

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 23340
[Redacted],)	
)	
Petitioners.)	DECISION
_____)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated June 29, 2010, asserting an additional liability for Idaho income tax, penalty, and interest in the total amount of \$16,574 for 2006.

The only issue involved in this docket is whether the petitioners are entitled to exempt from gross income a portion of the gain from the sale of real property due to a portion of the gain having been from the sale of a principal residence and, if so, what portion of the gain.

In 1979, the petitioners purchased the property which included a home, a barn, an implement shed, a well, and approximately 42 acres for \$150,000. The petitioners lived in the home continuously until the sale of the property in 2006. They used the land for raising livestock, filing Schedules F (Profit or Loss from Farming) in their income tax returns. The petitioners' accountant stated that, "for depreciation purposes, a value of \$5,700 was placed on the barn, \$6,000 on the implement shed, and \$1,000 on the well. There was no other allocation of basis between the home and the land because no depreciation was allowable on the land or the residence."

In 2006, the petitioners sold for \$905,000 approximately 22.61 acres of land on which their home and the other improvements were located.

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. (Emphasis added.)

To be able to determine the gain from the sale of the residence, several problems need to be overcome. We find the problems needing solutions to be as follows:

1. What was the basis properly attributable to the residence at the time of purchase?
2. What portion of the sales price should be attributed to the residence?

The petitioners contend that they are entitled to the entire \$500,000 exclusion. Their contention is apparently that the entire property involved, including the land and buildings used in farming, should properly be considered to be a part of their "residence." They rely on Treasury Regulation § 1.121-1(e)(3) which stated:

Method of allocation. For purposes of determining the amount of gain allocable to the residential and non-residential portions of the property, the taxpayer must allocate the basis and the amount realized between the residential and the non-residential portions of the property using the same method of allocation that the taxpayer used to determine depreciation adjustments (as defined in section 1250(b)(3)), if applicable.

Internal Revenue Code § 1250(b)(3) stated:

Depreciation adjustments.

The term “depreciation adjustments” means, in respect of any property, all adjustments attributable to periods after December 31, 1963, reflected in the adjusted basis of such property on account of deductions (whether in respect of the same or other property) allowed or allowable to the taxpayer or to any other person for exhaustion, wear and tear, obsolescence, or amortization (other than amortization under section 168 (as in effect before its repeal by the Tax Reform Act of 1976), 169 , 185 (as in effect before its repeal by the Tax Reform Act of 1986), 188 (as in effect before its repeal by the Revenue Reconciliation Act of 1990), 190 , or 193). For purposes of the preceding sentence, if the taxpayer can establish by adequate records or other sufficient evidence that the amount allowed as a deduction for any period was less than the amount allowable, the amount taken into account for such period shall be the amount allowed.

The allocation in question is the portion of the sales price attributable to the residence (which was not depreciable), land (which was not depreciable) and to some outbuildings (which presumably were depreciable). Internal Revenue Code § 1250(b)(3) deals with depreciation adjustments and is, therefore, not applicable to the attribution of the sales price to the nondepreciable assets such as the personal residence.

The petitioners contend that, since they determined that 23 percent of the value of the purchase of the realty sold in the transaction here in question and an adjacent parcel was 23 percent of the purchase price in 1979, that 23 percent of the sales price of the two parcels must be attributed to the sale of the residence regardless of the fair market value of the residence at the time of the sale.

The courts have addressed the allocation of the sales price, among various assets, as follows:

Moreover, it is now well settled that the Commissioner is not bound to accept an artificial and unrealistic allocation of a lump-sum purchase price made by the seller and purchaser; rather, the Commissioner may in such circumstances make an independent allocation of his own, assigning portions of the aggregate purchase price to individual assets or groups of assets *in accordance with their*

relative values and in accordance with the realities of the transaction. Kunz v. Commissioner, 333 F.2d 556 (C.A. 6), affirming a Memorandum Opinion of this Court; Copperhead Coal Co. v. Commissioner, 272 F.2d 45 (C.A.6), affirming a Memorandum Opinion of this Court; Hamlin's Trust v. Commissioner, 209 F.2d 761 (C.A. 10), affirming 19 T.C. 718; Sidney v. LeVine, 24 T.C. 147; C. D. Johnson Lumber Corp., 12 T.C. 348. See also Income Tax Regs., sec. 1-61-6 and sec. 1.167(a)-5. (Italics added.)

F. & D. Rentals, Inc. v. Commissioner, 44 T.C. 335, 345 (1965).

Allocation of the sales prices of various assets in a sale are to be based upon evidence as to the fair market value of each at the time of the sale. Bryant Heater Company v. Commissioner, 231 F.2d 938, 940 (6th Cir. 1956).

The information in the file indicates that there were between 2 and 3 acres considered by the county assessor to be “wasteland.” The petitioner appears to contend that any of the property not devoted to agricultural purposes are automatically considered to have been used as a residence. The Commission does not accept this premise. Treasury Regulation § 1.121-1(b)(3) sets forth requirements regarding the gain from the sale or exchange of vacant land as being excludable as having been from the sale of a principal residence. The regulation states, 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;

From the information in the file, the Commission cannot determine if the land in question was adjacent to the petitioners’ residence. We understand that it was near the residence, but we do not know if it was “adjacent” as required.

The Commission also finds that there is insufficient information in the file to allow for a determination of whether the property was “used” as a residence. What was done with the property, if anything, has not been presented.

Rules of statutory construction require that the Commission narrowly construe exclusions from income. Commissioner v. Schleier, 515 U.S. 323, 328. Under IRC § 121(a) and its legislative history, we cannot conclude, on the information in the file, that the farm land was “used by the taxpayer as their principal residence.” In such matters, the taxpayer bears the burden of proof. In this case, the petitioner has failed to prove that the land was adjacent to the residence or “used” as the petitioners’ residence. Further, the Commission finds that the petitioners have failed to offer evidence of the fair market value of the residence at the time of the sale. Accordingly, the Commission holds that the petitioners may not exclude from income under IRC § 121(a), the amount of gain they claimed from the sale of the property in question.

It appears that the best information in the file concerning the fair market value of the residence and the one acre upon which it was located had a fair market value of \$84,300. This information was from the [Redacted] County Assessor’s office. The auditor attributed \$25,000 of the (1979) purchase price to the residence. We find no contrary compelling information in the file. Therefore, the Commission finds that the petitioners’ basis in the residence was \$25,000 and that \$525 of the selling expense was attributable to the sale of the residence. Accordingly, the Commission finds that the excludable gain from the sale or exchange is \$58,875.

WHEREFORE, the Notice of Deficiency Determination dated June 29, 2010, is hereby MODIFIED, and AS SO MODIFIED, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax and interest (computed to May 31, 2011):

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2006	\$12,321	\$2,913	\$15,234

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

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.