

**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

In the Matter of the Protest of	)	
	)	DOCKET NO. 19528
[REDACTED]	)	
	)	DECISION
Petitioner.	)	
	)	

On July 12, 2006, the Idaho State Tax Commission’s (Commission) Income Tax Audit Bureau (Bureau) issued a Notice of Deficiency Determination (NODD) to [Redacted] (petitioner), proposing additional income tax and interest for the taxable years 2003 and 2004 in the total amount of \$30,179. The petitioner filed a timely protest and petition for redetermination. The petitioner did not request a hearing or submit additional information. The Tax Commission, having reviewed the file, hereby issues its decision.

The petitioner is a resident [Redacted][Redacted] with extensive land holdings [Redacted]. The petitioner filed an Idaho nonresident income tax return for tax years 2003 and 2004. In the Bureau’s NODD, the Bureau disallowed the petitioner’s Idaho capital gain deduction on the sale of Idaho timber and the petitioner’s share of deductions relating to the application and subsequent denial of a zoning change on land [Redacted] as follows:

	Tax year	<u>2003</u>	<u>2004</u>
Idaho Taxable Income as Reported		\$98,560	\$146,380
Audit Adjustments:			
Capital gain deduction disallowed		312,137	
Zoning expenses disallowed		20,467	4,913
Idaho Taxable Income as Adjusted		<u>\$431,164</u>	<u>\$151,293</u>

The petitioner disagrees with the Bureau’s disallowance of the zoning expenses.

## **1. In General**

[Redacted]. Title to the property was held [Redacted] a revocable trust [Redacted] hereinafter referred to as the Trust.

[Redacted]. The property is currently zoned rural and is designated as timber [Redacted]. Such use ended on or around May 15, 2001.

On or about January 2, 2001, the county advised the Trust to apply for a conditional zone development agreement rather than an enlarged conditional use permit [Redacted]. The Trust subsequently requested the zoning change [Redacted]. On March 21, 2001, the Trust's rezone application was heard and recommended for approval [Redacted]. Subsequently, on May 23, 2001, and thereafter, the [Redacted] (Board) held public hearings on the application. Several individuals/organizations objected to the zoning change request for various reasons.

On July 11, 2001, the Board issued a written decision denying the Trust's zone change request [Redacted]. On August 3, 2001, the Trust requested mediation of the rezone application pursuant to I.C. section 67-6510. That request was denied as well. The Trust appealed the county's denials to the First Judicial District of the State of Idaho, In And For The [Redacted] (District Court). On February 11, 2003, the District Court issued its decision upholding the Board's actions. The Trust appealed the District Court's decision to the Idaho Supreme Court. During 2003, the Trust sought to resolve the zoning issue through mediation; however, sometime in 2003, the Trust ended its attempts to resolve the issue through mediation or litigation and instead chose a different path by submitting a new zoning change request [Redacted]

On August 11, 2003, the Trust filed a zoning change request [Redacted]. On March 23, 2004, a hearing officer [Redacted] issued his recommendation to the Board that the application to rezone [Redacted] be denied. On April 21, 2005, the Board issued a decision

denying the Trust's zoning change request [Redacted]. On November 8, 2005, an Order For Stipulation For Dismissal With Prejudice was issued by the District Court.

During 2003 and 2004, the Trust incurred numerous professional expenses relating to the zoning change requests including litigation costs as follows:

	Tax year	2003	2004
County fees		3,855	(166)
Legal expenses		29,335	
Engineering/consultant fees		2,478	5,915
Aggregates consultant fees		5,266	4,076
Total		\$40,934	\$9,825

As half owner of the Trust, the petitioner claimed one-half of the expenses as a current deduction on his individual income tax returns for 2003 and 2004. The petitioner cites Internal Revenue Code (IRC) section 616(a) as support for his position that the expenses are a current deduction. The Bureau cites IRC section 263 and Treas. Reg. 1.212-1(k) as its support that the expenditures should be capitalized rather than allowed as current deductions.

## **2. Law and Analysis**

Income tax deductions are a matter of legislative grace, and the petitioner bears the burden of proving entitlement to the claimed deductions. INDOPCO, Inc. v. Commissioner, 503 U.S. 79, 84 (1992). The determination of whether an expenditure is deductible as a current deduction or must be capitalized is not always a straightforward or mechanical process. "[E]ach case 'turns on its special facts'", and "the cases sometimes appear difficult to harmonize." INDOPCO, Inc. v. Commissioner, supra at 86.

With respect to costs incurred relating to zoning change requests, it is well established that rezoning expenses are not deductible when made since they represent a capital outlay.

