

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
[Redacted],) DOCKET NO. 18471
)
Petitioners.) DECISION
)
_____)

On October 20, 2004, the staff of the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayers), proposing income tax, penalty, and interest for the taxable years 1998 and 1999 in the total amount of \$51,385.

On December 2, 2004, the taxpayers filed a timely appeal and petition for redetermination. The taxpayers requested a hearing, which was held as a telephone hearing on May 19, 2005. The Tax Commission, having reviewed the file, hereby issues its decision.

The Income Tax Audit Bureau (Bureau) found that the taxpayers sold property in Idaho in 1998 and 1999. The Bureau researched the Tax Commission's records and found that the taxpayers did not file Idaho income tax returns for those years as well as some other years. The Bureau contacted the taxpayers and asked them to file their Idaho income tax returns. After working with the taxpayers for more than two years, the Bureau finally received returns from the taxpayers. The Bureau reviewed the taxpayers' 1998 and 1999 returns and found that the taxpayers claimed Internal Revenue Code (IRC) section 121 exclusion on the gain they realized on the sales of their Idaho property. The Bureau obtained additional information on the properties and determined neither of the sales qualified for the exclusion in IRC section 121. The Bureau adjusted the taxpayers' returns and sent them a Notice of Deficiency Determination.

The taxpayers protested the Bureau's determination. The taxpayers stated the land sales were land they inherited in the 1940s and surrounding land they acquired over the years. The taxpayers stated this land was their permanent residence and that all the land was contiguous. The taxpayers provided copies of Quit Claim Deeds and Warranty Deeds with the legal descriptions of the land to show that the land was contiguous and qualified for the exclusion.

The Bureau referred the matter for administrative review. The Tax Commission sent the taxpayers a letter giving them two methods for having the Notice of Deficiency Determination redetermined. The taxpayers requested a hearing in Northern Idaho; however, the conditions for having a timely hearing did not materialize, so a telephone hearing was held on May 19, 2005.

In preparation for the telephone hearing, the taxpayers hired consulting engineers to map the properties sold by the taxpayers. The taxpayers provided a copy of the map, and it was the basis of most of the telephonic hearing. The map the taxpayers provided showed the layout of the land the taxpayers sold. One of the parcels was located in section [Redacted]. The other parcel was located in section [Redacted].

IRC section 121(a) states,

Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

The taxpayers stated the property sold was part of the original homestead inherited and lived on for over 60 years. The taxpayers and Mr. [Redacted]'s brother and his wife jointly owned the land. In the 1990s, the brothers decided it was time to divide up and dispose of the property. The taxpayers apparently found a buyer or were approached by a buyer for a portion of the property in Section [Redacted]. So in November 1996, [Redacted], the brother, quit claimed

his ½ interest in the parcel to the taxpayers. On that same day, the taxpayers sold the property to [Redacted]. The sale of this property was not part of the IRC section 121 exclusion but was the beginning of the property transactions between the brothers and between the taxpayers and a third party that set up the property sales for which the exclusion was claimed.

In 1998, [Redacted]. apparently wanted more of the taxpayers' property. Consequently, in October 1998, [Redacted] quit claimed his ½ interest in the remaining property in Section [Redacted] to the taxpayers and the taxpayers turned around and sold the property to [Redacted]. About a year later, the taxpayers sold their ½ interest in the total remaining property, Section [Redacted], to [Redacted] and his wife. This sale was apparently to equalize the property ownership between the two brothers. In addition to this conveyance, [Redacted] and his wife quit claimed a 10-acre parcel within the property in Section [Redacted] to the taxpayers for their new residence. The two large parcel sales or exchanges are the subject of the IRC section 121 exclusion.

