayer was kept fully informed throughout the audit.

**Excellent** – All communications are very professional, timely, thorough and accurate. You took a proactive approach by working with the taxpayer to gain their cooperation and resolve differences.

**Timeliness** – The amount of time between contacts with the taxpayer/representative is primary to the quality of an audit. This includes making the appropriate decisions, following up as needed and protecting statutes. If the taxpayer/representative is delaying the audit unnecessarily, you should use good judgment on how to proceed or discuss the situation with your supervisor to determine what action should be taken e.g., a summons or provisional audit. Criteria will include the amount of time between contacts and the overall amount of time taken on the audit.

**Unacceptable** - Decisions and actions were not made in a timely manner, despite having sufficient information or audit guidelines identifying the next step to take. Unnecessary gaps in contact with taxpayer occurred.

**Needs Improvement** – Statutes were not protected timely. Decisions and actions taken were delayed and not discussed with the supervisor. Overall time between contacts and on the audit was more than necessary.

**Good** - Contact with the taxpayer was generally timely and appropriate response dates were established. Response dates were generally monitored but without immediate follow-up. Time wasted by focusing too heavily in one area (research, immaterial expenses, etc.) is minimal. You were able to make all decisions, but did not perform all actions in a timely manner.

**Very Good** - Contact with the taxpayer was timely and set appropriate response dates. Response dates were monitored and followed up. Audit

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did not focus on immaterial items. You responded quickly upon the receipt of information from the taxpayer.

**Excellent** - Contact with the taxpayer was timely and set appropriate response dates. Response dates were clearly monitored and followed up. Correct decisions and actions were immediately made upon receipt of the information from the taxpayer. Any delays in the audit were solely due to the taxpayer. The audit was resolved very quickly when compared to other audits of this scope.

### **15520 AUDITOR DEVELOPMENT PLANS**

The auditor development plans for a Tax Auditor 2 (Underfill), Tax Auditor 3, Tax Auditor 4, and Tax Audit Manager are on the ITA SharePoint site. These development plans can be used to help improve your skills. They outline the requirements and competencies needed to qualify for promotional opportunities.

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**15605 CORRESPONDENCE PROCEDURES**

1. **Initial Correspondence** – Income Tax Audit (ITA) changed its policy for sending Power-of-Attorney (POA) forms in initial letters and billing letter on March 15, 2017. The change was enacted after it was determined that only a small percentage of the POA forms ITA sent out are actually returned by taxpayers. Therefore, it was determined that ITA would reference the Tax Commission’s website where the POA form could be found.
  
2. **All Subsequent Correspondence** – Use the following procedures:
  - A. If you **have** a completed POA form, follow these correspondence procedures:
    - If you’re sending a Notice of Deficiency:
      - a. The original should be mailed to the taxpayer, and
      - b. A copy should be mailed by regular mail to the taxpayer's authorized representative.
    - In all other correspondence:
      - a. The original should be sent to the authorized representative, and
      - b. A copy to the taxpayer.
  - B. If you **do not have** a POA form, any correspondence must only be with the taxpayer.

**15610 RECEIVING POWER OF ATTORNEY FORMS**

Upon receiving Power of Attorney (POA) forms, auditors need to take the following steps:

- Make a notation in the CRM notes in GenTax in the Taxpayer Manager that the POA has been received.

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- Boise auditors need to forward the original POA form to one of the following designated individuals:
  - Diana Johnson,
  - Christina Tromburg
- For field office auditors, scan the POA as a tiff or jpeg image (make sure it is readable). Place the image in your field office scans folder. Or scan the POA as a PDF and attach the document in your audit manager. Send an e-mail to one of the designated individuals listed above to let them know that a POA needs to be entered into GenTax and where it is located.
- Field office auditors should keep the POA for reference in your work file. Boise auditors should also keep the POA in their work file once it is returned by the support staff. A physical copy is needed if the audit is appealed and a workpaper file is sent to Tax Policy/Legal.
- **Do not process the form or forward it to RO/ARM for processing.**
- ISTC POA business procedures can be found at:  
Power of Attorney Business Procedures for Agency Staff

**15615 POWER OF ATTORNEY FORM**

Following are four acceptable Power of Attorney (POA) forms the taxpayer may use:

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

1. The Idaho POA form and instructions are accessible through GenTax.
2. Idaho POA form website link:  

[https://tax.idaho.gov/forms/EFO00104\\_02-06-2017.pdf](https://tax.idaho.gov/forms/EFO00104_02-06-2017.pdf)
3. Federal Form 2848:
  - References to the Internal Revenue Service must be changed to the Idaho State Tax Commission, and
  - The tax form number must indicate the Idaho form number.

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4. A written document containing the five items required by Idaho Tax Commission Administration and Enforcement Rule 702. These include: Durable, General, and Military POA's.

Auditors should encourage taxpayers to use the Idaho form.

**Carefully review** the authorizations to be sure that:

- There is a separate authorization for each entity (individual, corporation, and partnership),
- The form contains original signatures (fax or e-mail attachment are acceptable),
- The forms are OTHERWISE COMPLETE to include:
  - Taxpayer's name or company legal name, along with their SSN or EIN.
  - Spouse's name and SSN (if applicable).
  - Taxpayer address
  - Representative(s) name, firm/company name (if applicable)
  - Representative address
  - Tax type(s)
  - Permit number (if applicable)
  - Tax periods/years
  - Signature(s) of the taxpayer(s)
  - Signature of the representative
- Unacceptable forms need to be returned to the taxpayer along with an ISTC POA form for completion.

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

- Return the forms with the "POA Request for Information", "Didn't submit an Idaho POA form" letter found in GenTax.

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- Incomplete forms need to be returned to the taxpayer, highlighting the field(s) that are incomplete.

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

- Return the forms with the "POA Request for Information", "Didn't provide all required information" letter found in GenTax.
- Make a CRM notation. Examples: Received unacceptable POA for "tax type(s)", "tax period(s)" for "Representative Name", "phone number". Mailed ISTC POA form with Request for Information letter.; Received incomplete POA for "tax type(s)", "tax period(s)" for "Representative Name", "phone number". Mailed Request for Information letter.

## **15620 FREQUENTLY ASKED QUESTIONS ABOUT POWERS OF ATTORNEY**

**Power of Attorney (POA) Defined:** A POA is a signed, written instrument that allows one person (the "principal") to authorize another (agent, representative, or "attorney-in-fact") to conduct certain business on the principal's behalf. There are two types of POAs: "general" and "limited" (or "special"). A general POA gives the agent very broad powers to act on the principal's behalf. A limited POA grants the agent authority to act only on certain, limited matters. Every act performed by the agent within the authority of the POA is legally binding on the principal.

### **1. When is a POA required?**

A POA is necessary for anyone at the State Tax Commission to discuss confidential information with a representative of a taxpayer or before the representative can enter into an agreement on behalf of a taxpayer (such as a waiver or compromise) that is binding on the taxpayer. A POA is not necessary to discuss confidential information with a representative if the taxpayer is present.

A taxpayer may authorize, in writing, a disclosure of specific information to a third party not otherwise entitled to the information, without completing a full POA form. In such a case, the Tax Commission may disclose only the specified information, and the third party may not take any actions on the taxpayer's behalf. (The written authorization to disclose information can be thought of as a limited POA.) See Admin. & Enforcement Rule 702.2.