Chevy Chase Land Co. v. Commissioner, 72 T.C. 481, 487 (1979); see also Soelling v. Commissioner, 70 T.C. 1052 (1978), Galt v. Commissioner, 19 T.C. 892, 910 (1953), revd. in part and affd. in part on other issues 216 F.2d 41 (7th Cir. 1954). Additionally, zoning costs have been held to be “capital expenditures, not amortizable because indefinite and undeterminable in the duration of their consequence, and recoverable through addition to the basis of the property rather than through periodic deduction.” Id at 910. Moreover, even the cost of an unsuccessful attempt to obtain a zoning change has been regarded as retaining its character as a capital outlay and therefore ordinarily not deductible in the year incurred. Godfrey v. Commissioner, 335 F.2d 82, 85 (6th Cir. 1964), cert. denied 379 U.S. 966 (1965). Accordingly, unless some other provision of the IRC allows for the deduction of the expenditures relating to the rezoning change, successful or otherwise, the expenditures are capital in nature and not allowed a current deduction.

The petitioner argues that for those taxpayers engaged in [Redacted] operations the expenditures are “development expenditures” and are therefore allowed as a current deduction under IRC section 616(a). The Court in H. G. Fenton noted that:

There are, in general, three periods in the life of a mine, viz, the exploration period, the development period, and the production period. [Citations omitted]. Exploration expenditures are those “paid or incurred during the taxable year for the purpose of ascertaining the existence, location, extent, or quality of any deposit.” Sec. 617(a)(1); sec. 1.617-1(a), Income Tax Regs. Development expenditures are those paid or incurred to render the deposits thus discovered accessible to commercial production. Geoghegan & Mathis, Inc. v. Commissioner, 55 T.C. 672, 676 (1971), affd. 453 F.2d 1324 (6th Cir. 1972); S. Rept. 781 (Part 2, supp.), supra, 1951-2 C.B. at 559. Production expenditures are those paid or incurred to sustain a level of production. Production consists of all those activities purely for extraction. Sec. 1.616-2(b), Income Tax Regs.; see G.C.M. 13954, XIII-2 C.B. 66, 73 (1934). . . .

H. G. Fenton Material Co. v. Commissioner, 74 T.C. 584, 587-588 (1980).

The petitioner makes no claim with respect to treatment of the expenditures as “exploration expenditures” or “production expenditures”; however, the petitioner does claim that the expenses incurred with respect to the zoning change request are “development expenditures” under IRC section 616(a) which states:

Except as provided in subsections (b) and (d), there shall be allowed as a deduction in computing taxable income all expenditures paid or incurred during the taxable year for the development of a mine or other natural deposit (other than an oil or gas well) if paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed. This section shall not apply to expenditures for the acquisition or improvement of property of a character which is subject to the allowance for depreciation provided in section 167, but allowances for depreciation shall be considered, for purposes of this section, as expenditures.

Additionally, the petitioner points to Cushing Stone Co. Inc. v. United States, 210 Ct. Cl. 62, 535 F.2d 27 (1976), as authority for treating the rezoning expenses as a current deduction.

Cushing Stone involved an [Redacted] operation and presented the question of whether costs incurred in moving an adjacent property owner's facilities in exchange for the right to extend the operation onto the adjacent land were properly deductible as development costs. The taxpayer was faced with the alternative of tunneling under the adjacent land to reach property which it owned on the other side. The Court concluded that “In our opinion, the term 'development' expenditures is sufficiently flexible to cover the necessary costs of acquiring access, during the producing stage of a mine, to areas in which to conduct additional development activities.” Id at 36. The Court later reaffirmed its decision in Kennecott Copper Corp. v. United States, 347 F.2d 275 (Ct. Cl. 1965). On the other hand, the Sixth Circuit Court of Appeals, the United States Tax Court, and the Internal Revenue Service (IRS) refuse to follow

the result reached in the Kennecott Copper/Cushing Stone decisions, feeling that the cases were wrongly decided since the Court in those cases failed to distinguish a payment for a right of access and a payment to exploit an unimpaired right of access. See Geoghegan & Mathis, Inc. v. Commissioner, 453 F.2d 1324 (6<sup>th</sup> Cir. 1972), aff'g 55 T.C. 672 (1971), H. G. Fenton Material Co. v. Commissioner, 74 T.C. 584 (1980) and Rev. Rul. 67-35, 1967-1 C. B. 159. The IRS takes the position that IRC section 616(a) expenditures are limited to those expenditures “resulting directly from such physical mining process or activities as the driving of shafts, tunnels, galleries, and similar operations undertaken to make the ore or mineral in place accessible for production operations;” thus views the costs incurred for the right to mine as capital expenditures rather than expenditures deductible under IRC section 616(a). Rev. Rul. 67-35, 1967-1 C.B. 159.

### **3. Finding**

The Commission elects to follow the Tax Court and the IRS’s position on costs associated with a rezoning change for the right to engage in a specific activity as not being deductible under IRC section 616(a). Accordingly, the Bureau’s disallowance of the expenses connected to the rezoning change is affirmed.

WHEREFORE, the Notice of Deficiency Determination dated July 12, 2006, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following tax and interest.

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2003	\$25,942	\$4,514	\$30,456
2004	385	43	428
		TOTAL DUE	\$30,884

Interest is calculated through February 28, 2007, and will continue to accrue at the rate set forth in Idaho Code section 63-3045.

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

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_, 2006.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_, 2006, 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]

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