Treasury Regulation section 1.121-1(b) defines what qualifies as residence for the section 121 exclusion. Subpart (3) states that vacant land can be considered part of the sale or exchange of a principal residence. To qualify as part of the sale or exchange, the vacant land must: (a) be adjacent to the land containing the dwelling unit of the taxpayer's principal residence; (b) the taxpayer must have owned and used the vacant land as part of the taxpayer's principal residence; (c) the sale or exchange of the dwelling unit must meet the requirements of section 121 within 2 years before or 2 years after the date of the sale or exchange of the vacant land; and (d) the requirements of section 121 have otherwise been met with respect to the vacant land.

The taxpayers claim the property sales of October 28, 1998, to [Redacted]. and of October 22, 1999, to [Redacted] qualify for the section 121 exclusion. The Bureau, on the other

hand, found that the vacant property, the October 28, 1998 sale, was not adjacent to the property sale of October 22, 1999, per information it received from [Redacted] County. The Bureau also stated that the taxpayers' home or house was not part of either transaction.

The taxpayers provided the Tax Commission with a map of the properties of the subject sales. The map clearly shows the properties lie side by side. The Tax Commission verified this from its own information available from its mapping staff in the County Support division. From the information in the file, the Tax Commission surmised the information the County provided the Bureau was that for the property sale of November 1996, not the property for which the section 121 exclusion was claimed. Regardless, the evidence presented leaves no doubt that the subject properties are adjacent properties. Therefore, if the other requirements are met, the vacant land can be considered part of the taxpayers' principal residence.

The second property sale, the October 22, 1999 sale, was the sale of the property where the taxpayers had their principal residence. The taxpayers lived on the property in section [Redacted] for over 80 years. Mr. [Redacted]'s father initially purchased 80 acres in 1922. The land was devolved to Mr. [Redacted] and his brother as tenants-in-common. Other purchases of the surrounding property were made over the years until the [Redacted] brothers held almost an equivalent of a section of land. The taxpayers lived in the old family homestead until sometime in the 1970s when the house was gutted by fire. The taxpayers remained on the property converting the gutted house to a shop and storage area. They moved a mobile home on the property that they lived in until the property was sold in 1999.

The Bureau stated in its explanation of the adjustment that the taxpayers' house was not included in the sale of the property. However, there is nothing in the record to support this claim. There is little doubt that the taxpayers owned and used the land as part of their principal

residence. Therefore, the question becomes, “did the taxpayers sell their mobile home as part of the sale of the land to qualify the sale for the section 121 exclusion?” The Tax Commission finds that the mobile home was indeed part of the sale.

The taxpayers' property transactions divided the total holdings of the [Redacted] brothers between themselves. The transactions in 1996 and 1998 divided the property for the taxpayers' share of the land. The 1999 transactions relinquished the taxpayers' rights in the property and sold their interest in the improvements made to the family homestead. The land, the mobile home, and the homestead buildings were sold to [Redacted] completing the division of the property.

Since the taxpayer's sold their mobile home with the land, the sale qualifies for the section 121 exclusion. Therefore, the Tax Commission cancels the adjustment disallowing the 121 exclusion. However, the taxpayers' 1998 and 1999 returns were filed delinquent. The due dates for the returns were April 15, 1999 and April 15, 2000, respectively. The Tax Commission received the returns on June 21, 2004. Consequently, the Tax Commission finds the interest and the delinquency penalty is appropriate and in accordance with Idaho Code sections 63-3045 and 63-3046.

WHEREFORE, the Notice of Deficiency Determination dated October 20, 2004, is hereby MODIFIED, in accordance with the provisions of this decision and, as so modified, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1998	\$2,181	\$ 545	\$ 866	\$ 3,592
1999	3,215	804	1,027	<u>5,046</u>
			TOTAL DUE	\$ 8,638
		LESS	PAYMENTS	<u>(5,396)</u>
			BALANCE DUE	<u>\$ 3,242</u>

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

An explanation of the taxpayers' right to appeal this decision is included with this decision.

DATED this ____ day of _____, 2005.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2005, 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]
 [REDACTED]
 [REDACTED]

Receipt No.

[REDACTED]
 [REDACTED]
 [REDACTED]

[REDACTED]
 [REDACTED]
