BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 14748
[Redacted],	)	
	)	DECISION
Petitioner.	)	
	)	

[Redacted] (petitioner) protests the Notice of Deficiency Determination issued by the auditors for the Idaho State Tax Commission (Commission) dated March 15, 2000. The Notice of Deficiency Determination asserted additional liabilities of $41,126, $1,558, and $6,458 for 1996, 1997 and 1998, respectively.

There are two issues to be resolved in this docket. The first, which was addressed in the Notice of Deficiency Determination, is whether the petitioner is entitled to an Idaho capital gains deduction with regard to a gain realized from the disposition of her interests in two partnerships. The second is whether a purported exchange pursuant to Internal Revenue Code § 1031 qualifies under that section. This latter adjustment was not addressed in the Notice of Deficiency Determination but was recognized and addressed during the administrative appeal.

FACTS

The petitioner sold her interest in two partnerships to her brother who was also a partner in both of the partnerships. The petitioner was to have received, and presumably did receive, several forms of consideration in exchange for her interests in the partnerships. The consideration included a cashier's check in the amount of $650,000, an installment obligation with total payments in the amount of $3,000,000, and $350,000 which was to be transferred to an accommodator for the purpose of making a like-kind exchange for other property. The petitioner reported the capital gain (with the exception of the gain attributable to the $350,000 transferred to the accommodator) and claimed an Idaho capital gains deduction with regard to such a gain. It appears from the record that the petitioner used the $350,000 to purchase a parcel of bare ground (about 2/3 of an acre) in [Redacted], Idaho, on which, the following year, she completed the building of her residence.

The auditor disallowed the claimed capital gains deduction stating that a partnership interest is considered to be an intangible asset and does not qualify for the capital gains deduction. The auditor cited a decision (Docket No. 12569) rendered by the Tax Commission regarding the disallowance of an Idaho capital gains deduction with regard to a gain from the sale of a partnership interest.

THE PETITIONER'S POSITION

The representatives for the petitioner contend that the tax implications should be the same as if the partnership(s) had distributed assets to the petitioner that would have qualified for the capital gains deduction and that, subsequently, the petitioner had sold those assets. At a conference held with regard to this issue, the representatives for the petitioner repeatedly asked why the legislature would want to discriminate against a partner selling a partnership interest as compared to a partnership distributing partnership assets to the partner and that partner subsequently selling those assets. The representatives insist that the consequences should be the same.

DISCUSSION

There is no doubt that "partnership interests" were disposed of by the petitioner. The question to be resolved is whether the assets disposed of may be characterized as property qualifying for the Idaho capital gains deduction provided for in Idaho Code § 63-3022H. The representatives for the petitioner have not contended that the petitioner owned any of the assets of the partnership(s).

If a "partnership interest" may be characterized in whole or in part either as real property or as tangible personal property (following the nature of the assets held by the partnership), then gain from the disposition of the partnership interest may qualify for the deduction here in question. On the other hand, if a partnership interest is intangible personal property, regardless of the nature of the assets held by the partnership, then clearly the petitioners are not entitled to the capital gains deduction.

Idaho Code § 53-324 addressed the rights of partners. It stated:

> Extent of property rights of a partner. -- The property rights of a partner are:
> 1. His rights in specific partnership property.
> 2. His interest in the partnership
> 3. His right to participate in the management.

Clearly, partners have interests in partnership assets as tenants-in-partnership. If the petitioners held the real property as tenants-in-common rather than as tenants-in-partnership, the deduction might be allowable, at least in part. The rights of owners by tenancy-in-partnership and by tenancy-in-common are different.

A tenant-in-common owns an undivided interest in the property and is entitled to possession of the entire common property against all persons except his co-tenants. Dimmick v. Dimmick, 58 Cal. 2d 417, 374 P.2d 824, 24 Cal. Rptr. 856 (1962); Wilkerson v. Thomas, 121 Cal. App. 2d 479, 263 P.2d 678 (1953); Swartzbaugh v. Sampson, 11 Cal. App. 2d 451, 54 P.2d 73 (1936); Wood v. Henley, 88 Cal. App. 441, 263 P. 870 (1928).

Title to his interest is vested in him and he may sell or encumber it without the knowledge, consent, or approval of the other co-owners. Meyer v. Wall, 270 Cal. App. 2d 24, 75 Cal. Rptr. 236 (1969). A tenant-in-common's interest is inheritable. Wilkerson v. Thomas, supra.

