

Taxation, Probate, and Trust Law Section

Idaho State Bar

5/1/2014

Spring Edition

ROTH OR PRE-TAX 401(k) CONTRIBUTIONS: WHAT SHOULD YOUR FINANCIAL ADVISOR BE TELLING PARTICIPANTS? Part I

BY BOB WREGGELSWORTH

Regular pre-tax 401(k) deferrals:

Regular pre-tax 401(k) contributions allow you to reduce your taxable income by the amount you contribute to the plan each year. The tax benefit from making a regular pre-tax 401(k) contribution vs. a Roth 401(k) contribution depends on your federal and state tax-rate.

Contributing to a regular pre-tax 401(k) plan is more beneficial to you when you are in a high tax bracket rather than a low tax bracket. For example, if you are in the 28% federal tax bracket, and you make a \$5,000 regular pre-tax 401(k) contribution, you will save \$1,400 on your federal income taxes ($\$5,000 \times .28$). If your Idaho state income tax bracket is 7.4%, you will also save an additional \$370 on your state income taxes ($\$5,000 \times .074$). Total federal and state tax savings equals **\$1,770** ($\$1,400 + \370). **This means that it only cost you \$3,230 (\$5,000 – \$1,770) to put \$5,000 into your regular pre-tax 401(k) plan.**

On the other hand, if you are in a lower tax bracket, the tax savings are less. For example, if you are in the 15% tax bracket and you make a \$5,000 regular pre-tax 401(k)

contribution, you will save only \$750 on your federal income tax return ($\$5,000 \times .15$). If your Idaho state income tax bracket is 7.4%, you will also save an additional \$370 on your state income taxes ($\$5,000 \times .074$). Total federal and state tax savings equals **\$1,120** ($\$750 + \370). **This means that it cost you \$3,880 (\$5,000 - \$1,120) to put \$5,000 into your regular pre-tax 401(k) plan.**

Regular pre-tax 401(k) withdrawals, however, are taxed as ordinary income (the contributions as well as all of the accumulated earnings) when removed from a qualified retirement plan.

Roth 401(k) deferrals: Roth 401(k) contributions do not reduce your taxable income by the amount you contribute to the plan each year. In other words, you are making “after-tax contributions” to the plan (i.e., you get no up-front tax benefit when you make a Roth 401(k) contribution to the plan). This means that it will cost you \$5,000 to put \$5,000 into a Roth 401(k) plan.

Roth 401(k) withdrawals, however, are not subject to income tax (the contributions as well as all of the accumulated earnings come out

tax-free) when removed from a qualified retirement plan if the account has been in existence for at least five years (i.e. five year period starts with the first contribution to the Roth 401(k) plan) and you have attained age 59 ½ at the time you withdraw the money from the plan.

COMPARING REGULAR PRE-TAX 401(K) CONTRIBUTIONS TO ROTH 401(K) CONTRIBUTIONS –

General Considerations:

- The younger you are and the lower your current tax bracket, the more beneficial a Roth 401(k) plan is likely to be for you;
- If you will be in a higher tax bracket during your working years as opposed to your retirement years, making regular pre-tax 401(k) contributions is likely to be more beneficial to you;
- If you will be in the same tax bracket during your working years as in your retirement years, you will be in the same after-tax financial situation regardless of whether you contribute to a Roth 401(k) or a regular pre-tax 401(k).

Look for Part II in the Summer Edition of the Tax Section Newsletter

© Intermountain Community Bank,
A Division of Panhandle State Bank

2014 LEGISLATIVE REPORT

BY BOB ALDRIDGE

This session was the shortest in the last ten years (74 days). The number of bills passed (345) was about average for the prior 5 years. Partially because of May primaries, the legislature wanted things non-controversial. Medicaid expansion or repeal and transportation funding were studiously avoided. New laws take effect July 1, 2014, unless otherwise noted.

Guardianship & Conservatorship Monitoring:

HB 447. Removed the detailed language about contents of reports, especially for conservators, and left only the bare minimum requirements in the statute – annual status reports for guardians and an inventory and annual reports for conservators, with the details handled by Rule.

Minor Guardianships:

SB 124. Existing statutes on minor guardianships have no methods for termination of the guardianship except for the death, marriage, attainment of age, or adoption of the minor and lack clarity on how to modify a guardianship. New §15-5-318 allows modification or termination under other circumstances.