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**2. Must a POA be on the form provided by the State Tax Commission?**

No. However, all of the necessary elements for a valid POA must be present in the document. At a minimum, the POA must:

- Identify the principal (the taxpayer).

The Tax Commission can refuse to honor a POA that fails to unambiguously identify the principal. The best and preferred way to identify a particular taxpayer is with the taxpayer's SSN or EIN included in the POA document. Proper identification is the responsibility of the principal not the agent or the Tax Commission. An agent's authority can only be granted or defined by the principal or reasonably inferred from the principal's actions. An agent cannot grant or define his own authority.

- Identify the agent (representative).
- Express the scope of authority granted to the representative.

In a general power of attorney, this may be a very broad statement (such as "do all things" or "take all actions").

If the POA is a limited power of attorney, the expression of authority granted must include, at least, the matters of interest to the State Tax Commission about which the representative will act for the taxpayer.

- Be signed by the principal and dated.

**3. Must the taxpayer's signature be notarized?**

The State Tax Commission has no policy requiring the POA to be notarized. Verification by a Notary Public establishes that the signature on the POA is that of the person purporting to have signed it. If a properly completed notarization is present, it means we consider the taxpayer's signature is genuine.

**4. When the tax matter at issue results from a jointly filed individual income tax return, must both spouses sign the POA?**

If the taxpayers are Idaho residents, generally no. Under Idaho law, either spouse has the right to manage and control the community property (including liabilities

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such as tax debts) without the consent of the other spouse. However, one spouse acting alone cannot transfer or encumber real property owned by both or enter into a contract affecting rights to the other spouse's separate property. One spouse cannot, therefore, empower an agent to do either of these acts for the other spouse. This can be relevant when there are actions such as consent to filing a tax lien or when completing a compromise and closing agreement. Because of these exceptions, it is a better practice to have both sign the POA. However, the State Tax Commission need not deny validity to a POA signed by only one spouse so long as the acts of the representative do not affect title to realty or the separate property of the other spouse.

If taxpayers filing a joint return have later divorced, one former spouse may only empower a representative to act on behalf of himself or herself - not the other former spouse.

If the joint return is a nonresident return or it appears that the former resident taxpayers no longer reside in Idaho, the POA should be signed by both.

**5. Do we accept federal POAs?**

A limited POA must clearly express the taxpayer's intent that it applies to matters of Idaho state taxation. This can be done by making appropriate changes to the federal POA form by which the taxpayer expresses the intent that the POA apply to the state either in addition to, or in place of, the IRS. However, it must be clear that at the time the taxpayer signed the POA he or she approved any alterations. It is common (but not required) to do this by the taxpayer adding his or her initials at or near the point of any alterations.

**6. For how long is a POA valid?**

Generally, a POA is valid until:

- It expires on a date expressed in the POA.
- It expires on the conclusion of the specific matters to which it refers.
- The taxpayer expressly revokes it.
- It expires because the principal becomes incapacitated and unable to make his own decisions (such as the decision to revoke the POA). An exception to this rule is a "Durable Power of Attorney" which expresses the principal's



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desire that the power continue upon his or her disability. Many durable POAs apply only to medical care.

- It expires on the taxpayer's death.
- When a taxpayer dies, a representative will need a new POA signed by the personal representative (executor) appointed by the court or – in the event there is no probate proceeding in court – by the taxpayer's heirs.

### **7. How is a POA revoked?**

A POA may be revoked by:

- By the taxpayer expressing the intent to revoke it.
- By a new POA expressly revoking prior POAs.

Notes:

1. A taxpayer can revoke a POA orally. In such a case he or she should be encouraged to follow up the revocation with a written notice of this revocation. Even in the absence of such a follow-up notice, a verbal revocation should be considered valid. A letter to the taxpayer confirming the oral revocation is recommended. Also, a CRM note in GenTax should be made on the taxpayer's account explaining the verbal revocation of the POA.
2. A POA can be revoked without notice to the State Tax Commission. For this reason, we should not rely on older POAs where the matter to which it relates has been inactive for a lengthy period. Sending copies of correspondence to the taxpayer is one way to help ensure that the taxpayer knows we are communicating with his representative. If he does not object, then we may presume (absent something abnormal) that the POA remains valid.
3. More than one person can represent a taxpayer at the same time (such as both a lawyer and a CPA). When we receive a second POA that does not expressly state whether the first POA remains in effect, prudence requires seeking clarification from the principal or the representative named in the second POA about whether the first POA remains in effect.

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**8. Can the Tax Commission still contact the taxpayer if there is a POA in place?**

The "Idaho Taxpayer's Bill of Rights" limits, but does not prohibit, contacting a taxpayer who is represented by a person designated in a POA. Generally, we must communicate with the representative. We may send copies of correspondence to the taxpayer unless specifically instructed not to do so.

We may contact the taxpayer:

- About matters outside the scope of issues addressed in the POA.
- If we cannot determine the representative's name or address.
- If the representative does not respond within seven days.

See Idaho Code section 63-4003(1) for details.

**9. Should all written correspondence also be sent to the taxpayer?**

We may send copies of correspondence to the taxpayer unless specifically instructed not to do so. Sending copies of correspondence to the taxpayer helps ensure that the taxpayer knows we are communicating with his representative. If he does not object, then we may presume (absent something abnormal) that the POA remains valid.

**10. What rights are specifically granted by a POA?**

A POA does not grant rights; it gives authority.

A "general power of attorney" grants the representative authority to take any action the principal could take for himself.

A limited power of attorney grants the representative only the authority expressed in the POA. A party relying on the POA is charged with knowing the extent of the agent's authority and is charged with enforcing any limitations in the authority. Read a POA carefully to determine the extent of authority granted to the representative. The representative does not have any authority not clearly granted in the POA.

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If the POA is ambiguous about specific authority, it must be construed to not grant that authority. However, a representative is empowered to take actions that are reasonably necessary to carry out authority that is unambiguously granted in the POA. (For example, a representative appointed to resolve a protested deficiency notice necessarily has authority for disclosure of information from audit schedules on which the deficiency was based.)

**11. Do partners of a partnership, shareholders of a corporation, or members of an LLC need a POA to represent the business entity?**

General partners (including a partner designated as "tax matters partner" for federal tax purposes) of a partnership, managing members of an LLC, and officers of a corporation do not need a POA in order to represent the business. Similarly, employees assigned tax responsibility by the business (such as a "tax manager" or "financial vice president") do not require a POA. Other individuals (such as limited partners or non-managing shareholders) may not have this authority and need a POA to represent the business. If circumstances present a reason to doubt the extent of an individual's authority, it is appropriate to ask for clarification of that authority by means of a POA.

The State Tax Commission has no policy requiring a verification that the person signing the POA on behalf of a corporation or other legal entity is authorized to do so by the entity. If specific facts or circumstances present a question about the authorization, verification should be requested.

**12. In the case of corporate taxpayers included in a return based on a combined report or income, must the POA specifically identify all the subsidiary corporations or is it acceptable for it to identify the parent company "and its subsidiaries?"**

Either is acceptable. A listing of all subsidiaries may be both voluminous and carries the possibility of omissions. A principal who authorizes an agent to act on behalf of "all subsidiaries" grants a broader appearance of authority than one who lists the subsidiaries.