Unlike ownership as a tenant-in-common or ownership of a fee simple interest, a partner has no legal title to property "owned" by him under Idaho Code § 53-325(1) as a tenant-in-partnership; the interest of a partner-in-firm assets "is the share to which he is entitled after claims against the firm and accounts between the partners are settled; it is an equitable interest enforceable by an action for an accounting." Comstock v. Fiorella, 260 Cal. App. 2d 262, 67 Cal. Rptr. 104, 106 (1968). See also, Clarke v. Fiedler, 44 Cal. App. 2d 838, 113 P.2d 275 (1941). Idaho Code § 53-325(2) provides that--

The incidents of this tenancy-in-partnership are such that:

> (a) A partner, subject to the provisions of this chapter and to any agreement between the partners, has an equal right with his partners to possess specific partnership property for partnership purposes; but he has no right to possess such property for any other purpose without the consent of his partners.
> (b) A partner's right in specific partnership property is not assignable except in connection with the assignment of rights of all the partners in the same property.
> (c) A partner's right in specific partnership property is not subject to attachment, or execution, except on a claim against the partnership. When partnership property is attached for a partnership debt the partners, or any of them or the representatives of the deceased partner, cannot claim any right under the homestead or exemption laws.
> (d) On the death of a partner his right in specific partnership property vests in the surviving partner or partners, except where the deceased was the last surviving partner, when his right in such property vests in his legal representative. Such surviving partner or partners, or the legal representative of the last surviving partner, has no right to possess the partnership property for any but a partnership purpose.
> (e) A partner's right in specific partnership property is not subject to dower, courtesy, or allowances to widows, heirs, or next of kin.

On its face, section 53-325(2) reflects a number of differences between a fee interest or an interest as a tenant-in-common on the one hand and an interest as a tenant-in- partnership on the other. For example, the former is assignable, Hagge v. Drew, 27 Cal. 2d 368, 165 P.2d 461, 465 (1945); Russell v. Lescalet, 248 Cal. App. 2d 310, 56 Cal. Rptr. 399 (1967); see also, Tenhet v. Boswell, 18 Cal. 3d 150, 554 P.2d 330, 133 Cal. Rptr. 10 (1976), while the latter is not, section 53-325(2)(b); the former is subject to attachment, Hagge v. Drew, supra; Caito v. United California Bank, 20 Cal. 3d 694, 576 P.2d 466, 144 Cal. Rptr. 751 (1978); see also, People v. Nogarr, 164 Cal. App. 2d 591, 330 P.2d 858 (1958); Hagge v. Drew, supra; Wilkerson v. Thomas, supra, while the latter is not, section 53-325(2). Nothing in section 53-325(1) undermines the impact of these differences.

Idaho Code § 53-326 states:

> Nature of partner's interest in the partnership. -- A partner's interest in the partnership is his share of the profits and surplus, and the same is personal property.

The petitioners offer no persuasive authority suggesting this statute, a part of the Uniform Partnership Act, is inapplicable here.

The principle that a partnership interest is personal property in other jurisdictions is reinforced by a substantial body of law. Hatch's Estate v. Commissioner, 198 F.2d 26 (9th Cir. 1952); In re Palumbo,154 B.R. 357 (Bankr.S.D.Fl 1992); Blodgett v. Silberman, 277 U.S. 1, 48 S.Ct. 410, (1928).

In Blodgett, the U. S. Supreme Court stated, in part:

> Under section 51 of this law, a partner is a co-owner with his partner of specific partnership property, holding this property as a tenant in partnership. Such tenancy confers certain rights with limitations. A partner has a right equal to that of his partners to possess specific partnership property for partnership purposes, but not otherwise. His right in specific partnership property is not assignable, nor is it subject to attachment or execution upon a personal claim against him; upon his death the right to the specific property vests not in the partner's personal representative but in the surviving partner; his right in specific property is not subject to dower, courtesy, or allowance to widows, heirs or next of kin.

Section 52 specifically provides:

A partner's interest in the partnership is his share of the profits and surplus and the same is personal property.

Under section 73, when any partner dies and the partnership continues, his personal representative may have the value of his interest at the date of dissolution ascertained and receive as an ordinary creditor an amount equal to the value of his interest in the partnership with interest.

Under section 98, c. 640, Laws of 1922, the rights of a general partner in a limited partnership, which was the interest of the decedent here when he died, are identical with those of a general partner in a general partnership. And in regard to a limited partner's interest, section 107 of the law specifically provides:

‘A limited partner's interest in the partnership is personal property.’

