

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 23619
[Redacted],	)	
	)	
Petitioner.	)	DECISION
_____	)	

[Redacted] (petitioner) protests the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated April 14, 2010, asserting no additional liability for 2006 since the attributes flowed through to the members of the LLC.

The petitioner built one spec home. The gain from the sale of this home was reported as long-term capital gain. The auditor determined that the income should have been reported as ordinary income. Ultimately at issue in this matter is whether the partners are entitled to the Idaho capital gains deduction with regard to the gain produced by the sale of the property. The petitioner also contends that the basis of the property sold was understated.

Internal Revenue Code (IRC) § 1221 states, 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 purpose of the section 1221(1) exclusion is to “differentiate between gain derived from the everyday operations of a business and gain derived from assets that have appreciated in value over a substantial period of time.” McManus v. Commissioner, 65 t.c. 197, 212 (1975). affd. 583 F.2d 443 (9th Cir. 1978) citing Malat v. Riddle, 383 U.S. 569, 572, 86 S.Ct. 1030 (1966).

Speaking generally of the issue at hand, the Fifth Circuit Court of Appeals stated, in part:

“ If a client asks you in any but an extreme case whether, in your opinion, his sale will result in capital gain, your answer should probably be, ‘I don't know, and no one else in town can tell you.’ ” FN1

FN1. Comment, Capital Gains: Dealer and Investor Problems, 35 Taxes 804, 806 (1957) quoted in 3B Mertens, Law of Federal Income Taxation § 22.138 n. 69 (Zimet & Weiss rev. 1958); Biedenharn Realty Co. v. United States, 509 F.2d 171, 175 (5th Cir.1975), rev'd en banc, 526 F.2d 409 (5th Cir.), cert. denied, 429 U.S. 819, 97 S.Ct. 64, 50 L.Ed.2d 79 (1976); Thompson v. Commissioner, 322 F.2d 122, 123 n. 2 (5th Cir.1963); Cole v. Usry, 294 F.2d 426, 427 n. 3 (5th Cir.1961).

Sadly, the above wry comment on federal taxation of real estate transfers has, in the twenty-five years or so since it was penned, passed from the status of half-serious aside to that of hackneyed truism. Hackneyed or not, it is the primary attribute of truisms to be true, and this one is: in that field of the law—real property tenure—where the stability of rule and precedent has been exalted above all others, it seems ironic that one of its attributes, the tax incident upon disposition of such property, should be one of the most uncertain in the entire field of litigation.

Byram v. United States, 705 F.2d 1418, 1419 (5<sup>th</sup> Cir. 1983).

The construction and sale of the house in question was the only business of the petitioner. The sale of the house was characterized on the income tax return as “[Redacted].” There is no indication in the file of any intent on the part of the petitioner other than to build a home on the property with the specific intent to sell it.

Different courts have used different criteria to try to facilitate determining the nature of the income in question in such cases. The Fifth Circuit Court of Appeals addressed the factors, in part, as follows:

The tendency to overemphasize the independent meaning of the “factors” has been accompanied by, perhaps even caused by, a tendency to view the statutory language as posing only one question: whether the property was held by the taxpayer “primarily for sale to customers in the ordinary course of his trade or business.” This determination was correctly seen as equivalent to the question whether the gain was to be treated as ordinary or capital. However, probably because the question “is the gain ordinary” is a single question which demands an

answer of yes or no, the courts have on occasion lost sight of the fact that the statutory language requires the court to make not one determination, but several separate determinations. In statutory construction cases, our most important task is to ask the proper questions. In the context of cases like the one before us, the principal inquiries demanded by the statute are:

- 1) was taxpayer engaged in a trade or business, and, if so, what business?
- 2) was taxpayer holding the property primarily for sale in that business?
- 3) were the sales contemplated by taxpayer “ordinary” in the course of that business?

Suburban Realty Company v. United States, 615 F.2d 171, 178 (5<sup>th</sup> Cir. 1980).

Facts similar to those found in this docket are involved in Petit v. Commissioner, T. C. Memo 1997-438. In that case, the taxpayer had only one construction project. The taxpayer incurred a loss on the sale of the property. The Internal Revenue Service argued that the loss was a capital loss, and the taxpayer argued that the loss was an ordinary loss. The court found that the loss was an ordinary loss. The Court stated, in part, “[w]e find that the controlling factor in this case is the extent to which petitioner developed the . . . property.”

The petitioner contends that the gain from the sale should be determined to have been long-term capital gain. The petitioner cited no authority to support its position.

The Commission finds that the petitioner was in the business of buying, improving, and selling the real property, and that the property was held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Accordingly, the auditor’s position on this issue is affirmed.

The petitioner stated that the basis of the property had been understated. The petitioner was invited to submit its computation of the higher basis. No such computation was received. Accordingly, the Commission has no reasonable basis upon which to depart from the basis reported on the petitioner’s income tax return.

WHEREFORE, the Notice of Deficiency Determination dated April 14, 2010, is hereby APPROVED, AFFIRMED, and MADE FINAL.

An explanation of the petitioner's 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.  
  
\_\_\_\_\_