**13. Do people listed as contacts on IBR forms have rights to information or do they need a POA?**

The status of persons identified as "contacts" in the Initial Business Resolution (IBR) can change without notice to the Tax Commission. If information available to the Tax Commission (such as updated contact information in GenTax) shows a newer contact identification, then the name on the original IBR should not be

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accepted as an authorization from the taxpayer to make contact without a POA or a written authorization to disclose information. The reliability of the contact identification shown on the IBR or in GenTax diminishes over time. Whether the taxpayer or the Tax Commission initiates contact, consider the timeliness of the contact identification when relying on it to disclose information. If the contact information is dated, steps to verify it are appropriate. This may mean obtaining a new POA or a written authorization to disclose information from the taxpayer. (But see the answer to question 11 as to authority of owners, partners, and officers.)

**14. What is the effect of the box on Idaho individual income tax return forms allowing the Tax Commission to contact a paid preparer within 180 days?**

This limited power of attorney is primarily intended to allow contact with the preparer concerning processing matters (such as the need to obtain missing schedules) within 180 days of the filing. It authorizes "contact" with the preparer to "discuss" the return, but does not otherwise spell out the scope of the preparer's authority to act on the taxpayer's behalf. The instructions tell the taxpayer that checking the box authorizes "the Tax Commission to contact your preparer to resolve any questions related to your return,"

We should consider the authorization created by a taxpayer who checks the box (and signs the return) as authorization to exchange information with the preparer, but not as authority for the preparer to take actions binding on the taxpayer without the taxpayer's consent evidenced by a signature.

It does not preclude contacting the preparer on other matters (such as collection). However, when contacting the preparer on other matters, be sure to clarify the representative's authority, especially if you anticipate that continued contact after 180 days is likely. This may require the completion of a new POA.

**15. Is a POA to a law firm or CPA firm good for the whole firm or just specific individuals named in the POA?**

Only if the POA names the firm itself as the representative or attorney-in-fact may any member of the firm act as the taxpayer's representative. Otherwise, only the individuals named are authorized to represent the taxpayer. This does not preclude such ordinary business practices such as leaving a message or scheduling an appointment with an accountant's or lawyer's assistant or secretary.

**16. Does a bankruptcy trustee need a POA?**

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No. A bankruptcy trustee stands in the shoes of the debtor (taxpayer) for all matters relating to the bankruptcy. The trustee may do anything in regard to the bankruptcy case (take all actions or receive any information) that the debtor, acting on his own behalf, could do for himself.

**17. After a bankruptcy is discharged, is a trustee's authority automatically revoked?**

Generally, a bankruptcy trustee's authority expires when the bankruptcy is closed. In some instances, the bankruptcy court may reopen a closed bankruptcy action.

**18. Does a licensed attorney representing a client need a POA?**

Generally yes, except in the context of matters in court (or the BTA) where a lawyer's conduct is subject to supervision and sanction as an officer of the court. The attorney-client relationship confers some inherent authority (and corresponding duties) on the attorney, but only after the client has retained the lawyer to act as his attorney. A third party (such as the Tax Commission) is not required to rely on this inherent authority and may require a written POA from the attorney as from other representatives. The State Tax Commission has established no policy of exceptions to POAs for licensed attorneys.

**15625 MORE QUESTIONS AND ANSWERS**

**1. A POA Form lists both an individual and an LLC and designates a CPA to represent both. Does this constitute a valid POA?**

Because the individual had signed the entity's return as a Partner and Treasury, the POA is valid even though the individual was not listed as a tax matter partner.

**2. An adult Child signs a POA on behalf of Mom and Dad as they are unable to do so due to a medical condition like dementia. No POA exists authorizing Child to represent Parents. Does this constitute a valid POA?**

If prior to Mom and Dad's debilitating condition they execute a general POA or another form of legal guardianship or conservatorship authorizing them to attend to Mom and Dad's affairs, then the Child can sign the Idaho POA form. If they did not, then the Child will need to take action to be awarded

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guardianship or conservatorship of Mom and Dad before he can sign the Idaho POA form.

- 3. POA is received for a joint return, but is only signed by the husband. Taxpayers are nonresidents who live in a non-community property state and wife is unable to sign due to a medical condition like dementia. Does this constitute a valid POA?**

We are likely okay if only the husband signs the POA. If possible, it would be preferred that the wife also put her mark on the form.

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A taxpayer who is issued a Notice of Deficiency Determination has the right to file a written protest to request a redetermination of the deficiency. The auditor should make every reasonable attempt to resolve the protested issues. However, sometimes the issue cannot be resolved in audit and the case must be transferred to Tax Appeals for a redetermination.

**15805 NOTICE OF DEFICIENCY – PROTEST**

- The brochure “Your Rights to Appeal” is sent with the NODD.
- Within 63 days from the date of the NODD, the taxpayer must file a written protest. The taxpayer’s representative may also provide a written protest, with or without a POA on file. A perfected protest must contain:
  1. Taxpayer's name, address, and social security number/taxpayer identification number;
  2. The period to which the deficiency relates;
  3. The specific item or items in the deficiency notice to which the taxpayer objects;
  4. The factual or legal basis for the objections made.

**15810 UNPERFECTED PROTEST**

If a protest is received that does not contain the four items listed above, the protest is considered unperfected. In this case:

- The auditor will send the 28-Day Unperfected Protest letter notifying the taxpayer that the protest is not perfected. The letter will state the inadequacies and the corrective action needed to perfect the protest.
- The taxpayer has 28 days from the date of the letter to perfect the protest. If a perfected protest is subsequently received, the procedures for a perfected protest should be followed.
- Normally, the 28 day period to perfect the protest expires after the 63 day protest period for the NODD ends. However, even in those rare situations where the 28 day period expires before the 63 day period ends, the NODD becomes final on the 29th day following the date of the Commission letter if the taxpayer does not perfect the protest.

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- If the taxpayer fails to file a written protest within the 63 days, then all avenues of appeal are closed and the taxpayer is legally bound to pay any deficiency.

**15815 PERFECTED PROTESTS**

If the audit is protested and perfected, the auditor will:

- Send a 14 day letter acknowledging the receipt of the perfected protest.
- Change the stage in the audit springboard/manager from NODD Issued to Protest.
- If the taxpayer has submitted additional evidence or documentation, or has requested additional time in which to do so, the auditor can decide to keep the case for resolution at the audit level. The protested audit should not be held more than 180 days from the date of the protest without approval from the auditor's manager.
- If the auditor decides to send the case to Tax Appeals, the auditor should inform the taxpayer of such in the 14 day letter.

**15820 PROTEST AFTER BILLING LETTER**

Sometimes a taxpayer will protest a billing letter.

A letter responding to a billing letter is not an official protest. The auditor should recognize that the taxpayer disagrees with the billing letter and may want to protest their case or provide more information.

However, if the taxpayer's letter is a perfected protest (and the taxpayer has made it clear that they intended their letter to be a perfected protest), then the auditor should issue an NODD. Also, a 14 day letter should be issued at the same time acknowledging the protest. The 14 day letter could include a sentence or two informing the taxpayer that "pursuant to the procedural requirements of Idaho law, an official 'Notice of Deficiency Determination' has been included." The official Notice of Deficiency Determination could be included with the 14 day letter.

**15825 PREPARING PROTEST FOR TAX APPEALS**



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When a taxpayer has protested and the case cannot be resolved in audit, it must be transferred to Tax Appeals.