It is very plain, therefore, that the interest of the decedent in the partnership of William Openhym & Sons was simply a right to share in what would remain of the partnership assets after its liabilities were satisfied. It was merely an interest in the surplus, a chose in action. It is an intangible, and carries with it a right to an accounting.

There were among the holdings and property of the partnership buildings and land. Although these statutes were passed after the decision in Darrow v. Calkins, 154 N. Y. 503, 49 N. E. 61, 299, 61 Am. St. Rep. 637, we have no reason for thinking that the partnership law of New York is now any different from what its Court of Appeals said it was in that case (pages 515, 516 (49 N. E. 64)) as follows:

‘It is, however, generally conceded that the question whether partnership real estate shall be deemed absolutely converted into personalty for all purposes, or only converted pro tanto for the purpose of partnership equities, may be controlled by the express or implied agreement of the partners themselves, and that where by such agreement it appears that it was the intention of the partners that the lands should be treated and administered as personalty for all purposes, effect will be given thereto. In respect to real estate purchased for partnership purposes with partnership funds and used in the prosecution of the partnership business, the English rule of 'out and out' conversion may be regarded as properly

> applied on the ground of intention, even in jurisdictions which have not adopted that rule as applied to partnership real estate acquired under different circumstances and where no specific intention appeared. The investment of partnership funds in lands and chattels for the purpose of a partnership business, the fact that the two species of property are in most cases of this kind, so commingled that they cannot be separated without impairing the value of each, has been deemed to justify the inference that under such circumstances the lands as well as the chattels were intended by the partners to constitute a part of the partnership stock and that both together should take the character of personalty for all purposes, and Judge Denio in Collumb v. Read (24 N. Y. 505), expressed the opinion that to this extent the English rule of conversion prevailed here. That paramount consideration should be given to the intention of the partners when ascertained, is conceded by most of the cases.'

II

SALE OF TANGIBLE PERSONAL PROPERTY

One must also consider whether the sale of the partnership interest should be construed as having been a sale of tangible personal property, thereby qualifying the gain for the Idaho Capital Gain deduction under Idaho Code § 63-3022H(3)(b). A partnership interest is a general intangible. In re Vannoy, 176 B.R. 758, 771 (Bankr. M.D.N.C. 1994); In re Hartman, 102 B.R. 90 (Bankr. N.D.Tex. 1989); In re Ellingsen MacLean Oil Co., Inc., 98 B.R. 284 (Bankr.W.D.Mich. 1989); Wharf v. Wharf., 306 Ill. 79, 137 N.E. 446 (1922). Nothing in Idaho Code § 63-3022H provides for an Idaho capital gains deduction for the gains from the disposition of intangible assets.

AGGREGATE VERSUS ENTITY THEORY

There have long been two fundamental theories regarding partnerships, the aggregate theory and the entity theory. The aggregate theory holds that a partnership is simply the aggregation of the individual efforts of the partners. This places certain limitations on the acts in which a partnership may participate, most notably here that a partnership could not hold title to real property. The entity theory removes some of these limitations. Under the entity theory, a partnership can hold title to real property. The Texas Court of Appeals addressed the matter, in part, as follows:

> Appellants insist that under the Texas common law, the partnership interest of a partner was recognized as an interest in the partnership property, and was properly characterized in accordance with the nature of such property (here realty). They aver that the common law of Texas is here applicable to characterization of the partnership interest, since the partnership was formed and the property was acquired prior to the adoption of Tex.Rev.Civ.Stat. Ann. art. 6132b (Texas Uniform Partnership Act). The UPA was passed in 1961 and became effective January 1, 1962. Appellants point to Section 4(5) of the Act which provides that "[the] Act shall not be construed so as to impair the obligations of any contract existing when the Act goes into effect, nor to affect any action or proceedings begun or right accrued before this Act takes effect."
>
> It should be stressed that the disputed real property was partnership property, as opposed to property owned separately by the partners and loaned to the partnership. The trial court found that the property in question was owned by the partnership; this finding is supported by the testimony of Joe A. Humphrey.
>
> * * *
>
> Characterization of the partnership interest was complicated under Texas common law by the tension inherent in treating the partnership as an aggregate of partners acting as individuals pursuant to a contract, as opposed to treating the partnership as an entity legally distinct from its partners. Under the aggregate theory of partnership property, followed by Texas courts, a partnership was not capable of holding title to realty; title had to be in a partner. Bromberg, Source and Comments, 17 Tex.Rev.Civ.Stat.Ann. 300 & 321-22 (1970); Crane and Bromberg, Law of Partnership § 38 (1968). Under the entity theory of partnership property, adopted by the UPA, a partnership can hold title to real property. Tex.Rev.Civ.Stat.Ann. art. 6132b, § 8(3) (1970); Bromberg, *supra.*

Humphrey v. Bullock, 666 S.W.2d 586, 588-590 (Tex. Ct. App., 1984).

