

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)
[Redacted],) DOCKET NO. 22484
Petitioners.)
DECISION
_____)

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated October 26, 2009, asserting an additional liability for Idaho income tax, penalty, and interest in the total amount of \$16,189 for 2006.

The only issue involved in this docket is whether the petitioners are entitled to the exemption from gross income as gain from the sale of a principal residence, gain from the sale of approximately 33 acres of land that was, for a time, adjacent to their principal residence. In May 2002, the petitioners purchased a house, which became their home, and 3.683 acres. In May 2004, the petitioners bought 31.178 acres of land that was adjacent to their home. In May 2005, the petitioners sold their home and 1.5 acres of the land. In December 2006, the petitioners sold the remaining acreage, the gain from which is the subject of this docket.

The petitioners received rental income from the lease of the property at issue. They also reported income from agricultural program payments in each year. The land in question was leased to farmers for the vast majority of the time the petitioners owned the land. The land was leased to one farmer on a year-to-year (September 1 through September 1 of the following year) lease when the petitioners purchased the property. This lease apparently was the controlling document until the execution of another lease on or about March 2, 2006. The term of this lease was from March 2, 2006 through October 30, 2006.

The specific terms of the first contract include the following provision:

2. Time is of the essence of this Lease. Upon full performance of the provisions herein, LESSEE shall peacefully and quietly enjoy the Premises. (Emphasis in original.)

Aside from this specific provision of the agreement, in Idaho there is an implied covenant in every lease for quiet enjoyment of the property. McCullough v. Cuthbert, 46 Idaho 294, 267 P. 828 (1928). Thus, if a landlord substantially interferes with a tenant's use and enjoyment of the premises, he has breached this covenant. Worden v. Ordway, 105 Idaho 719, 722 (1983).

Internal Revenue Code § 121(a) stated:

Exclusion. 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. (Emphasis added.)

Treasury Regulation § 1.121-1(b)(3) addressing this situation stated, in part:

Vacant land.

(i) In general. The sale or exchange of vacant land is not a sale or exchange of the taxpayer's principal residence unless—

- (A) The vacant land is adjacent to land containing the dwelling unit of the taxpayer's principal residence;
- (B) The taxpayer owned and used the vacant land as part of the taxpayer's principal residence;
- (C) The taxpayer sells or exchanges the dwelling unit in a sale or exchange that meets 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 land in question was being used to grow agricultural crops. The land was considered for property taxation purposes, to be agricultural rather than residential. Agricultural payments were received from the government with regard to this land. When asked how the petitioners “used” the property as their “residence,” the response was that “they could look at it.” The petitioners contend that the use of the acreage was much like one uses a gardener for a large

estate. The farmer received compensation for keeping the weeds under control and keeping erosion to a minimum. The petitioners contend that they really weren't intending to be farmers or landlords, but only to keep the rural nature of the surrounding property for the benefit of their enjoyment of the residence. They further contend that if one were to consider whether they engaged in the activity for profit (pursuant to Internal Revenue Code § 183), one might find that they did not do so. The U.S. Tax Court, in considering whether a considerable acreage might qualify as the taxpayers' 'residence' stated, in part:

Petitioner's only argument is that if we should determine that he did not operate the farm as a business for a profit, then we must find that the entire Libertyville property of some 80 acres, within the exception of the buildings and acreage used for engineering purposes, must be regarded as his new residence for purposes of section 1034.

We do not agree with petitioner's either-or argument. We do not believe that petitioner's 'residence' can reasonably be said to include some 38 acres under a soil conservation contract and 27 or 28 acres of marshland and wooded area.

Beckwith v. Commissioner, T.C. Memo 1964-254.

The petitioners cite Bolaris v. Commissioner, 776 F.2d 1428 (9th Cir. 1985), affg. in part and revg. in part 81 T.C. 840 (1983) for the point that property could be rented without losing its status as a personal residence. In [Redacted], the taxpayers had fulfilled the period for owning and using the personal residence prior to renting the property prior to attempting to sell the property. In this docket, however, the period for holding the property in question while simultaneously owning the adjacent dwelling as their residence was for only approximately one year. During this entire period, the land in question was leased to another. Therefore, [Redacted] is not controlling on this point.

Rules of statutory construction require that we narrowly construe exclusions from income. Commissioner v. Schleier, 515 U.S. 323, 328. Under section 121(a) and its legislative

history, we cannot conclude on the facts of this case that the farm land was “used by the taxpayer as their principal residence.” Accordingly, we hold that the petitioners may not exclude from income under Internal Revenue Code section 121(a) the gain realized on the sale of the farmed property.

WHEREFORE, the Notice of Deficiency Determination dated October 26, 2009, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax, penalty, and interest (computed to December 31, 2010):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2006	\$12,749	\$1,275	\$2,803	\$16,827

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.