When a file is transferred to Tax Appeals it must be organized in a consistent fashion with the Table of Contents file on ITA's SharePoint site. The "Protest Legal File TOC" and the "Protest Summary (New)" must be prepared and included in the physical file.

- The "Protest Legal File TOC" is the table of contents for the case. Add or delete items as applicable for the specific case, but follow the general order. Delete the text in red for the file copy. In the physical file, place tabs on the documents to indicate where each section starts.
- The protest summary is a brief summary of the case and the unresolved protest items. Each item should only be a paragraph, and refer to other documents within the file for more detailed information, such as the NODD explanation, or 14 day letter.

Before sending the file to Tax Appeals, scan and attach the relevant documents into GenTax. Also, create a "Send to Appeals" work item and assign it to your manager.

Give the hard copy of the file to your manager and copy the Protest Summary document into your manager's review folder in IAPUB.

**15830 PROTEST RECEIVED AFTER THE NODD HARDENS**

When an untimely protest is received:

- The auditor will evaluate any additional information the taxpayer provided with the protest. If the information is acceptable and impacts adjustments made in the NODD, the auditor can, at that point, modify or cancel the NODD. Even if the NODD is changed, the protest will not be accepted as valid and protest procedures will not be followed. However, a letter should be sent informing the taxpayer of the changes and that the protest is not valid.
- If no additional information is provided or accepted, the auditor will send a Protest-Late Filed letter to the taxpayer explaining that the protest was not timely filed and the case has been sent to the Collection Division.
- The auditor should also contact the Collection Division employee assigned to the account (if the audit has been posted in GenTax) to inform them of the

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communication with the taxpayer. If the account has not been assigned, the auditor should contact the Collection supervisor.

**15835 APPEALS PROCESS**

When a protested audit goes to Tax Appeals:

- A hearing rights letter is sent to the taxpayer.
- A hearing is available for the taxpayer to present his/her case.
- The taxpayer may request a final decision from the Tax Commission. A final decision of the Tax Commission must be issued within 180 days after receiving such request or within 180 days after the hearing is held unless the taxpayer has requested and received an extension of time.
- If the taxpayer does not agree with the decision rendered by the State Tax Commission, he may appeal to the Board of Tax Appeals or file a complaint in the appropriate district court within 91 days following the issuance of that decision and after paying 20% of the deficiency amount.
- Sales or use tax and corporate income tax decisions can generally be appealed to the Board of Tax Appeals. If the tax asserted is greater than \$25,000, no appeal to the Board of Tax Appeals is allowed.
- The next step in the appeal process is appealing to the Idaho Supreme Court. The complaint must be filed with the Idaho Supreme Court within 42 days from the date the final judgment is entered by the district court.
- Decisions of the Idaho Supreme Court may be appealed to the U.S. Supreme Court if there is a constitutional issue.

**15840 CANCELING AN NODD**

If the auditor agrees with the taxpayer's protest and determines the deficiency should be canceled:

- Prepare the Protest Cancel Deficiency letter informing the taxpayer that you are canceling the audit.
- Submit the audit through your normal no change review process.

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- Once approved, cancel the NODD and close the audit as a no change.
- Mail the Protest Cancel Deficiency letter to the taxpayer. A copy of this letter should be attached in GenTax.

**15845 MODIFYING AN NODD**

If the audit should be modified due to additional information provided with or subsequent to the protest, a modified audit report should be issued.

- The audit explanation should fully describe the adjustments that have been modified.
- A new audit report should be prepared with "MODIFIED" written in the top left corner of the 042/044, explanation pages, and any modified schedules. The modifications should be clearly identifiable to the taxpayer.
- If the original deficiency is being modified downward because of additional information we have received from the taxpayer, do not reissue the NODD page for the new amount.
- If there are new issues or a reconsideration of a previous issue that results in an increase in the amount of the deficiency, a new NODD must be issued.
- Prepare a modified deficiency letter along with the modified audit report. Include a Protest Withdrawal Statement to be signed and returned. Any action required on the part of the taxpayer should be stated in the letter. Treat the date the taxpayer mailed the additional information as the protest date if you did not receive an official protest letter.
- Submit the audit through your normal review process. See section 800.

**15850 APPLICABLE AUTHORITY**

- Idaho Code section 63-3045 establishes taxpayer's protest rights and time allowed to correct an imperfect protest.
- Idaho Code section 63-3045B establishes when an NODD and a tax decision become final.

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- Idaho Code section 63-3049 establishes the requirement that the taxpayer must pay 20% of the proposed tax deficiency when appealing to district court or Board of Tax Appeals.
- Idaho Tax Commission Administration and Enforcement Rule 320 details the requirements for filing a protest and unperfected protest procedures.
- Idaho Tax Commission Administration and Enforcement Rule 325 provides procedures that apply after a perfected protest has been filed.

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4/2020

PUBLIC RECORDS ACT

SEC 15900

In 1990, the Idaho Legislature passed the Public Records Act allowing the public to examine and or copy public records, unless exempted from public disclosure.

**15905 GENERAL INFORMATION**

The ISTC [website](#) provides basic information about public records requests. The ISTC has developed the form, "[Request to Examine and/or Copy Public Records](#)," to facilitate the requests of public records.

The Idaho Attorney General's Office has also published the *Idaho Public Records Law Manual*, which that provides a more exhaustive set of questions and answers than the ISTC's website.

**15910 ISTC PUBLIC RECORDS REQUESTS GUIDELINES**

The Tax Commission has also put together a document entitled, "Guidelines for Processing Requests for Public Records".

In brief, it is ISTC's policy that:

- An appropriate response must be given to the requestor **within three (3) working days from the date the request was received** and to provide access to and copies of public records immediately upon request whenever possible.
- Basic requests for routine information can be provided by the auditor.
  - Routine request include public information that:
    - is frequently requested;
    - is of an ordinary or usual nature;
    - is not exempted from public disclosure by Idaho Code;
    - can be copied or reviewed without undue disruption of the official work;
    - is not a request which implies a tax protest or potential of current legal challenge; and/or
    - is generally 100 pages or less
- Requests for complete copies of an audit file or any "non-routine" information must be in writing.
  - Non-routine requests include:

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- If the request is for information that is not theirs, businesses, third parties, etc.
  - If the request is out of the ordinary, ex. the case is closed, they have requested the same information over and over, some tax protestors
  - If the request is going to be well over 100 pages
  - If there are items that is exempted from public disclosure
1. When a written request is received in Boise, it should be date stamped and immediately hand delivered to the Designated Custodian.
  2. Field offices should notify the Designated Custodian of the receipt of any non-routine public records requests. This notification should be followed immediately by faxing or e-mailing a copy of the request to the Designated Custodian.

If you have a question as to whether the request is for routine or non-routine information, contact the designated custodian.

Nicole Boehland is the Designated Custodian for Audit. If Nicole is unavailable, contact your Supervisor.

**15915 APPLICABLE AUTHORITY**

The Idaho Public Records Act can be found in Idaho Code sections 74-101 through 74-126.