The Idaho Supreme Court has addressed the issue as follows:

> The rationale behind and the reason for the adoption of the particular Uniform Partnership Act provision in I.C. § 53-308(3) was in direct response to the common law view which required that title to real estate be held by recognized legal persons, necessitating a holding by the courts that a partnership could not take title to realty in the firm name. (Footnote omitted.)
>
> As noted in *Crane and Bromberg On Partnership*, by Allen R. Bromberg (1968), at page 223:
>
> The obvious solution to the common law non-entity view was to authorize partnerships to take legal title (or any other estate) in the firm name, and this is what the U.P.A. has done. There can be little doubt that the Act means what it says, or that this is one of the more profound theoretical changes it has made. (Footnotes omitted.)
>
> The rationale of the Uniform Partnership Act was to clearly depart from that which had been held by the common law. The Uniform Partnership Act authors, however, did recognize that a partnership interest could be conveyed other than in the partnership name, as reflected in I.C. § 53-310(2), as long as the partner conveying the interest had the authority to do so. In this case we have held that Dykstra did have the authority pursuant to the partnership agreement. The two sections, I.C. § 53-308(3) and I.C. § 53-310(2), permit the conveyance of the legal title under the terms of I.C. § 53-308(3), and the equitable interest of the partnership under I.C. § 53-310(2).

Treasure Valley Bank v. Butcher, 117 Idaho 974, 977-978, 793 P.2d 206, 209-210 (1990).

III

QUALIFIED PROPERTY FROM PARTNERSHIP

The petitioners contend the gain should be considered to have been from "qualified property" from a partnership as if the partnership had distributed the property to the petitioner and that the petitioner had sold the qualifying property. Sales of partnership interests are addressed by Internal Revenue Code § 741 which stated, in pertinent part:

> Recognition and character of gain or loss on sale or exchange.
>
> In the case of a sale or exchange of an interest in a partnership, gain or loss shall be recognized to the transferor partner. Such

> gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751 (relating to unrealized receivables and inventory items which have appreciated substantially in value).

The United States Tax Court in a decision reviewed by the court has addressed the issue as follows:

> At issue is the character of loss, whether capital or ordinary, incurred by petitioner on the disposition of his interest in a limited partnership. [FN1]
>
> > FN1. Petitioner's disposition of his partnership interest technically involved a liquidation of such interest under the applicable statutory provisions. However, the resulting loss is considered as a loss from the sale or exchange of a partnership interest. Secs. 761(d), 736(b), and 731(a)(2), I.R.C. 1954. The character of such loss therefore falls within the ambit of sec. 741.
>
> Generally, the treatment accorded gain or loss from an isolated transaction constituting the sale or exchange of a partnership interest is covered by section 741 [FN2] which specifically provides that "Such gain or loss shall be considered as gain or loss from the sale or exchange of a capital asset, except as otherwise provided in section 751." Similarly, the regulations provide that "The sale or exchange of an interest in a partnership shall * * * be treated as the sale or exchange of a capital asset." Sec. 1.741-1(a), Income Tax Regs.
>
> > FN2. Unless otherwise indicated, all statutory references are to the Internal Revenue Code of 1954, as amended.
>
> The focus of the present controversy is whether section 741, if applicable, or section 1221 is dispositive of the treatment accorded the gain or loss realized by a partner on the sale or exchange of a partnership interest.
>
> Petitioner maintains that the interest involved failed to qualify as a capital asset under section 1221 and that, despite the language of section 741, the interest constituted an ordinary asset in his hands. Consequently, he concludes, the loss he suffered on its disposition entitles him to either an ordinary and necessary business expense deduction under section 162(a) or an ordinary business loss deduction under section 165(a). [FN3]

> FN3. In support of his position that the interest involved represents an ordinary asset in his hands, petitioner relies upon the judicial exception to sec. 1221, I.R.C. 1954, carved out by Corn Products Co. v. Commissioner, 350 U.S. 46 (1955), and the myriad of cases which have since applied such exception.

