

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 23300 & 23301
[Redacted]	)	
Petitioners.	)	
	)	DECISION
	)	
	)	
_____	)	

[Redacted] ([Redacted]) protests the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated June 16, 2010, adjusting the attributes of the petitioner's income. Since this petitioner is an S corporation, there was no additional liability asserted as the attributes flow through to the shareholder or shareholders. [Redacted] protests the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated June 16, 2010, asserting additional tax, penalty, and interest in the total amount of \$39,735 for 2007.

[Redacted] was the sole shareholder of [Redacted], which operated a [Redacted]. The land upon which the facility operated was owned by and leased from the government. All adjustments to Mr. [Redacted] liability are due to the changes made with regard to [Redacted]. [Redacted] sold their interest in the [Redacted] to an unrelated party in 2007. The questions to be resolved all have to do with the implications of that sale.

There was a substantial gain from the sale. The sales price was attributed to the various assets, and the gains were computed. All of the questions to be resolved involve whether the respective gains from the dispositions of the assets qualify for the Idaho capital gains deduction. The questions are primarily whether the various assets should be classified as real property. If the gains are from the disposition of real property, the gains qualify for the Idaho capital gains

deduction. If they are not from the sale of real property, as is further discussed below, the gains do not qualify for said deduction.

Idaho Code § 63-3022H sets out the authority for the Idaho capital gains deduction. It stated [2007], in 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;
- (b) Tangible personal property used in Idaho for at least twelve (12) months by a revenue-producing enterprise;

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(7) As used in this section “revenue-producing enterprise” means:

- (a) The production, assembly, fabrication, manufacture, or processing of any agricultural, mineral or manufactured product;
- (b) The storage, warehousing, distribution, or sale at wholesale of any products of agriculture, mining or manufacturing;
- (c) The feeding of livestock at a feedlot;
- (d) The operation of laboratories or other facilities for scientific, agricultural, animal husbandry, or industrial research, development, or testing.

As was stated above, given the facts of this docket, if the gains are not from the disposition of real property, they do not qualify for the Idaho capital gains deduction. This is due to the activity not qualifying as a “revenue producing enterprise” as defined in Idaho Code § 63-3022H(7). Therefore, the main issue in this decision is the determination of which assets qualify as real property.

One of the assets sold was characterized as “contractual rights.” The sales price was shown to be \$320,000 with a zero basis, therefore reflecting a gain of \$320,000. The Commission finds that this gain clearly does not qualify as “qualified property” as defined in Idaho Code § 63-3022H.

Most of the assets acquired were depreciated using a method not allowable for the depreciation of Internal Revenue Code (IRC) § 1250 property . Upon sale, however, the petitioner wishes the property to be deemed to have been real (IRC § 1250) property. All of the assets in question were given a depreciable life of 5, 7, or 10 years. For each asset, one of the accelerated methods of depreciation was used while, until 2004, such was not available for IRC § 1250 property.

The effect of the methods employed is to convert income from ordinary income to capital gain income. This would be beneficial both for federal income tax purposes as well as for Idaho income tax purposes in the case of the disposition of assets which were qualifying property for the Idaho capital gains deduction. For federal purposes, the deduction would be against ordinary income, and the gain would be taxed at a reduced rate. The petitioner received no billings from the county for real property taxes on any of the assets here in question.

For most of the assets here in question, the petitioner depreciated the property as if it were IRC § 1245 property. As has been stated, this provided the petitioner with greater deductions in the first years of owning the assets. However, if when IRC §1245 property is sold, the recapture of depreciation is far less beneficial than would be recapture of the depreciation of IRC § 1250 property. If the property is IRC § 1250 property depreciated over the appropriate life, only the amount above straight-line is recaptured. However, if the recapture is from the disposition of IRC § 1245 property, the gain is fully taxable as ordinary income to the extent of all of the

depreciation taken. Also, since the income is classified as ordinary income, it does not qualify for the Idaho capital gains deduction.

The method used would seem to be the optimum method; depreciate the property pursuant to IRC § 1245 getting the more rapid deduction and possibly have it qualify for the Idaho investment credit, then classify the gain as having been from the disposition of IRC § 1250 property when it is sold reducing the amount of ordinary income and qualifying the gain for the Idaho capital gains deduction. However, it doesn't appear that the courts necessarily allow such fickle treatment. A duty of consistency applies when: (1) The taxpayer made a representation or reported an item for income tax purposes in one year, (2) the Commissioner acquiesced in or relied on that representation or report for that year, and (3) the taxpayer attempts to change that representation or report in a subsequent year, after the period of limitations has expired with respect to the year of the representation or report, and the change is detrimental to the Commissioner. LeFever v. Commissioner, 103 T.C. 525, 543 (1994), affd. 100 F.3d 778 (10th Cir.1996); *see also* Herrington v. Commissioner, 854 F.2d 755 (5th Cir.1988), affg. Glass v. Commissioner, 87 T.C. 1087 (1986) at 758. When these requirements are met, the Commissioner may treat the previous representation by the taxpayer as true, although, in fact, it is not. Herrington v. Commissioner, 854 F.2d 755, 758.

The Ninth Circuit Court of Appeals addressed the matter, in part, as follows:

When all is said and done, we are of the opinion that the duty of consistency not only reflects basic fairness, but also shows a proper regard for the administration of justice and the dignity of the law. The law should not be such . . . that it cannot prevent a taxpayer from changing the historical facts from year to year in order to escape a fair share of the burdens of maintaining our government. Our tax system depends upon self assessment and honesty, rather than upon hiding of the pea or forgetful tergiversation.

Estate of Ashman v. Comm'r, 231 F.3d 541, 544 (9th Cir. 2000) (footnote omitted).

Ashman laid out the following elements for application of the duty of consistency:

(1) A representation or report by the taxpayer; (2) on which the Commission [er] has relied; and (3) an attempt by the taxpayer after the statute of limitations has run to change the previous representation or to recharacterize the situation in such a way as to harm the Commissioner. If this test is met, the Commissioner may act as if the previous representation, on which he relied, continued to be true, even if it is not. The taxpayer is estopped to assert the contrary.

Janis v. Commissioner, 461 F.3d 1080, 1085 (9th Cir. 2006).

The Commission finds that the required elements are present in the immediate case and that the “duty of consistency” (or “doctrine of consistency”) requires that, for the property depreciated by the petitioner as IRC § 1245 property or that was otherwise treated as having been IRC § 1245 property, the recapture of depreciation must also be treated as having been from the disposition of IRC § 1245 property aside from any other consideration. Therefore, property depreciated by the petitioner pursuant to a class life prescribed only for IRC § 1245 property shall be treated as having been IRC § 1245 at the time of sale regardless of other considerations.

THEREFORE, the Notices of Deficiency Determination dated June 16, 2010, are hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner, [Redacted], pay the following tax, penalty, and interest (computed to February 29, 2012):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2007	\$32,269	\$3,227	\$6,334	\$41,830

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 \_\_\_\_\_ 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.

Receipt No.

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