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REFERENCE MATERIALS

SEC 17300

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**17305 TAX RESEARCH**

RIA Checkpoint: [Checkpoint](#)

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

**Do Not Disclose Usernames and Passwords**

Court Cases (Find Law): <http://www.findlaw.com/casecode/>

Accurint: Search for addresses. Other miscellaneous information also available.  
(user name & password required – see supervisor)

**17310 LOCAL NETWORK – ITA SHAREPOINT SITE**

1. Various types of forms and information are available on ITA's SharePoint site.
2. You will find:

- Audit Manuals – Both Intrastate and Multistate Manuals
- ITA Letters
- Intrastate Templates
- Multistate Templates
- Issue Analysis
- Audit Explanations – Examples
- Audit Narratives – Examples
- Summons
- Administrative Decision Index
- Links to Code-Rules Income – From 1991 Forward
- Penalty Table
- Cheat-Split – Spreadsheet showing changes in the law over the years on various issues and how they are applied in each year. (i.e. NOL carryback and carryovers, ITC carryovers, etc.)

**17315 FEDERAL**

Internal Revenue Service: <http://www.irs.gov/>

Federal Tax Code: <http://www.fourmilab.ch/ustax/>

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[Pacer – Federal repository \(password required, check with Kris Fosness\)](#)

**17320 IDAHO**

Idaho State Tax Commission: <http://www.tax.idaho.gov/>

Idaho Statutes: <https://legislature.idaho.gov/statutesrules/idstat/>

Idaho Administrative Rules:  
<http://adminrules.idaho.gov/rules/current/35/index.html>

Business Licensing: <http://www.state.id.us/business/licensing.html>

Secretary of State:

- Business Entity:

<http://www.accessidaho.org/public/sos/corp/search.html?SearchFormstep=crit>

- Lien Search:

<https://www.accessidaho.org/secure/sos/liens/search.html?SearchSitteraction=premium>

Contact Collection to use this resource.

County Property Information:

- Data on many counties (but not all):

<https://tax.idaho.gov/gis/parcelmaps.cfm>

- Ada County:

<http://www.adacountyassessor.org/propsys/>

- Kootenai County:

<http://id-kootenai-assessor.governmax.com/propertymax/rover30.asp>

Supreme Court Data Repository:



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<https://www.idcourts.us/repository/start.do>

Idaho Tax Assessors:

[http://www.realmarketing.com/idaho\\_assessors.htm](http://www.realmarketing.com/idaho_assessors.htm)

**17325 OREGON**

Secretary of State: [http://egov.sos.state.or.us/br/pkg\\_web\\_name\\_srch\\_inq.login](http://egov.sos.state.or.us/br/pkg_web_name_srch_inq.login)

**17330 WASHINGTON**

Secretary of State: <http://www.sos.wa.gov/corps/search.aspx>

Spokane County Property Information: <http://www.spokanecounty.org/pubpadal/>

Department of Licensing: <https://fortress.wa.gov/dol/dolprod/bpdLicenseQuery/>

**17335 ALL STATES**

Voting registration: <http://www.canivote.org/>

Multistate Tax Commission: <http://www.mtc.gov/>

State Tax Forms (Federation of Tax Administrators):

<http://www.taxadmin.org/state-tax-forms>

**17340 MISCELLANEOUS**

VIN Decoders

<http://www.fleet.ford.com/partsandservice/vin-guides/>

<http://www.decodethis.com/>

IRS Qualified Charitable Organizations

<http://www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check>

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FAA Aircraft Registration: <http://registry.faa.gov/aircraftinquiry/>

Assessor Lookup: [http://www.realmarketing.com/idaho\\_assessors.htm](http://www.realmarketing.com/idaho_assessors.htm)

Zillow – Information on houses, when built, etc.

Reverse Phone lookup

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REFUND INTEREST

SEC 17600

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Idaho Code section 63-3073 requires interest be paid on refunds and credits.

**17605 CALCULATING INTEREST ON REFUNDS AND CREDITS**

**A. Refunds from amended returns or audit determination (no NOL or capital loss)**

Interest is computed from the **due date of the return** or the date the tax was paid, whichever is later.

If the refund is due to the allowance of an account credit transferred from an open year, interest is computed to the **due date of the return the credit is applied to**.

**B. Refunds from NOL or capital loss carryback/carryover**

Interest is calculated from the **last day of the loss year**.

**17610 AUDIT REFUND PROCESSING PROCEDURES**

**A. Acceptance of amended returns**

See Audit Manual section 0300.

**B. Net refund audits**

*[Information redacted pursuant to Idaho Code § 74-107(1) and 74-107(15)]*

If your audit results in a NOR, calculate interest out 14 days from the anticipated issuance date. Submit the file for review following the procedures of Audit Manual section 0800.

See section 6100 for additional information on work items.

**C. Net tax due audits**

The clerical staff will calculate interest for audits that have one or more refund periods but a net tax due for the standard 70 days on all audited years.

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2-2017

SHORT FILER PROJECT

SEC 18300

**18305 WHAT IS A “SHORT FILER”?**

The *short filer* program is an audit selection process computed as follows:

$$\begin{array}{r} \text{Federal adjusted income (AGI)} \\ - \text{ Idaho adjusted income (Resident Return) } \\ = \text{ Amount of unreported income (Short Filer)} \end{array}$$

**18310 MOST COMMON REASONS FOR THE DISCREPANCIES IN AGI**

- Part Year residents or Nonresidents filing on resident forms
  - o Individuals who have moved into or out of Idaho during the year file using a resident form claiming only the income earned while living in Idaho
  - o Nonresidents file using the resident form to report Idaho source income
- Residency status and domicile issues
  - o See Residency Manual
- Idaho residents with income from other states
  - o Resident individuals who may live or work in another state or have income from another state but only report the income from Idaho sources on the Idaho return
  - o May require allowance of credit for taxes paid to another state (See Section 8615)
- Filing married-joint federal return but married-separate Idaho returns
- Married couples who may be residing in separate states or have separate domiciles. The spouse with the Idaho connection files married-separate reporting only their Idaho income.
- Amended returns
- Due to the timing of this process, often times the comparison is being done using the amounts from the original federal return but the amended Idaho return.

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**18315 RESOURCES:**

- Financial Technician Desk Audit Manual
- ITA Letters

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

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STATUTE OF LIMITATIONS

SEC 18600

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Statutes of limitation are an important concept to understand. A missed statute date will result in an invalid audit.

**18605 GENERAL**

Ordinarily, an NODD must be issued within 3 years from either the due date of the return or the date the return was filed whichever is later (Idaho Code section 63-3068(a)).

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

**18610 AUDIT ISSUES WITH MODIFIED STATUTE OF LIMITATIONS**

**Federal Audits**

When a taxpayer provides a copy of the final federal determination (including all IRS schedules and written explanations) the statute of limitation is one year from the date of delivery to the State Tax Commission or 3 years from either the due date of the return or the date the return was filed whichever is later (Idaho Code section 63-3068(f)).

If the taxpayer does not provide us a copy of the final federal determination, then there is no statute of limitations to adjust the specific items addressed in the federal audit and any Idaho adjustments subsequently affected.

For more information on federal audits see section 5100.

**Amended Returns**

Amended returns have the same 3-year-from-receipt statute as any income tax return. However, only those items that were changed on the amended return can be adjusted if the amended return was received by ISTC within the 3-year statute period for the original return and the amended statute date falls outside that date (Idaho Code section 63-3068(h) and (i)).

For more information on amended returns see section 300.