Respondent, on the other hand, contends that except for specific exceptions not relevant herein, section 741 mandates the loss be characterized as a capital loss. We agree with respondent that both the legislative history of section 741 and its language indicate that Congress intended it to operate independently of section 1221 so as to be dispositive of the character of petitioner's loss.

Section 741 was enacted by Congress as part of subchapter K of the Internal Revenue Code of 1954. Subchapter K was enacted to resolve the chaos which permeated the partnership area under the 1939 Code. While it would serve no useful purpose here to attempt to articulate each and every difficulty which led to the enactment of subchapter K, the general situation can be aptly summarized by the following observation contained in its legislative history:

The existing tax treatment of partners and partnerships is among the most confused in the entire income tax field. The present statutory provisions are wholly inadequate. The published regulations, rulings, and court decisions are incomplete and frequently contradictory. As a result partners today cannot form, operate, or dissolve a partnership with any assurance as to tax consequences.

Because of the vital need for clarification, your committee has undertaken the first comprehensive statutory treatment of partners and partnerships in the history of the income tax laws. In establishing a broad pattern applicable to partnerships generally, the principal objectives have been simplicity, flexibility, and equity as between the partners. H. Rept. 1337, to accompany H.R. 8300 (Pub. L. 591), 83d Cong., 2d Sess. 65 (1954).

A prime example of such confusion under the 1939 Code was the treatment of gain or loss from the sale or exchange of a partnership interest. Prior to 1950 the Government took the position, under the so-called aggregate theory of partnership, that the selling partner actually sold his undivided interest in each of the partnership's assets, and the character and amounts resulting from the disposition of those assets should be considered individually.

[FN4] See Commissioner v. Lehman, 165 F.2d 383 (2d Cir. 1948), affg. 7 T.C. 1088 (1946), cert. denied 334 U.S. 819 (1948).

FN4. Such was not always the Government's consistent position, especially when a loss was incurred on the sale of the interest. See McClellan v. Commissioner, 42 B.T.A. 124 (1940), affd. 117 F.2d 988 (2d Cir. 1941).

This position, however, found no acceptance in the courts, which consistently held a partnership interest to be a capital asset in its entirety regardless of the nature of the underlying partnership assets. See Swiren v. Commissioner, 183 F.2d 656 (7th Cir. 1950), revg. a Memorandum Opinion of this Court dated Oct. 11, 1949, cert. denied 340 U.S. 912 (1951). In response, the Government in 1950 reversed its position in G.C.M. 26379, 1950-1 C.B. 58, stating that: the sale of a partnership interest should be treated as the sale of a capital asset under the provisions of section 117 of the Internal Revenue Code (of 1939).

The result of the Government's concession, however, was to engender the use of the "collapsible partnership" device, by which a partner was able to convert his share of what would otherwise be ordinary income to capital gain by means of the sale of his partnership interest. [FN5]

FN5. see Jackson, Johnson, Surrey, Tenen, and Warren, "The Internal Revenue Code of 1954: Partnerships," 54 Colum. L. Rev. 1183, 1216 (1954).

Faced with this situation, Congress, in the 1954 Code, sought to eliminate the confusion on this point by codifying the Government's concession in G.C.M. 26379 and, at the same time, reduce the availability of the collapsible partnership as a tax avoidance device. See H. Rept. 1337, to accompany H.R. 8300 (Pub. L. 591), 83d Cong., 2d Sess. 71 (1954). Congress accomplished its dual purpose by enactment of section 741, which treated the sale of a partnership interest as the sale of a capital asset, and section 751, which specifically excluded from capital gain or loss treatment that portion of the partnership interest representing income from unrealized receivables and substantially appreciated inventory items. See S. Rept. 1622, to accompany H.R. 8300 (Pub. L. 591), 83d Cong., 2d Sess. 96 (1954). [FN6]

FN6. See also sec. 706, I.R.C. 1954, for a further exception to the capital gain or loss treatment accorded the transferor partner.

