

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 23570
[Redacted],	)	
	)	
Petitioners.	)	DECISION
_____	)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated November 1, 2010, asserting additional liabilities for Idaho income tax, penalty, and interest in the total amount of \$16,658 for 2008.

Mr. [Redacted] held an interest in [Redacted], a general partnership<sup>1</sup> (partnership). The partnership was owned by some, not all, of the partners in [Redacted]. In 2008, [Redacted] purchased Mr. [Redacted] interest in the partnership producing a substantial gain for the petitioners. They reported this gain and claimed the Idaho capital gains deduction with regard to this gain. The auditor disallowed the capital gains deduction. Whether this deduction should be allowed is the sole issue to be decided for this docket.

The auditor, in denying the Idaho capital gains deduction, stated that the partnership interest sold was not qualified property pursuant to Idaho Code § 63-3022H(3). Idaho Code § 63-3022H stated:

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.

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<sup>1</sup> The petitioners contend that the entity was not a partnership, but a joint venture. However, the agreement for the relationship is entitled "GENERAL PARTNERSHIP AGREEMENT." The SETTLEMENT AGREEMENT through which Mr. [Redacted] interest was redeemed stated that the entity was "an Idaho partnership." The [Redacted]. The Commission finds that the entity was a general partnership.

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;
- (c) Cattle or horses held for breeding, draft, dairy or sporting purposes for at least twenty-four (24) months if more than one-half (1/2) of the taxpayer’s gross income (as defined in section 61(a) of the Internal Revenue Code) for the taxable year is from farming or ranching operations in Idaho;
- (d) Breeding livestock other than cattle or horses held at least twelve (12) months if more than one-half (1/2) of the taxpayer’s gross income (as defined in section 61(a) of the Internal Revenue Code) for the taxable year is from farming or ranching operations in Idaho;
- (e) Timber grown in Idaho and held at least twenty-four (24) months;
- (f) In determining the period for which property subject to this section has been held by a taxpayer, the provisions of section 1223 of the Internal Revenue Code shall apply, except that the holding period shall not include the holding period of property given up in an exchange, when such property would not have constituted qualified property under this section without regard to meeting the holding period.

(4) If an individual reports a capital gain from qualified property from an S corporation or a partnership, a deduction shall be allowed under this section only to the extent the individual held his interest in the income of the S corporation or the partnership for the time required by subsection (3) of this section for the property sold.

(5) If an individual reports a capital gain from an estate or a capital gain from property acquired as a beneficiary of an estate, no deduction shall be allowed under this section unless the holding period required in subsection (3) of this section was satisfied by the decedent, the estate, or the beneficiary, or a combination thereof.

(6) If an individual reports a capital gain from a trust or a capital gain from property acquired as a beneficiary of a trust, no deduction shall be allowed under this section unless the holding period required in subsection (3) of this section was satisfied by the grantor, the trust, or the beneficiary, or a combination thereof.

(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.

The petitioners contend that they sold real property rather than a partnership interest.

They were asked to address Idaho Code § 53-3-501 which stated:

Partner not co-owner of partnership property. – A partner is not a co-owner of partnership property and has no interest in partnership property which can be transferred, either voluntarily or involuntarily.

Idaho Code § 53-3-502 stated:

Partner's transferable interest in partnership. – The only transferable interest of a partner in the partnership is the partner's share of the profits and losses of the partnership and the partner's right to receive distributions. The interest is personal property.

The petitioners argue that the partnership was terminated, the property distributed, and therefore, the asset sold was an undivided interest in the real property, not a partnership interest.

They cite Idaho Code § 53-3-503 which stated, in part:

Transfer of partner's transferable interest. (a) A transfer, in whole or in part, of a partner's transferable interest in the partnership:

- (1) Is permissible;
- (2) Does not by itself cause the partner's dissociation or a dissolution and winding up of the partnership business;

The petitioners stated:

The next section, § 53-3-303(a)(2) [sic] points out that a transfer does not, **by itself**, work a dissolution of the partnership. The logical corollary of that section is that a transfer **may** work such a dissolution. And if the partnership is dissolved, then the sale is not of a general intangible, but a “hard” asset – the share of the building itself. (emphasis in original.)

The petitioners further stated:

The Agreement itself also leads to the same conclusion, unlike that in the prior cases. Article XII of the Partnership Agreement provides that the partnership may be dissolved at any time by, among other things, the withdrawal of any of the partners. If that occurs, “the partners shall proceed with reasonable promptness to liquidate the business of the partnership.” (Underlining added.)

The petitioners have set out some interesting discussion of what might have happened. However, what we don't have is any evidence either that an undivided interest in the real property was conveyed to the petitioners or that the partnership was dissolved. We have nothing in the record indicating that the petitioners sold any qualifying property. In the Settlement

Agreement through which the petitioners were paid by [Redacted] for their interest stated that the payment was, “for [Redacted] partnership interest in [Redacted]. . .” The agreement does not state that any interest in the real property was conveyed. Even if real property was conveyed, it would appear that the holding period would not have been met.

The question before us does not need to reflect how the transaction could have been structured. It must reflect the transaction as it, in fact, came to pass. In addressing such a situation, the U.S. Supreme Court stated, in part:

This Court has observed repeatedly that, while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, Higgins v. Smith, 308 U.S. 473, 477, 60 S.Ct. 355, 357, 84 L.Ed. 406 (1940); Old Mission Portland Cement Co. v. Helvering, 293 U.S. 289, 293, 55 S.Ct. 158, 160, 79 L.Ed. 367 (1934); Gregory v. Helvering, 293 U.S. 465, 469, 55 S.Ct. 266, 267, 79 L.Ed. 596 (1935), and may not enjoy the benefit of some other route he might have chosen to follow but did not. 'To make the taxability of the transaction depend upon the determination whether there existed an alternative form which the statute did not tax would create burden and uncertainty.' Founders General Corp. v. Hoey, 300 U.S. 268, 275, 57 S.Ct. 457, 460, 81 L.Ed. 639 (1937); Television Industries, Inc. v. Commissioner of Internal Revenue, 284 F.2d 322, 325 (C.A.2 1960); Interlochen Co. v. Commissioner of Internal Revenue, 232 F.2d 873, 877 (C.A.4 1956). See Gray v. Powell, 314 U.S. 402, 414, 62 S.Ct. 326, 333, 86 L.Ed. 301 (1941).

Commissioner v. National Alfalfa Dehydrating and Milling Company, 417 U.S. 134, 149 (1974).

The Commission finds that the asset conveyed is the partnership interest as clearly stated in the Settlement Agreement and, accordingly, the gain here in question does not qualify for the Idaho capital gains deduction as determined by the auditor.

THEREFORE, the Notice of Deficiency Determination dated November 1, 2010, 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 March 15, 2012):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
2008	\$14,046	\$1,405	\$1,878	\$17,329

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.