

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 15170
[REDACTED],)	
)	DECISION
Petitioners.)	
_____)	

[Redacted], (Petitioners) protest the Notices of Deficiency Determination issued by the Idaho State Tax Commission (Commission) dated October 20, 2000. The Notice of Deficiency asserts additional liability for Idaho individual income tax and interest in the total amount of \$7,946 for 1998.

The sole issue in this case is whether the holding period for Idaho capital gains deduction purposes has been met regarding one parcel of real estate. The date of sale is not disputed. The date of acquisition is the sole issue of dispute.

The petitioners were, during the period here in question, nonresidents of Idaho. They filed their income tax return reporting, in part, gain from the disposition of a parcel of real property pursuant to an installment sale of Idaho real property. The Form 6252, which was a part of their federal income tax return indicated that they had acquired the parcel of real property on January 1, 1993 and sold the parcel on October 1, 1997.

In 1997 (the year of sale), the Idaho law required that real property be held for five years to qualify for the deduction. Idaho Code § 63-3022H(3)(a). The auditor for the Commission determined that the petitioners had not held the property for the requisite period of time to be entitled to the deduction. Therefore, he asserted additional liability and sent them the Notice of Deficiency Determination referred to above.

The petitioners appealed. They contended that the purchase date of January 1, 1993 (as shown on their return) was incorrect. They contended that the actual acquisition date was

August 31, 1992. The petitioners submitted a copy of a letter to the lessor/seller from Mr. [Redacted] (dated August 31, 1992) which stated the following:

In conjunction with the terms of the lease of the property at [Redacted], Idaho [Redacted], this letter is to serve as notice of exercise of the purchase option. A check in the amount of \$39,000 accompanies this notice. It is made payable to "[Redacted]" per the instruction of [Redacted] and to coincide with the instructions for making monthly lease payments.

Please call me and we will finalize closing documents.

The lease agreement has a purchase option which stated:

29. PURCHASE OPTION:

(a) The lessor hereby grants to the lessee an option to purchase the exclusive and non-exclusive use property subject to driveway easement on the following terms and condition:

(b) The option price is \$260,000.

(c) Notice of exercise of the option must be given not later than September 30, 1992.

(d) Lessee must not be in material default, either at the time of giving the notice, or at the time that a sale pursuant to the exercise of the option takes place.

(e) Notice of exercise of option must be accompanied by a payment of \$39,000, which will be applied on the down payment if the sale closes pursuant to the option, forfeited to the lessor if the lessee fails to proceed with the purchase pursuant to the option, or refunded if, for any reason beyond the control of either of the parties, the sale pursuant to the option is not completed.

(f) Terms of payment are \$39,000 down. The balance of \$221,000 will be, at the election of the lessor, on a real estate contract, on a note and mortgage or on a note and deed of trust with commercially reasonable terms. The note will be amortized in equal monthly payments over 10 years at ten percent (10%) interest. Payment will be allowed at any time without penalty. There will be a late charge equal to 5% of any payment which is not paid within five days after its due date. In the event of default wthe (sic) interest rate will go to 18%. The interest of the purchaser cannot be assigned without the consent of the seller, which will not be withheld except for a valid business reason. The purchaser will pay the seller's reasonable costs incident to considering any such sale or assignment.

(g) The obligation of the purchaser will be personally guaranteed by Douglas B. Burpee.

(h) The lessor, as seller, will convey to (sic) subject property by warranty deed with no exceptions which would render title nonmerchantable. If, despite the lessor's best efforts, he is unable to provide merchantable title and the lessee/optionee is unwilling to accept title as provided, then this option and its exercise will be null and void and the lessee's payment which accompanied the exercise of the option will be refunded.

(i) Pro-rated and closing costs will be allocated between the parties in accordance with local closing practice.

While the petitioner advised the seller through his letter dated August 31, 1992, that he wished to exercise the option to buy the subject property, the "REAL ESTATE CONTRACT" was not executed until June 22, 1994. A letter submitted by the petitioners' representatives set out the reason for the delay: "The 22-month delay between the exercise of the option and the real estate contract and closing was because of the difficulty of the owner, [Redacted], clearing the title to his property."

It appears that the petitioners' position is that the purchase option in the lease agreement constituted an offer of sale. The letter (dated August 31, 1992) constituted an acceptance of such offer, thereby concluding the contract of sale.

In examining the purchase option in the lease agreement, there are a few distinctive portions which appear to be relevant. First, the seller was to convey the property "by warrantee deed with no exceptions which would render title nonmerchantable." It appears that this portion of the agreement was not fulfilled at or near August 31, 1992, the acquisition date proposed by the petitioners. It appears that this part of the performance required of the seller was not possible until some time in 1994.

The interest rate provided by the purchase option of the lease agreement was to have been a fixed ten percent. However, the actual contract contained a variable interest rate.

Due to the variations between the terms set out in the purchase option of the lease agreement and the actual terms contained in the REAL ESTATE CONTRACT, it is clear that the combination of the purchase option in the lease agreement and the letter did not amount to an offer and acceptance. The performance necessary by the seller apparently was not possible until some time in 1994. If the language in the purchase option of the lease contract and the letter at some time

constituted a contract, this did not occur until the seller could perform. According to the letter from the petitioners' representative, this did not occur until some time in 1994.

The failure of the seller to provide a merchantable title was addressed in the purchase option portion of the lease agreement. The remedy for such failure was that, "this [purchase] option and its exercise will be null and void and the lessee's payment which accompanied the exercise of the option will be refunded." The agreement did not require specific performance on the part of the seller.

The actual terms agreed to were apparently negotiated at some time after the date of the letter and on or before the date the contract was dated (July 1, 1994). The Commission finds that, based upon the information in the file, there is insufficient information to support a finding that the acquisition date was early enough to qualify the gain here in question for the Idaho capital gains deduction.

WHEREFORE, the Notice of Deficiency Determination dated October 20, 2000, is hereby APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax and interest:

YEAR	TAX	INTEREST	TOTAL
1998	\$7,038	\$1,313	\$8,351

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioners' right to appeal this decision is enclosed 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 a envelopes addressed to:

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

[REDACTED]

ADMINISTRATIVE ASSISTANT 1