> In view of the foregoing legislative record and the plain language of the statute itself, we conclude that Congress intended section 741, if applicable, to provide capital gain or loss treatment on the sale or exchange of a partnership interest by a partner without regard to section 1221. [FN7] Indeed, congressional use of the phrase "shall be considered as" in section 741 is unambiguous and mandatory on its face. [FN8] See Helvering v. Flaccus Leather Co., 313 U.S. 247 (1941). Furthermore, the singular meaning of such phrase is demonstrated by its consistent interpretation in sections 731, 735, 736, and 751. See secs. 1.731-1(a)(3), 1.735-1(a), 1.736-1(a)(4), and 1.751 -1(a)(1), Income Tax Regs. In fact, where Congress has intended section 1221 to apply despite similar statutory specificity, it has generally either expressly or impliedly said so. See, e.g., secs. 302, 331, 1232, 1233; compare sec. 1235.
>
> > FN7. Having concluded that sec. 1221, I.R.C. 1954, is not applicable, we need not consider whether the Corn Products doctrine exception to that section is applicable in this case. See Corn Products Co. v. Commissioner, 350 U.S. 46 (1955).
> >
> > FN8. Respondent has so interpreted the statute for many years. See sec. 1.741-1(a), Income Tax Regs.; Rev. Rul. 59-109, 1959-1 C.B. 168. Clearly, such interpretation is not unreasonable in light of the legislative record and the language of the statute. See Commissioner v. South Texas Lumber Co., 333 U.S. 496 (1948). Furthermore, while the present case is one of first impression, this Court has likewise previously assumed the result reached herein. See, e.g., Coven v. Commissioner, 66 T.C. 295, 303 (1976); Holbrook v. Commissioner, T.C. Memo. 1975-294.
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> Accordingly, we hold that petitioner realized a capital loss on the disposition of his limited partnership interest in Millworth Associates, irrespective of his motive in acquiring such interest.

Pollack, Jr. v. Commissioner, 69 T.C. 142, 144-147 (1977).

Counsel for the petitioner contends that the Commission should treat the matter in a manner that the petitioner *could have* structured the transaction e.g. to have distributed qualified assets to franchise partnership to the petitioner with the petitioner subsequently selling such qualifying assets. The Commission finds two problems with this treatment. First, if the partnership(s) here in question had distributed ratable portions of the assets they held to the petitioner, this would have been a mixture of assets. The partnerships appear to have been involved in the business of farming and/or ranching. It appears that a distributive share of the assets held would have included real property, equipment, cash, and receivables and probably other assets. Gain from the disposition of some of the assets would have qualified for the Idaho capital gains deduction while gain from the disposition of others would not have so qualified.

Secondly, counsel for the petitioner would have the Commission deem their client's tax consequences to have been based upon how she *could have* structured her affairs. The U. S. Supreme Court has addressed the matter as follows:

> This Court has observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, Higgins v. Smith, 308 U.S. 473, 477, 60 S.Ct. 355, 357, 84 L.Ed. 406 (1940); Old Mission Portland Cement Co. v. Helvering, 293 U.S. 289, 293, 55 S.Ct. 158, 160, 79 L.Ed. 367 (1934); Gregory v. Helvering, 293 U.S. 465, 469, 55 S.Ct. 266, 267, 79 L.Ed. 596 (1935), and may not enjoy the benefit of some other route he might have chosen to follow but did not. 'To make the taxability of the transaction depend upon the determination whether there existed an alternative form which the statute did not tax would create burden and uncertainty.' Founders General Corp. v. Hoey, 300 U.S. 268, 275, 57 S.Ct. 457, 460, 81 L.Ed. 639 (1937); Television Industries, Inc. v. Commissioner of Internal Revenue, 284 F.2d 322, 325 (C.A.2 1960); Interlochen Co. v. Commissioner of Internal Revenue, 232 F.2d 873, 877 (C.A.4 1956). See Gray v. Powell, 314 U.S. 402, 414, 62 S.Ct. 326, 333, 86 L.Ed. 301 (1941).

Commissioner v. National Alfalfa Dehydrating and Milling Company, 417 U.S. 134, 149 (1934).

Echoing the same sentiment, the Tax Court of New Jersey stated, in part:

> *General Trading Co., Inc. v. Taxation Div. Director*, 83 N.J. 122, 416 A.2d 37 (1980), dictates precisely the opposite result: if the tax is due, what *might* have been done for a different tax result is

of no consequence. The legal principle which governs this case is the same as in *General Trading,* in which Chief Justice Wilentz wrote:

In our view the legal principle which governs this case is that a voluntary business decision "is to be given its tax effect in accord with what actually occurred and not in accord with what might have occurred." *Commissioner v. National Alfalfa Dehydrating and Milling Co.,* 417 U.S. 134, 148, 94 S.Ct. 2129, 2137, 40 L.Ed.2d 717, 727 (1975).

