

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

| | | |
|---------------------------------|---|------------------|
| In the Matter of the Protest of |) | |
| |) | DOCKET NO. 22896 |
| [Redacted], |) | |
| |) | |
| Petitioners. |) | DECISION |
| _____ |) | |

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued on September 22, 2009, by the auditor for the Idaho State Tax Commission (Commission) asserting an additional liability for Idaho income tax and interest in the total amount of \$3,245 for 2005.

The only issue in this docket is whether the petitioners are entitled to the Idaho capital gains deduction with regard to gains passed through to them from [Redacted] which filed its tax returns as a partnership. The petitioners claimed this deduction. The auditor disallowed the deduction and asserted the additional liability referred to above. The auditor stated that it had been determined that the income was ordinary income to [Redacted] and, therefore, was also ordinary income to the petitioners.

Idaho Code § 63-3022H sets forth the authority for the Idaho capital gains deduction. It stated, in pertinent part:

Deduction of capital gains. -- (1) If an individual taxpayer reports capital gain net income in determining taxable income, eighty percent (80%) in taxable year 2001 and sixty percent (60%) in taxable years thereafter of the capital gain net income from the sale or exchange of qualified property shall be a deduction in determining Idaho taxable income.

(2) The deduction provided in this section is limited to the amount of the capital gain net income from all property included in taxable income. Gains treated as ordinary income by the Internal Revenue Code do not qualify for the deduction allowed in this section. The deduction otherwise allowable under this section shall be reduced by the amount of any federal capital gains deduction relating to such property, but not below zero.

(3) As used in this section "qualified property" means the following property having an Idaho situs at the time of sale:

- (a) Real property held at least twelve (12) months

[Emphasis added.]

Internal Revenue Code § 1221 provides the authority for the determination of whether an asset is a capital asset. It stated, in part:

Capital asset defined. (a) In general.

For purposes of this subtitle, the term “capital asset” means property held by the taxpayer (whether or not connected with his trade or business), but does not include—

- (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

The income in question was from the sale of real property by [Redacted]. It was determined that this income in the hands of [Redacted] was ordinary income. The petitioners contend that they were simply passive investors in [Redacted] and, therefore, this income should be treated as capital gain for the purpose of determining the taxable income of the petitioners. The petitioners did not cite authority to support their position.

The auditor contends that the character of the income is to be determined at the partnership level as opposed to the partner level. The Ninth Circuit Court of Appeals has addressed an argument much like the one at issue as follows:

She contends, first of all, that the ‘intent’ of the partners engaged in indirect development activities through [Redacted] ought not to be attributed to her. For her, she argues, the [Redacted] venture was merely an ‘investment.’ This latter assertion may, of course, be true. But it is the intent of the partnership, and not of any individual partner, that is in issue according to the Internal Revenue Code. Under the written partnership agreement, to which petitioner Lowthian was a party signatory, the business policy of [Redacted] was to be determined by the general partners, Berger and Freeland; Lowthian, as a limited partner, thus agreed that she should have no hand in determining that purpose. The case of United States v. Rosebrook, 318 F.2d 316 (9th Cir. 1963), aff’g 191 F.Supp. 356 (N.D.Cal.1960), cited by petitioner, is inapposite. There, the taxpayer sold a one per cent interest in land which had originally been purchased by her father in the name of a trust having her as beneficiary. Although the interest had been committed to a joint venture, it was directly owned by the taxpayer, who was a

tenant in common; under section 1221 of the Code, therefore- and especially since she had succeeded involuntarily to ownership of the land and participation in the joint venture- the court looked to her purpose rather than to that of other participants in the venture, and ruled that she had held the land as an investment. Here, both essential elements of the factual situation in Rosebrook - direct ownership and involuntary participation in the joint scheme - are absent. Petitioner's tax liability is clearly governed by the purpose of the partnership.

Freeland v. Commissioner, 393 F.2d 573, 584 (9th Circuit 1968).

The petitioners have not shown that the characterization of the income in question should be determined at the partner level rather than at the partnership level given the facts of this case.

WHEREFORE, the Notice of Deficiency Determination dated September 22, 2009, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax and interest (computed to January 15, 2011):

| <u>YEAR</u> | <u>TAX</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|------------|-----------------|--------------|
| 2005 | \$2,643 | \$752 | \$3,395 |

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.
