

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 22459
[Redacted],	)	
	)	
Petitioners.	)	DECISION
_____	)	

[Redacted] (taxpayers) protested the Notice of Deficiency Determination issued by the staff of the Idaho State Tax Commission (Commission) dated August 5, 2009, asserting additional Idaho income tax, penalty, and interest for taxable year 2004 in the total amount of \$7,591.

The only issue in this docket is whether the disposition of property by the taxpayers in taxable year 2004 qualified as a like-kind exchange pursuant to Internal Revenue Code (IRC) § 1031.

**BACKGROUND FACTS**

[Redacted] are [Redacted] residents that owned real property in [Redacted], Idaho. The taxpayers sold this property in 2004. The Commission learned of this sale and discovered that the taxpayers had not filed an Idaho income tax return for taxable year 2004. After two requests, [Redacted] called on April 29, 2009, and indicated that his tax preparer would be sending information concerning the sale of the Idaho property. On June 11, 2009, the Commission received a copy of the taxpayers' 2004 federal return. The property sale was not [Redacted]. A letter was sent requesting copies of the purchase agreement and closing statement related to the property sale. On August 5, 2009, the Commission had not received any information from the the taxpayers, so a Notice of Deficiency Determination was issued.

On September 8, 2009, a 2004 Idaho income tax return for the taxpayers was received by the Commission. The return reported the sale of the property as part of an Internal Revenue Code section 1031 exchange, but no federal Form 8824 was provided. The protest was acknowledged and a request was made for all documents relating to the property exchange.

The taxpayers sold the real property in [Redacted], Idaho, on May 26, 2004, for \$92,800. Settlement charges and taxes were paid from the proceeds; then the taxpayers walked away with \$346 cash and two promissory notes for \$51,375 and \$40,175. [Redacted] stated that he held these notes for two to three years before the notes were paid off.<sup>1</sup> The taxpayers provided a copy of a check issued by [Redacted], Inc. dated October 7, 2005, which was payable to [Redacted] for the amount of \$51,074.85. According to the taxpayers, the note was paid off to the title company who then wrote a check to the taxpayers.<sup>2</sup> It is unclear when the other note was paid off.

The taxpayers joined with another couple to purchase real property in [Redacted], Nevada, on November 2, 2004. According to the taxpayers, part of the consideration given for the Nevada property was a promissory note.<sup>3</sup> It appears from the settlement statement that this promissory note was in the amount of \$70,000. According to the taxpayers, once they received the check payment for the Idaho property note, the payment went directly to the holder of Nevada property note.<sup>4</sup>

The taxpayers stated that both the Idaho and the Nevada properties were bare ground purchased for subdividing and development of residential and commercial parcels.<sup>5</sup>

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<sup>1</sup> Telephone Hearing with Taxpayer and Taxpayers' tax preparer June 23, 2010.

<sup>2</sup> Telephone Hearing with Taxpayer and Taxpayers' tax preparer June 23, 2010.

<sup>3</sup> Telephone Hearing with Taxpayer and Taxpayers' tax preparer June 23, 2010.

<sup>4</sup> Telephone Hearing with Taxpayer and Taxpayers' tax preparer June 23, 2010.

<sup>5</sup> Telephone Hearing with Taxpayer and Taxpayers' tax preparer June 23, 2010.

In a letter to the Commission received December 28, 2009, [Redacted] stated, “We used [Redacted] [Redacted] to facilitate the 1031 exchange.” However, in the telephone hearing with the taxpayers and the taxpayers’ tax preparer on June 23, 2010, when the tax preparer was asked what he did as the facilitator of the transaction, the tax preparer replied, “What is a facilitator?” The tax preparer was then asked if he arranged the transaction or handled the transfer of the funds. The tax preparer stated that he did neither; he stated that the taxpayers received the check and it went directly to the Nevada note holder.

The taxpayers asserted that they had an adjusted basis in the Idaho property of \$32,060.<sup>6</sup> This amount is the total of four different figures asserted by the taxpayers. The four amounts asserted by the taxpayers are: Settlement Charges on Sale - \$794; Original Cost (03-04-94) - \$20,000; Improvements (Road) - \$6,666; Travel/Interest/Misc. Costs - \$4,600.

#### LAW AND ANALYSIS

No gain or loss is recognized on transactions that meet the requirements of IRC § 1031.<sup>7</sup> A 1031 like-kind exchange must be a transfer of property for property. Treasury Regulation § 1.1031(k)-1(a) provides:

In order to constitute a deferred exchange, the transaction must be an exchange (i.e., a transfer of property for property, as distinguished from a transfer of property for money). For example, a sale of property followed by a purchase of property of a like kind does not qualify for nonrecognition of gain or loss under section 1031 regardless of whether the identification and receipt requirements of section 1031(a)(3) and paragraphs (b), (c), and (d) of this section are satisfied.<sup>8</sup>

Treasury regulation § 1.1031(k)-1(a) further provides:

If the taxpayer actually or constructively receives money or property which does not meet the requirements of section 1031(a) in the full amount of the consideration for the relinquished property, the transaction will constitute a sale, and not a deferred

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<sup>6</sup> Letter from Taxpayer received July 6, 2010.

<sup>7</sup> I.R.C. § 1031(a).

<sup>8</sup> 26 C.F.R. § 1.1031(k)-1(a).

exchange, even though the taxpayer may ultimately receive like-kind replacement property.<sup>9</sup>

The facts provided by the taxpayers and their tax preparer do not establish that the taxpayers made a like-kind exchange that would qualify under IRC § 1031 for nonrecognition treatment. The facts suggest that the taxpayers' exchange was a sale of property followed by a purchase of property of like kind. The taxpayers received promissory notes as payment for the Idaho property. Later, they received payment for those Idaho notes by check payable to the order of [Redacted]. The taxpayers then used those proceeds to pay off the outstanding promissory note on the Nevada property. As stated in the federal regulations, such a transaction does not meet the requirements of IRC § 1031.

The Idaho property transaction will be treated as a sale. The gain on the sale will be the sale price of \$92,800 minus the taxpayers' adjusted basis in the property. The Commission is willing to accept the amounts that the taxpayers asserted for the purchase price, sales settlement costs, and improvements. Thus, the taxpayers adjusted basis in the Idaho property is \$27,460. However, the amounts that the taxpayers asserted should be included in the basis for "Travel/Interest/Misc. Costs" have not been substantiated to show that (1) they were actually incurred and (2) that these costs would qualify as costs to be included in the adjusted basis of the property. The gain on the sale is \$65,340.

Available information suggests also that the sale of the Idaho property qualifies for the 60 percent capital gains deduction of Idaho Code § 63-3022H.

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<sup>9</sup> Id.

CONCLUSION

WHEREFORE, the Notice of Deficiency Determination dated August 5, 2009, is hereby MODIFIED 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 (computed to February 23, 2011):

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>PENALTY</u>	<u>TOTAL</u>
2004	\$648	\$225	\$162	\$1,035

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.

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2010.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2010, 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.  
  
\_\_\_\_\_