This Court has observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not . . ., and may not enjoy the benefit of some other route he might have chosen to follow but did not. "To make the taxability of the transaction depend upon the determination whether there existed an alternative form which the statute did not tax would create burden and uncertainty." [*Id.* at 149, 94 S.Ct. at 2137 (citations omitted)]. [*Id.* at 136-137, 94 S.Ct. at 2131]

In *General Trading,* a corporation authorized the issuance of 10 million rather than 100,000 shares of stock, with no apparent business purpose. This action resulted in a deficiency assessment of over $26,000. In holding that the taxpayers must suffer the consequence of their inadvertence, the court said:

That the stockholders and officers of General Trading may not have given a minute's thought to the tax consequences of their decision is irrelevant to the question of liability under the Statute. [*Id.* at 134, 416 A.2d 37]

This court has also held that "a contractual obligation which now appears to be less advantageous than originally anticipated . . . cannot be the basis for nontaxability." *Atlantic City Airlines, Inc. v. Taxation Div. Director,* 4 N.J.Tax 97, 105 (Tax Ct.1982), citing *General Pub. Loan Corp. v. Taxation Div. Director,* 13 N.J. 393, 99 A.2d 796 (1953).

The court sympathizes with plaintiff's claims that the lease was approved by the Board of Public Utility Commissioners of the State of New Jersey; that it would not have entered into the lease if it expected that the property would be taxed, and that the lease was entered into to reduce its costs, to reduce its rate base and, hence, to reduce the cost of electricity to the consumer. However, such arguments are more appropriately made to the Legislature than to

> this court. *MacMillan v. Taxation Div. Director,* 180 N.J.Super. 175, 434 A.2d 620 (App.Div.1981), aff'd o.b. 89 N.J. 216, 445 A.2d 397 (1982).

Atlantic City Electric Company v. Taxation Division Director, 5 N. J. Tax 15, 23-24 (1979).

The transaction, as structured by the petitioner, was the disposition of two partnership interests. A partnership interest is an intangible. Idaho Code § 63-3022H does not allow a capital gains deduction with regard to gains from the disposition of intangibles. Therefore, the auditor's denial of the capital gains deduction must be affirmed.

LIKE-KIND EXCHANGE

The transaction producing the capital gains deduction referred to above also included $350,000 transferred to an accommodator with the intention of subsequently completing an exchange pursuant to Internal Revenue Code § 1031 (like-kind exchange). The Commission finds that the transfer of these funds and subsequent purchase of real property does not qualify as a like-kind exchange pursuant to Internal Revenue Code §1031 for three reasons. First, the disposition of the partnership interests by the petitioner does not qualify for like-kind exchange treatment. Second, the property obtained was not used either for a trade or business or for investment. The Commission finds that the property obtained by the petitioner did not to qualify for like-kind exchange treatment. Finally, the disposition by the petitioner of a 200-acre parcel to a different taxpayer than the one making the $350,000 deposit with the accommodator does not qualify as the property given up for purposes of Internal Revenue Code § 1031.

On December 28, 1995, the petitioner obtained a 200-acre parcel from Sand Springs Ranch. The agreement through which this parcel was obtained stated, in part:

> [Redacted] and [Redacted], formerly known as [Redacted], agree that [Redacted] will transfer to [Redacted] a tract of land being the South Half of the Northwest Quarter, the North Half of the Southwest Quarter and the Southwest Quarter of the Southwest

> Quarter all of Section 22, Township 8 South, Range 14 East, [Redacted] [Redacted], [Redacted], Idaho, containing approximately 200 acres, in return for the transfer from [Redacted] to [Redacted] of that number of general partnership units of [Redacted], formerly known as [Redacted], received by [Redacted] from the Estate of [Redacted] pursuant to the Partial Renunciation of Succession dated March 8, 1990, and signed by [Redacted], having a value equal to the property and funds transferred to her. The parties also agree that [Redacted] will lease the transferred property from [Redacted] for an annual payment equal to the property taxes against the property by [Redacted], Idaho. This agreement will not reduce the amount of rent income already received by [Redacted] from the partnership.
>
> This agreement transfers land that approximately equals the value of the land and funds transferred to [Redacted] in the December 13, 1991 agreement between [Redacted] and [Redacted].

This purported exchange was not reflected in the income tax returns filed by the petitioner. It also does not appear to agree with some of the other documentation. The Form K-1 issued to the petitioner by [Redacted] for 1995 indicates that her percentage of ownership remained unchanged from the beginning of the year to the end of the year.