**Fraudulent Returns**

If a return is determined to be a fraudulent or false return with the intent to evade tax, an NODD may be issued without regard to any statute of limitation (Idaho Code section 63-3068(c)).

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**Credit for Taxes Paid to Other States**

When a final determination of any tax due to another state changes the amount of the Idaho credit for taxes paid to another state, a claim for credit or refund should be filed within one year from the date the adjustment became final. An NODD can be issued by the later of one year from the date of delivery of the other state's notice or three years from the due date of the original return (Idaho Code section 63-3069A).

For more information on Credit for Taxes Paid to Another State see section 8600.

**Bonus Depreciation**

Idaho does not conform to IRC section 168(k), except for tax years ending in 2008 and 2009. Therefore, bonus depreciation additions and subtractions are required by Idaho Code section 63-3022O for other years. Idaho Code section 63-3022O(5) provides that the period of limitations for bonus depreciation additions and subtractions expires on the due date of the return (or filing date, if later) for the last taxable year an adjustment was required. This extension only applies to adjustments to bonus depreciation additions and subtractions.

**Investment Tax Credit (ITC), Net Operating Loss (NOL) or Capital Loss**

When ITC, NOL, or capital loss carryovers from years closed to statute affect years open to assessment, adjustments may be made to the closed years. Any resulting tax due and/or refunds in the years closed to statute will not be assessed or paid.

However, any adjustments made to closed years resulting from the use or disallowance of ITC, NOL or capital loss from open years, are allowed, even though it results in an assessment or refund to a closed year (Idaho Code section 63-3068(g) and 63-3072(f)).

For additional information on ITC see section 8900

For more information on NOLs see section 13300 **Pass-**

**Through Entities and Shareholders/Partners**

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STATUTE OF LIMITATIONS

SEC 18600

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If an amended return is filed or an audit is conducted on a pass-through entity the statute of limitations remains open on the individual shareholders/partners but only for the flow-through items.

Although the statute expiration is determined at the level of the pass-through entity, auditors are encouraged to get waivers for each shareholder/partner, if possible.

For more information on Partnership and S-corps see section 15000

**18615 AUDIT REPORT**

Tax due or refunds resulting from audit adjustments or filing amended returns for tax years in which the statute of limitations has expired are not allowed. Use the following procedure:

1. The amount lost due to statute expiration must be shown as an additional tax or as a refund for tax due on the audit report, zeroing out the bottom line.
2. The description in the audit report for the additional tax should state something like "Amount Lost to Statute" or "Out of Statute."
3. The explanation page in the audit report should cite relevant Idaho Code in regard to the statute of limitation adjustment. (See Idaho Code sections 63-3068 and 63-3072).

**18620 PROTESTED AUDITS**

Assessment and collection activities are suspended "until the decision of the State Tax Commission becomes final" (Idaho Code section 63-3045(1)(c)). Under Idaho Code section 63-3068(n), the statute of limitations is suspended until 30 days after the termination of the period during which the assessment and collection are suspended.

As a result, neither the 3-year statute of limitations nor the 1-year statute can expire if the notice of deficiency is issued within that time.

**18625 EXTENSIONS AND TENTATIVE PAYMENT**

Idaho Code section 63-3072(b) and (c) provide that the original due date of the return is the filing due date, and not the extended due date of a valid request for extension of time, when the taxpayer does not timely file the return. The taxpayer

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has three years from the due date of the return to request a refund of withholding.

**18630 STATUTORY DEADLINE FALLING ON A WEEKEND OR HOLIDAY**

When the date for filing any income tax document falls on a Saturday, Sunday, or legal holiday, the deadline for filing the document will expire the next business day. The same standard will apply to any deadline imposed on the Tax Commission (Idaho Income Tax Administrative Rule 810.02).

**18635 STATUTE WAIVERS**

If your audit is within 90 days of the statute date and it appears that you will not be able to complete the audit 60 days before the statute date it is important to get a signed statute waiver.

For more on Statute Waivers see section 23100

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7-2015

SUMMONS

SEC 18800

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In some audits the taxpayer will not be willing to give the auditor the information that has been requested, or sometimes the auditor will need to get information from a third party. When this is the case, the summons is a tool that the auditor can use.

**18805 SUMMONS USE**

The Tax Commission can use a summons when:

- Ascertaining the correctness of any return,
- Making a return where one has not been filed
- Determining the liability of any person for any tax
- Collecting any such liability.

We are not allowed to issue a summons for general research not related to a specific taxpayer, encouraging settlement, or harassment.

**18810 ISSUING AN AUDIT REPORT VS. SUMMONS**

If no response is received after several requests for information, the auditor will need to discuss with their supervisor the need for issuing an audit report or the use of a summons.

- Unreported income - consideration should be given to the summons since the burden is on the State to prove the income exists.
- Deductions – issuing an audit report may be chosen since the burden is on the taxpayer to prove their existence.

In the case where no return has been filed:

- Determine that a return is required with the following research tools:

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

**18815 SUMMONS**

There are templates that can be used for preparing a summons. Generally the Summons-Formal will be the template used. However, if you are requesting

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electronic records you will need to use some of the wording in Summons-Electronic Records.

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

Analyze each situation in light of its particular facts and circumstances.

The Summons Criteria and Checklist will remain with the summons as a part of the audit workpaper file. The form can be found at: SUMMONS CRITERIA AND CHECKLIST

The summons is to be signed by:

- the Bureau Chief or,
- the Division Administrator or,
- a Field Office Manager, who will sign a summons after phone approval from the Bureau Chief or Division Administrator.

It is recommended that the summons be reviewed by a deputy attorney general to insure that all legal issues are properly addressed.

The purpose of the summons is to initiate the voluntary cooperation of the person summoned and to resolve the matter prior to the date set in the summons for the person to appear. The summons should state that the taxpayer may be excused from the appearance if they provide the requested information in advance. If this occurs, the auditor should send a letter to the taxpayer excusing them from the appearance date listed on the summons.

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

A summons is little more than a "formal request" and may not always be successful.

In either case, the summons will be valuable in demonstrating that the Tax Commission is doing all that it can to try to determine the correct tax liability.

**18820 SERVICE OF SUMMONS**

There must be at least twenty days between the date of the summons and the date the taxpayer is required to appear. Depending on the nature of the request, the taxpayer may need more than twenty days to respond.

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Service is affected by personally serving the person summoned. Serving the summons on the spouse or leaving the summons with any responsible adult at the person's place of residence is not formal service and will mean the summons is not enforceable in a subsequent legal action.

If the summons is addressed to a business organization, care should be taken that:

- The entity named in the summons has possession and control of the requested information.
- For a corporation, the summons may be served on an officer, managing agent, or registered agent of the corporation.
- The summons must refer to the named officer or managing agent in his or her official, representative capacity and not as an individual.
- The person named in the summons must be personally served.

When the corporation is an out-of-state corporation that is not authorized to conduct business in Idaho, it will not have a registered agent in Idaho. The summons then must be served in the state where the corporation is headquartered or which is a principal place of business for the corporation.

When the business entity is a sole proprietorship, partnership or other unincorporated association, the summons should be served on:

- The proprietor
- General partner or managing partner
- Managing member of the LLC
- Registered Agent of the limited partnership or LLC

As with corporations, if an individual is named in the summons, the summons must refer to the individual in his or her official capacity.

