BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 23216
[Redacted],	)	
	)	
Petitioners.	)	DECISION
	)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated June 7, 2010, asserting additional liabilities for Idaho income tax and interest in the total amount of $9,792 for 2007.

The petitioners held an interest in a limited partnership. Interest in the amount of $29,835 and Internal Revenue Code (IRC) § 1231 gains in the amount of $81,203 were reported to the petitioners on a K-1 issued to them by the partnership for 2007. The petitioners did not include either the interest income or the IRC § 1231 gains in the computation of their Idaho taxable income. The auditor for the Commission included in the computation of the petitioners' income the interest income and IRC § 1231 gains.

Given the record before us, the Commission must necessarily speculate as to some of the relevant facts. It appears that both the interest income and the IRC § 1231 gains were produced by an installment sale of real property by the partnership to related parties in 1999. The sale was reported on the installment basis by the partnership. Apparently, the remaining balance from the installment sale was paid to the partnership in December 2007, thereby producing the interest income and gains. The K-1 issued to the petitioners by the partnership further indicated that there had been a distribution to the petitioners by the partnership in the amount of $150,975. Apparently, the petitioners had their portion of the distribution paid to a third party which, in

turn, loaned the funds to an unrelated third-party with the listed creditor being the petitioners (as opposed to the partnership).

The petitioners submitted with their 2007 Idaho and federal income tax returns a Form 8824 representing that they had participated in an exchange pursuant to IRC § 1031. It appears that the property given up (by the partnership) was the petitioners' portion of the payoff of the indebtedness related to the 1999 installment sale of the real property. It further appears that the property acquired (by the petitioners) in 2008 was a debt from a different debtor with different terms and different security than the one given up (by the partnership).

After the beginning of this administrative appeal, an amended return was filed for both the partnership and the petitioners. These amended returns reflected that the petitioners' portion of the interest income somehow ceased to exist and that the bulk of the distribution to the petitioners was eliminated. How this is reconcilable with the purported replacement debt appearing with the petitioners being the creditors as opposed to the partnership is far from clear.

The petitioners object to the taxation of the gain triggered by the payoff of the installment sale. They currently concede that they did not comply with the requirements of IRC § 1031. They argue instead that the payoff of the installment sale to the partnership should not trigger taxation of the balance.

There are shortcomings in the attempt by the petitioners in their effort to qualify for like-kind exchange treatment. First, as best as can be determined from the information in the file, neither the partnership nor the petitioners completed an exchange since one party (the partnership) gave up property and another party (the petitioners) received property. Chase v. Commissioner, 92 T.C. 874 (1989).

Second, evidences of indebtedness are specifically precluded from qualifying for treatment pursuant to IRC § 1031. IRC § 1031(a))2) stated, in pertinent part:

> Exception. This subsection shall not apply to any exchange of –
> (A) stock in trade or other property held primarily for sale,
> (B) stocks, bond, or notes,
> (C) other securities or evidences of indebtedness or interest,

Accordingly, the Commission finds that the petitioners did not successfully complete a like-kind exchange pursuant to Internal Revenue Code § 1031 as reported on their income tax return.

The petitioners argue that they should not be required to report the income since their transaction giving up one debt and acquiring another debt did not disturb the initial sale and it should be treated as a continuation of their receiving the income from the initial (1999) installment sale. They cite as authority for this position Revenue Rulings 74-157 and 55-5 and Private Letter Ruling 8848054.

Revenue Ruling 74-157 dealt with a taxpayer that sold property on the installment basis and subsequently gave up the note receivable, simultaneously receiving in its place, two notes receivable totaling the same amount with the same terms and security as the note given up. This change was due to the buyer wishing to subdivide the property. The ruling was that this did not require the reporting of the receipt of the remaining balance for tax purposes.

Revenue Ruling 55-5 also involved a seller of real property on the installment basis. A mortgage contract was simultaneously substituted for the land contract containing the same terms and conditions for payment of the balance due as set forth in the land contract. The security for the debt remained unchanged. The ruling was that the remaining balance was not required to be currently taxed due to this change in the form of the debt.

Private Letter Ruling 8848054 also involved a seller of real estate on the installment method. At some time after the sale, the purchaser, under threat of condemnation, sold the property to the government. The buyer and seller arranged for a simultaneous change of the security for the note to be transferred from the property sold pursuant to a threat of condemnation to another parcel of real estate. The ruling was that this did not trigger the reporting of the remaining gain.

The Commission finds that the authorities cited by the petitioners are easily distinguishable from the Commission's understanding of the facts at hand. First, all of the authorities cited by the petitioners involved a simultaneous exchange of the security. In this case, it appears that it was not a simultaneous exchange.

In the authorities cited by the petitioners, the creditor did not change. In this case, the partnership gave up property and the petitioners acquired the replacement property. Neither the partnership nor the petitioners completed an exchange.

Further, the petitioners have cited no authority for the premise that interest income of a partnership in which they held an interest doesn't have to be reported if the partnership enters into some kind of exchange.

The petitioners wish to exempt the interest income and IRC § 1231 gains from the computation of their taxable income. The taxpayer must have specific authority to support a claim for an exemption. The Second Circuit Court of Appeals addressed the matter, in part, as follows:

> The Supreme Court has consistently given this definition of gross income a liberal construction "in recognition of the intention of Congress to tax all gains except those specifically exempted. " Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 430, 75 S. Ct. 473, 476, 99 L.Ed. 483 (1955) (emphasis added); see also United States v. Stewart, 311 U.S. 60, 71, 61 S. Ct. 102, 109, 85 L.Ed. 40 (1940) ("those who seek an exemption from a tax must rest it on more than a doubt or

> ambiguity"); United States Trust Co. v. Helvering, 307 U.S. 57, 60, 59 S. Ct. 692, 693, 83 L.Ed. 1104 (1939) ("Exemptions from taxation do not rest upon implication."); Bank of Commerce v. Tennessee ex rel. Memphis, 163 U.S. 416, 423, 16 S. Ct. 1113, 1116, 41 L.Ed. 211 (1896) ("[T]he claim for exemption must rest upon language in regard to which there can be no doubt as to its meaning, and ... the exemption must be granted in terms too plain to be mistaken...."). The mere fact that Congress specifically included certain payments as "income" does not mean that all other payments not specifically included are therefore not "income". Rather, Herbert's separation allowance is taxable as gross income unless Congress has enacted a specific exemption evidencing "clear congressional intent" to the contrary. Glenshaw, 348 U.S. at 431, 75 S. Ct. at 477.

Herbert v. United States, 850 F.2d 32, 34 (CA2 1988).

The Commission finds that the petitioners have failed to carry their burden of proof that they were not required to report the interest income and IRC § 1231 gains.

The petitioners also contend that, should it be found that the income in question must be reported, they should be allowed the Idaho capital gains deduction with regard to the gains. The Commission finds that the Idaho capital gains deduction should be allowed as to the reportable gains, but not with respect to the interest income.

THEREFORE, the Notice of Deficiency Determination dated June 7, 2010, is hereby MODIFIED, and as so modified is APPROVED, AFFIRMED, and MADE FINAL.

The petitioners have paid the deficiency. Therefore, no further demand is made.

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

DATED this _____ day of _____ 2011.

IDAHO STATE TAX COMMISSION

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COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2011, 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.

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