On September 26, 1996, two transactions occurred with regard to this docket. The petitioner quit-claimed a 200-acre parcel of land to [Redacted], a partnership in which (prior to that date), the petitioner, her brother, and their mother were the partners. Nothing in the record before us indicates that [Redacted] transferred anything to the petitioner in return for this transfer of real property. On this same date, the petitioner sold her partnership interests in [Redacted] and another partnership to her brother. A part of the compensation that her brother paid to the petitioner for her partnership interests was $350,000 paid to an accommodator to purchase a parcel of land in [Redacted], Idaho. The petitioner treated the $350,000 as an exchange pursuant to Internal Revenue Code § 1031.

Counsel for the petitioner wrote the following:

> Ms. [Redacted] owned the "200 acre parcel" that was sold for a deposit on her behalf of $350,000 with a qualified 1031 exchange intermediary. The proceeds were utilized to purchase parcel of bare land in [Redacted], Idaho, that she held for investment. Several years after she purchased the bare land, she decided to construct improvements on the property. Prior to constructing the improvements on the land in 1999, her personal residence was in [Redacted]. You would have to agree that there is not much that you can do with bare land other than hold it for investment.

While counsel for the petitioner contends that there was a sale of the property in exchange for the transfer of the funds to the accommodator, the record indicates that the facts may have been quite different. The petitioner quit-claimed the 200 acres to one entity ([Redacted]) while a different taxpayer (the petitioner's brother), pursuant to an "AGREEMENT TO EXCHANGE PROPERTY" made the deposit with the accommodator. While the petitioner contends that such an arrangement qualifies for like-kind treatment, no authority for this position has been offered.

The AGREEMENT TO EXCHANGE PROPERTY which produced the $350,000 here in question does not mention the petitioner's giving up in the exchange anything but her partnership interests. As was referred to above, counsel for the petitioner argued for the Idaho capital gains deduction referred to above based upon the premise that the petitioner could have structured her transactions differently so as to have qualified. It appears that counsel's argument here is similar. While the petitioner might have been able to structure the transaction so as to convey the 200-acre parcel in exchange for the land in [Redacted], that is clearly not what the documents state. See the discussion of this argument above.

While counsel for the petitioner contends that the petitioner did not build a house on the property until several years after the acquisition of the property, information received from the building department for [Redacted] contradicts this statement of fact. The information received from the [Redacted] building department indicates that a building permit was issued for the property on November 6, 1996, 41 days after the purported exchange. The anticipated cost of the improvement on the property was $425,000. Considering the time that it would take to make decisions regarding the type of house to be built and the time for the permit to be issued, it seems clear that, at the time of the acquisition of the property, the petitioner's intent was to build her personal residence there. Information from [Redacted] further indicates that the house was completed on or before August 4, 1997. The Commission finds that the property was obtained for personal purposes.

Internal Revenue Code § 1031 stated, in part:

> Exchange of property held for productive use or investment.
> (a) Nonrecognition of gain or loss from exchanges solely in kind.
> (1) In general. No gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment is such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.
> (2) Exception. This subsection shall not apply to any exchange of –
> (A) stock in trade or other property held primarily for sale,
> (B) stocks, bonds, or notes,
> (C) other securities or evidences of indebtedness or interest,
> (D) interests in a partnership,
> (E) certificates of trust or beneficial interests, or
> (F) choses in action.
>
> For purposes of this section, an interest in a partnership which has in effect a valid election under section 761(a) to be excluded from the application of all of subchapter K shall be treated as an interest in each of the assets of such partnership and not as an interest in a partnership.

The Commission is not aware of a valid election under Internal Revenue Code § 761(a) for the partnerships here in question. Therefore, it would appear that Internal Revenue Code §1031(a)(2)(D) precludes like-kind exchange treatment of the partnership interests in this case.

WHEREFORE, the Notice of Deficiency Determination dated March 15, 2000, is hereby MODIFIED and, as so modified, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following tax, penalty, and interest (calculated to January 15, 2002):

YEAR	TAX	INTEREST	TOTAL
1996	$58,655	$17,591	$76,246
1997	1,350	208	1,558
1998	5,997	1,276	7,273
			85,077
		Less Payment Received	(42,684)
		TOTAL DUE	$42,393

An explanation of the petitioner's right to appeal this decision is enclosed with this decision.

DATED this ____ day of __________________, 2001.

IDAHO STATE TAX COMMISSION

____

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _______________, 2001, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[Redacted] Receipt No. [Redacted]
[Redacted] [Redacted]
[Redacted] [Redacted] [Redacted]
[Redacted] [Redacted] [Redacted] [Redacted]

____
ADMINISTRATIVE ASSISTANT 1