When the person named in the summons resides outside the state, the summons may be sent via certified mail.

The person summoned should be given a copy of the summons with the original summons kept by the person performing the service. Once the service is completed, the person who served the summons completes the affidavit of service in the presence of a notary public. A number of persons within the commission are notary publics. The original summons and the affidavit are placed in the taxpayer's file.

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Notaries in their respective locations as of November 5, 2015, are as follows.

*[Information redacted due to outdated information regarding specific employees]*

Per the Audit Division Summons Service Policy of 10/18/2015. When it comes to the service of a summons, these two situations should be addressed differently.

**Service of a summons to a taxpayer that is not cooperative or refuses to provide requested information** should be executed by a “disinterested party.” This will include when the taxpayer refuses to acknowledge other contacts and there is evidence of unreported income but insufficient information to issue a Notice of Deficiency Determination.

To fulfill this requirement, the summons (once approved by the appropriate bureau chief) should be forwarded to another bureau for service. The request for service should be sent to the bureau chief of a bureau other than the bureau of the auditor. The receiving bureau chief will assign the service of the summons to a staff member who will serve the summons and notify the requesting auditor that the summons has been served by returning the signed certified affidavit of service to them for case records.

**Service of a summons to a taxpayer that is fulfilling company policy** can be executed by the auditor directly to the taxpayer. There is no need to contact another bureau to have the summons served by a “disinterested party.”

In the case of a large corporate entity, the registered agent often refers the summons to the legal department for review. It may take some time for the legal department to review the summons and relevant Idaho law before directing the summons to the person who will actually respond to the summons. Contacting the records custodian or tax manager at the same time the summons is served on the entity may ensure more timely compliance with the summons. The auditor must simply use their own discretion and judgment in the area.

**18825 OUT OF STATE SUMMONS COMPANY**

If the company being served is not registered to do business in Idaho and the registered agent will not serve the summons. The service will have to take place in the state of commercial domicile or where the home office is located. Check with the secretary of state’s web site in the state where the taxpayer is located to make sure the company being served is registered and to get the address of the registered agent.

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When there is not a registered agent in Idaho, a summons can be issued out of state via certified mail. Prior to mailing the summons contact the entity and request permission to mail the summons, also, ask if the summons should be sent to a particular person or department.

If mailing a summons, the second page of the formal summons must be changed. Use the Certificate of Service by Mailing Form.

Keep in mind that if the summons is sent by mail the Tax Commission has no authority to force compliance. Complying with a summons that has not been served in person is completely voluntary.

**18830 APPLICABLE AUTHORITY**

- Idaho Code section 63-3042(b) gives the Tax Commission the authority to issue a summons.
- Idaho Code section 63-3042(c) provides guidelines for summons procedure.

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TAX PROTESTERS

SEC 19100

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**19105 INTRODUCTION**

A “non-complaint taxpayer” can be brought into compliance through education, or brought into compliance through enforcement. A “tax protester” is someone who refuses to pay a tax on constitutional or legal grounds, typically because he or she claims that the tax laws are unconstitutional or otherwise invalid.

A “non-complaint taxpayer” isn’t considered a “tax protester.” A taxpayer has every right to dispute a deficiency on legitimate legal and factual reasons. A taxpayer has the right to file a protest and stand on a soapbox and decry the appropriateness of a particular tax policy; it’s a completely legitimate act to do so.

A “tax protester” is someone who rejects the fundamental basis, the legal underpinnings of our entire tax system, and flies in the face of legal precedent going back decades that has upheld the Constitutional and statutory validity of that system.

**A. Illegal Tax Protester Designations**

The Internal Revenue Service Restructuring and Reform Act of 1998 (the “1998 Act”) prohibits officers and employees of the Internal Revenue Service from designating a taxpayer as an “illegal tax protester” or using any similar designation for a taxpayer. Therefore, the tax protester terminology is often referred to frivolous tax arguments, and tax defier in IRS publications.

Congress enacted the prohibition against Illegal Tax Protester designations because it was concerned that some taxpayers were being permanently labeled as Tax Protesters even though they had subsequently become compliant with the tax laws and that the label could bias IRS employees and result in unfair treatment.

There has been discussion if the Tax Commission should also remove “illegal tax protester” and similar designations for a taxpayer. Since no official policy has been implemented, the tax protester designation will continue to be used in the document.

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

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SEC 19300

During the audit, you'll communicate with taxpayers and their representatives via regular mail, email, faxes, or phone calls. Auditors are required to maintain regular contact with taxpayers or their representatives to ensure that the status of the audit is effectively communicated. Contact should be made at least every 45 days unless prior arrangements have been agreed upon with the taxpayer or their representative. Contacts must be noted in the CRM notes within GenTax or an equivalent log attached to the audit in GenTax.

**19305 WRITTEN CONTACT**

All written correspondence must be scanned and attached to the audit springboard/manager in GenTax. This should be done when the correspondence is sent to the taxpayer or representative.

The taxpayer may not respond to the initial letter or other request because of:

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

1. Failure of Delivery - The correspondence will be returned:
  - a. Technical Support can do an Accurint check for a more current address.
  - b. If a new address is located, the correspondence is sent to the new address.
  - c.
2. Delivery – but no response:
  - a. Send a Second Request Letter. Allow enough time for a response – generally 2 - 3 weeks.
  - b. If no response is received to the Second Request Letter, send a Third Request Letter. Allow 2-3 weeks, and then if you haven't received a response, prepare the NOD or issue a summons for the requested information.

**19310 TELEPHONE CONTACT**

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

When contacting an individual by phone, always identify yourself and state you are an Idaho State Tax Commission employee. You should record all phone calls with the taxpayer or the representative in the CRM Notes.



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1. The contact notes should include the names of the parties, dates, issues discussed, agreements and/or resolutions and any follow-up required.
2. Unsuccessful phone calls must also be recorded.

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

When contacted by phone, you'll need to verify the identity of the taxpayer.

Contact between the taxpayer's representative and the auditor:

1. If the auditor has a phone call with the representative and the taxpayer's return is discussed, or if the audit is discussed, the auditor must have a Power of Attorney (POA) for the representative. The representative can tell the auditor information, but without a POA, the auditor can't disclose any details regarding the case. Exercise caution when talking to a representative without a POA. For guidelines regarding the POA form and general questions, see Audit Manual Section 15600
2. If the representative contacts the auditor and no POA has been executed, the auditor should contact the taxpayer and notify him of the contact.

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

Voicemail

Taxpayers may call when you are unavailable to answer the phone. Your voicemail should have a message stating who you are, the normal office hours you work, and that the caller can press 0 and be transferred to speak with someone during the normal work day.

When you receive a voicemail, make a CRM note, and include the return phone number that the taxpayer provided. Update the contact information in GenTax if needed.

**19315 EMAIL ATTACHMENTS**

When sending or receiving information as an attachment to an email, use the following guidelines:

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1. Make sure a POA form is on file for outgoing emails to taxpayer's representative.
2. Prior to sending or receiving emails with any attachments, confirm with the taxpayer or representative that email isn't secure and that you'll need to either encrypt or redact sensitive data on emails that you send. If taxpayers insist on getting information unredacted or unencrypted, have them give their authorization in the email when you reply.
3. All emails to and from employees of the Tax Commission go through and are stored at the Department of Administration. This includes emails to co-workers and to the field offices. Therefore, any emails with SSN, EIN, or credit card information must either be redacted to remove this information or encrypted. (See instructions on how to encrypt a file below.)
4. Never email Federal Tax Information (FTI) (including letters, NODDs, and Billing letters containing FTI in the explanation). This applies to:
  - a. Emails to taxpayers or their representatives,
  - b. Emails to other Tax Commission employees, regardless if they are in the same department, a field office, or another department (like TDB or Tax Policy), and
  - c. Using the email feature of multifunction copiers.