Testamentary Appointment of Guardian for Minor Child:

SB 1248. A parent may appoint a guardian by Will for a minor child. Amendments to §15-5-202 impose a 30 day time limit after the start of the probate for the first nominated guardian to file an acceptance or decline in writing, or for proof that the proposed guardian is deceased. Then the next nominated guardian can then accept or decline. The minor, if 14 years or older, has the right to object to the appointment.

Time Limits on Summary Administration and Small Estate Affidavit:

SB 1249. Summary Administration under §15-3-1205 and the Small Estate Affidavit under §15-3-1201 are now clearly exempt from the three year limitation placed on standard probate.

Trust and Estate as Residents: HB 369a. Amends §63-3015. An estate is a resident estate if the decedent was a resident of Idaho on the date of death, otherwise it is a nonresident estate. No part-year treatment method. For trusts, other than qualified funeral trusts, the trust is a resident trust if 3 or more of the following existed for the entire taxable year:

- (a) the domicile or residency of the grantor is in Idaho;
- (b) trust is governed by Idaho law;
- (c) trust has real or tangible personal property located in Idaho;
- (d) the domicile or residency of the trustee is in Idaho;
- (e) administration of the trust takes place in Idaho, which includes conducting trust business, investing trust assets, making administrative decisions, record keeping, and preparation and filing of tax returns.

A trust is a part-year resident trust for each day of the taxable year during which 3 or more of the above conditions existed. If not a resident or part-year resident trust, is a nonresident trust. No distinction is made between inter vivos trusts and testamentary trusts, or between revocable and irrevocable trusts.

Net Operating Loss Carryback Limit: HB 374. The \$100,000 net

operating loss carryback limit for a married couple can be taken at \$50,000 on each married filing separate return. Also, an entity described in IRC Section 501 that loses its federal tax exempt status for failure to file Form 990 loses its Idaho nonprofit status unless otherwise exempt.

Marriage Status and Compliance

Bill: HB 375. Amends 63-3004 annual compliance update from 2013 to 2014 IRS Code. Also states: "For all purposes of the Idaho income tax act, a marriage must be one that is considered valid or recognized under section 28, article III, of the constitution of the state of Idaho and defined in section 32-201, Idaho Code, or as recognized under section 32-209, Idaho Code."

Mark your Calendar! Tax Section Events

•••

May 15th 5:45 p.m.

Tax Section Social
Bardenay Downtown Boise

May 22nd 8:30 a.m.

Tax Liaison Meeting
Contact John McGown for
more details.

July 17th, 7:30 a.m.

ISB Annual Conference; Tax
Section meeting

September 12th-13th

Annual Estate Planning
Seminar, Sun Valley, Idaho.

November 11th, 12:00 p.m.

Tax Section Meeting
ISB Law Center

None of these recognize same sex marriage. Same-sex couples who filed a single federal return as married in Idaho must prepare two dummy individual federal returns as single persons and use that for two single Idaho returns. All of this is subject to the Idaho federal lawsuit before Federal Magistrate Candy Dale, and eventually what happens at the U.S. Supreme Court.

Individual Definition Income Tax:

HB 377. "Individual" under existing law means a natural person. Bill expands: (1) natural person; (2) a grantor trust; (3) a qualified subchapter S trust; and, (4) a single member LLC that has not elected corporate taxation and

is a disregarded entity for federal income tax. STC had been rejecting requests for such entities to be included in composite returns. However, once the composite return calculation moved to its current withholding structure, if a nonresident inserted an SMLLC or a grantor trust between the individual and the pass-through entity, it would appear that STC could not require the SMLLC or grantor trust's income from the pass-through entity to be included within a composite return payment nor require withholding since the SMLLC or grantor trust was not a "natural person". The bill changes the definition and also has the Permanent Building Fund paid or withheld as part of composite return. Individual can file form 43 if needed.

Innocent Spouse: SB 1301. As of Jan. 1, 2014, those who qualify for innocent spouse relief under federal law also qualify under Idaho law. Retroactive to Jan. 1, 2014. The Idaho State Tax Commission will accept a copy of the IRS determination or any other documentation that shows the taxpayer has been approved for federal innocent spouse relief.

Sales and Use Tax on "Remotely Accessed Computer Software:" HB 598. Idaho tax policy excludes services from sale tax, so remotely accessed computer software-related items (the "Cloud") should not be subject to Idaho sales or use tax. This was previously amended in 2013, but problems in the rule-making process made further legislation necessary.

