

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

| | | |
|---------------------------------|---|------------------|
| In the Matter of the Protest of |) | |
| |) | DOCKET NO. 24237 |
| [Redacted] |) | |
| |) | |
| Petitioner. |) | DECISION |
| _____ |) | |

On April 28, 2011, the Income Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to [Redacted] (taxpayer) for taxable year 2008. No tax was assessed at the entity level but will instead be assessed at the member level. On June 30, 2011, the taxpayer filed a timely protest and petition for redetermination. An informal hearing was held October 25, 2011. Present at the hearing were [Redacted], CPA, representative for the taxpayer, Commissioner [Redacted], and Tax Policy Specialist [Redacted]. The Commission, having reviewed the file, hereby issues its decision based on the information in the file.

BACKGROUND

In 2005, [Redacted], an Idaho limited liability company, was formed with the intent to purchase and develop real estate into residential lots. In March 2006, the taxpayer purchased six parcels of land totaling 179 acres in [Redacted], Idaho, for approximately ten million dollars. Subsequently, the taxpayer paid and capitalized over two million dollars of development costs and interest expense consistent with Internal Revenue Code section 263A(a)(1). In late 2007, the taxpayer lost financing and was unable to secure other financing or additional investors. The taxpayer stopped making payments on the property in November 2007 but continued trying to develop the property until September 2008. In 2008, the primary lienholder began foreclosure proceedings on the note. The taxpayer tried to prolong this action while trying to gain additional

interest from outside investors/buyers. An offer to purchase the property was received in 2008 but was rejected by the lienholder. The lienholder continued with their action and filed a lawsuit in December 2008, against the taxpayer and all guarantors. According to documents provided by the taxpayer, the lienholder went into receivership with the FDIC near the end of 2008 and the loan was transferred to another financial institution. Another offer to purchase the property was received in July 2009, and was rejected by the lienholder. To date, no foreclosure documents have been filed. The taxpayer has continued to pay property and irrigation taxes on the land for 2009 and 2010 and has continued to hold it for sale.

ISSUE

The taxpayer filed a 2008 Idaho income tax return claiming an abandonment loss of \$4,697,780 on real property purchased in 2006. The abandonment loss was denied by the auditor on the grounds that there was neither a completed transaction nor an identifiable event allowing the loss. The taxpayer appealed the auditor's denial of the abandonment loss deduction. They claimed that due to the downturn in the market, lack of financing, and imminent loss of the property, it was abandoned for its' originally intended use.

LAW

Federal Treasury Regulation 1.165-2(a) states that a loss deduction is allowed for loss of usefulness or for obsolescence of nondepreciable property, both tangible and intangible (e.g., land, a contract), if:

- (1) the loss is incurred in business or a transaction entered into for profit;
 - (2) it arises from the sudden termination of usefulness in the business or transaction;
- AND
- (3) the property is permanently discarded from use, or the business or transaction is discontinued.

According to Federal Treasury Regulation 1.165-1(b), to be deductible, a loss must be evidenced by a closed and completed transaction fixed by identifiable events such as a sale, exchange, foreclosure, stock redemption, casualty, theft, abandonment, governmental condemnation, or seizure. Mere fluctuations in an asset's value don't result in deductible losses.

FINDINGS

In the protest, the taxpayer's representative cited Echols v. Commissioner and Rhodes v. Commissioner in support of their position. Upon analysis of these cases, the conclusions drawn by the taxpayer's representative are flawed. Echols v. Commissioner, 69 AFTR 2d 92-433 (950 F.2d 209) 12/20/1991, does not support an abandonment loss of real estate but an abandonment loss of a partnership interest. The case establishes a requirement that intent to abandon be manifested by some overt act or statement reasonably calculated to give a third-party notice of abandonment before an abandonment loss can be allowed. The case also distinguishes between the terms "worthlessness" and "abandonment" and deems that they are not interchangeable, but are "separate but equal grounds for loss deductions."

Rhodes v. Commissioner, 22 AFTR 366 (100 F.2d 966) 01/17/1939, allows a loss due to worthlessness—not abandonment. The issue in the present case is abandonment, not worthlessness, and as such, Rhodes is not applicable in this case.

CONCLUSION

According to Federal Treasury Regulations 1.165-1(b) and 1.165-2, a loss deduction is generally allowed for loss of usefulness or for obsolescence if the loss is incurred in a business or transaction entered into for profit. For the deduction to be allowable for a tax year, two conditions must be satisfied in that year: there is termination of usefulness of the property and the taxpayer shows intent to abandon it coupled with overt acts of abandonment. Abandonment

may occur when the business or transaction is discontinued or when the property is permanently discarded from use. Abandonment must be permanent: later use, even if reduced or for a different purpose, generally indicates abandonment never occurred. Mere nonuse of the property does not constitute abandonment. The taxpayer failed to prove that a closed and completed transaction fixed by an identifiable event has occurred.

Idaho State Tax Commission Administrative Decision No. 21052 further affirms the auditor's findings as well as the case law and federal regulations presented. According to this decision, "if a taxpayer has not relinquished possession of an item, the taxpayer must prove 'abandonment', i.e., a concurrence of the act of abandonment and the intent to abandon, both of which must be shown from the surrounding circumstances of such item in order to determine that a loss has occurred in the year of deducting. Neither mere intention alone nor mere non-use alone is sufficient to accomplish abandonment. It has also been held in these cases of claimed loss and abandonment that a deduction is permissible only where there is a complete elimination of all value coupled with recognition by the owner that the item no longer has any utility or worth to him."

The taxpayer has provided nothing to prove their entitlement to the abandonment loss.

THEREFORE, the Notice of Deficiency Determination dated April 28, 2011, and directed to [Redacted] is APPROVED.

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

DATED this _____ day of _____ 2012.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2012, 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.