**A. How To Encrypt a file with Microsoft Word or Excel**

If you need to encrypt a Microsoft Word or Excel document, you can do this through the following steps:

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

These instructions will work with either product.

1. Open Word or Excel,
2. In the document click the file tab,
3. Click the Protect Document (or Protect Workbook in Excel) button
4. Select Encrypt with Password,
5. Enter a password.
6. Enter the password again,
7. Now the file is password protected,

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8. As a reminder. If you need to email the encrypted document to someone. Do not include the password in the email. Either send it in a separate email or give it to them in some other way.

**B. Encrypting a pdf**

Your version of adobe pdf viewer doesn't allow for encrypting a pdf file. The file must be encrypted by the Administrative Support staff.

If you are emailing a pdf that needs to be encrypted:

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

1. Place the pdf in your folder on IAPUB.
2. Send an email to your designated Administrative Support member stating you want the file encrypted, and what you want as the password.
3. The encrypted document will be placed in your IAPUB folder.

**19320 FIELD VISIT**

Some audits require a field visit. A field visit request will be sent to the business or individual. If you have communicated with the taxpayer regarding a field visit, you'll need to send them a field audit confirmation letter.

The audit letter is generally used to identify the:

1. purpose of the audit,
2. information the auditor needs to examine during the field visit, and
3. time the auditor will arrive at the taxpayer's office.

The audit letter should be sent well in advance of the audit date to allow the taxpayer time to prepare for the audit. The auditor should call the taxpayer's representative 5 to 10 days prior to the audit to remind them of the audit and ensure they will be ready with the requested information on the date agreed to.

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TAXPAYER'S FAILURE TO RESPOND

SEC 19500

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This section discusses the actions an auditor may take when taxpayers refuse and/or fail to cooperate during an audit.

### **19505 TAXPAYERS REFUSE AND/OR FAIL TO RESPOND**

When a taxpayer fails to respond to our initial request letter, we may follow-up with two additional request letters. If the taxpayer still does not respond to our request, we are faced with two options:

1. Issue an audit report based on information available to the Tax Commission.
2. Issue a judicially enforceable summons.

### **19510 INFORMATION RESOURCES**

As an employee of the Tax Commission, we have many resources available for gathering information. These resources are useful in helping us to determine whether to issue an audit report or to prepare a judicially enforceable summons. Some of the available resources are:

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

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**Federal transcripts:** Return Transcripts, Wage and Income Records, and Account Transcripts.

**Other state tax agencies:** we are allowed to exchange information with all other state tax agencies except for the state of Nevada. Contact our Government Liaison Specialist for information requests from other states.

**Other governmental agencies within Idaho:** we have exchange agreements with several other governmental agencies within Idaho. These agreements are found in the MOUs.

### **19515 ISSUANCE OF AUDIT REPORT**

Generally, if we are able to make a reasonable determination using information available to us, issuance of an audit report would be the best option for resolving an audit for unresponsive/uncooperative taxpayers.

The audit report needs:

- An explanation of the information requested including specific dates,
- A statement that the taxpayer failed or refused to comply with requests for information per Idaho Code section 63-3042 to examine books and records,
- A statement explaining the basis for each adjustment. (e.g., income was from 1099's, W-2's, K-1's, or adjusted basis was not substantiated, etc.).
- Avoid using terms such as: arbitrary, provisional, estimate, etc.

### **19520 USEFUL AUTHORITIES FOR NO RESPONSE AUDIT REPORT**

Treasury Regulation § 1.6001-1(b) provides that as a general rule, everyone who is required to pay or collect any Internal Revenue tax must keep permanent books of account or records that are sufficient to establish the correct amount of income, credits, deductions and other matters required to be reported on returns.

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TAXPAYER'S FAILURE TO RESPOND

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Deductions are a matter of legislative grace, and the taxpayer bears the burden of showing that they are entitled to the deduction. *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 54 S.Ct. 788 (1934), *Higgins v. C.I.R.*, T. C. Memo. 1984-330 (1984). The burden rests on the taxpayer to disclose his receipts and claim his proper deductions. *United States v. Ballard*, 535 F.2d 400 (1976).

Idaho Code section 63-3042(a) authorizes the ISTC to examine any books, papers, records, or other data which may be relevant or material for the purpose of ascertaining the correctness of any return.

Tax Commission Administration and Enforcement Rule 201.01(a) provides that a taxpayer shall maintain all records that are necessary to a determination of the correct tax liability. Required records must be made available on request by the Tax Commission or its authorized representatives.

Tax Commission Administration and Enforcement Rule 201.04 provides that 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.

### **19525 ISSUANCE OF SUMMONS**

See Audit Manual Section 18800 for details on Summons.

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WAIVERS

SEC 23100

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Ordinarily, an NODD must be issued within 3 years from either the due date of the return or the date the return was filed whichever is later (Idaho Code section 63-3068(a)). Waivers allow an extension of time to complete or perform an audit.

For more information on statutes see Section 18600.

**23105 WAIVER OF RESTRICTION FORMS**

It is important that the wording of the waiver remains consistent throughout ITA. Waiver templates are on the ITA SharePoint site under Audit Letters and Templates. Auditors should use only these waivers and not modified versions:

- Individual
- Business

**23110 REQUESTING A WAIVER**

If your audit is within 90 days of the statute date and it appears that you will not be able to complete it before the required 60-day review period, a request for a waiver should be sent to the taxpayer(s).

Waivers may be requested by the Commission, its delegate or deputy. They can be requested in person or by letter. The cover letter "Waiver Request," is on the ITA SharePoint site.

The waiver must be signed by both the taxpayer and the auditor. We can accept a signed copy.

If you have questions about whether or when to send a request for a waiver, contact your supervisor.

**23115 RECEIPT OF WAIVER**

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

When a signed waiver is received, the auditor can either process the waiver or request this be done by Admin Support.

**23120 PASS-THROUGH ENTITY WAIVERS**

Waivers signed by pass-through entities automatically extend the statute date for adjusting the entities' partners/shareholders taxable income to reflect the adjustments your audit made to the pass-through entity.

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WAIVERS

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**CAUTION:** The code does not specifically address whether adjustments for other items related to the pass-through entity adjustments are covered by the pass-through entity waiver.

For example, during your audit you increased the income of an entity conducting business in multiple states. The partners/shareholders claimed a credit for taxes paid to another state on their Idaho return. The increased entity income increases the Idaho tax on the individual taxpayer's return. As a result, the credit for taxes paid to another state should be adjusted.

It is therefore ITA policy to procure statute waivers for both the pass-through entity and the partners/shareholders. This way, the statute restriction is extended not only for the pass-through adjustments but also for other adjustments on the partners/shareholders returns.

**23125 RELEVANT AUTHORITY**

Issuing an NODD - Idaho Code section 63-3068(m)

Credits and Refunds - Idaho Code section 63-3072(h)