TAXATION OF PERSONAL PROPERTY IN IDAHO

Part I BY GEORGE BROWN

In recent years, Idaho has seen a movement to exempt personal property from taxation. In 2013, the Idaho legislature passed HB 315, a partial exemption for personal property, and passed House Bill 441(aaS) in the 2014 session to ensure proper administration of that exemption. Part of the exemption in HB 315 mirrored language in House Bill 599, passed in 2009, exempting the first \$100,000 of a taxpayer's personal property. The exemption in HB 599 never went into effect, however, because its application was based on a trigger of certain economic goals that the state never met. While to a casual observer this new exemption may have come out-of-the-blue, it is really just the next step in a long history of limiting taxation on items of personal property in Idaho. Because the new exemption is capped and because some of the tax revenue lost by taxing districts due to the exemption is being replaced by the state, issues have arisen in the effort to administer the exemption.

In Idaho, property is statutorily classified into three categories: real, personal, and operating. Real property is land and improvements to the land, like buildings and structures. Operating property is the property of certain types of businesses that often operate throughout the state, like utilities, and is assessed centrally by the Tax Commission. Personal property is the rest, what

2014 ISB Annual Meeting After-Hours

•••

July 17 7:30 – 9:30 p.m.

Tax Section Social at
Sumisu Fusion Restaurant
Hors d'oeuvres & no host bar

Tee Times at Highland Golf Course for ISB Members

Highland Golf Course is making Tee Times available for those interested.

Mountain/Road Bike Group Rides

Those interested in hitting the trails/roads contact Eric for group ride information.

For more information on any of these events please contact

Erick Olsen:

elo@racinelaw.net

(208) 232-6101

we usually identify as “stuff” like clothes, electronics, business equipment, tables and chairs. Almost anything portable falls into the personal category.

Property taxes are collected by local taxing districts to fund each of their specific statutory functions. There are about 1200 of these taxing districts in Idaho, from the smallest of mosquito abatement districts to the largest counties. Even before Idaho became a state, the territorial and local governments relied heavily on property taxes and exempted certain types of personal property, such as property owned by hospitals, widows and orphans, and tools owned by mechanics.

After Idaho became a state, Article VII, Section 2 of the Idaho Constitution authorized the legislature to levy a tax “so that every person or corporation shall pay a tax in proportion to the value of his, her, or its property. . .”

Section 6 of the same Article allows the legislature to invest the power to tax in municipal corporations.

Many of the property tax exemptions previously recognized under territorial law were reenacted under the new state law, including those on personal property like tools and for certain businesses or social demographics.

Over the years since statehood, the legislature exempted more and more personal property from

taxation. Many exemptions have been designed to support certain industries or vocations. In addition to the aforementioned mechanic’s tools, property used to pump water for drainage (1941), owned by insurance agents (1961), and owned by credit unions (1977) all received exemptions. Other types of property were exempted to facilitate different tax schemes, such as titling and registration of aircraft (1945), motor vehicles (1961) recreational vehicles (1975), and fuels tax on aviation fuel (1983). Certain exemptions paved the road, both in a policy sense and in the way they were administered, to a more broad personal property tax exemption. In 1901, an exemption of household goods, the “pots and pans” exemption, was enacted. In 1967, a business inventory exemption was phased in over a four year period. Most recently, in 2001, the legislature exempted agricultural machinery and replaced and paid to taxing districts the lost revenue out of the State’s general fund.

One result of the many personal property exemptions the state enacted is that, for the most part, personal property tax is a tax on business property because the average individual does not own any non-exempt personal property. The legislation passed in the last two years started Idaho down a new path: a broad exemption on

all types of personal property, while using the previously adopted technique of replacement of lost revenues for taxing districts coming from the state to limit damage to taxing district budgets. House Bill 315 actually contained two exemptions, codified in Idaho Code § 63-602KK. The first is an exemption of \$100,000 of a taxpayer’s personal property, the same exemption as the aforementioned HB 599 but effective as of January 1, 2013. The second is an exemption of any item of personal property with a value of less than \$3,000 that was purchased after January 1, 2013. The nature of both exemptions presents both policy and administrative issues that will likely result in future statutory adjustments and rulemaking to ensure the exemptions can be administered according to the legislative intent.

The passage of HB 315 left Idaho with key questions effecting the implementation of the new personal property tax exemption which, ultimately, resulted in further statutory changes and administrative rulemaking. Part II of this article will discuss some of these questions and how they were answered.

NEWSLETTER ARTICLE SUBMISSIONS

The Tax Section invites members to submit articles for publication in its next Newsletter. [Choose your topic!](#) Please submit your articles for consideration to Chelsea Kidney at chelsea.kidney@tax.idaho.gov.