

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

In the Matter of the Protest of	)	
	)	DOCKET NO. 24472
[Redacted],	)	
	)	
Petitioner.	)	DECISION
_____	)	

[Redacted] protests the Notice of Deficiency Determination (NODD) issued by the auditor for the Idaho State Tax Commission (Commission) dated July 28, 2011, asserting additional Idaho income tax and interest in the total amount of \$10,668 for 2008.

The petitioner owned [Redacted] located on real property leased from others. Most of the [Redacted] were located in Idaho. However, one of the billboards was located in [Redacted]. The petitioner claimed the Idaho capital gains deduction relating both to the sale of the [Redacted] and with regard to income from a non-compete agreement. The petitioner concedes the capital gain issue with regard both to the [Redacted] property and to the non-compete agreement. Therefore, the sole remaining issue in this docket is whether the gain from the sale of the [Redacted] located in Idaho qualifies for the Idaho capital gains deduction. The petitioner contends that the [Redacted] were real property, thereby qualifying the gain from the sale for the deduction. The auditor contends that the [Redacted] are not properly treated as real property and, therefore, the gain does not qualify for the deduction here in question.

Idaho Code § 63-3022H sets out the authority for the Idaho capital gains deduction. It stated [2008], 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) Property held by an estate, trust, S corporation, partnership, limited liability company or an individual is "qualified property" under this section if the property had an Idaho situs at the time of sale and is:

(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;

\* \* \*

(4) 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.

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(4). Therefore, the issue in this decision is the determination of whether the assets qualify for treatment as real property.

The assets were depreciated using a method not allowable for the depreciation of Internal Revenue Code (IRC) § 1250 [real] property. Upon sale, however, the petitioner wishes the property to be deemed to have been real property. All of the assets in question were given a depreciable life of five or seven years. For each asset, a method of depreciation was used which was not available for IRC § 1250 property.

The effect of the methods employed by the petitioner is to convert income from ordinary income to capital gain income. This would be beneficial both for [Redacted] income tax purposes

as well as for Idaho income tax purposes in the case of the disposition of assets which might qualify for the Idaho capital gains deduction. For [Redacted] purposes, the deduction would be against ordinary income and the gain would be taxed at a reduced rate. The petitioner submitted no billings from the county for real property taxes on any of the assets here in question, even though such submission was invited.

For 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 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 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 inconsistent 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, supra at 758. The duty of consistency is an affirmative defense raised by respondent, and respondent has the burden of showing that it applies.

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 Notice of Deficiency Determination dated July 28, 2011, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioner pay the following tax and interest (computed to October 31, 2012):

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2008	\$9,562	\$1,520	\$11,082

DEMAND for immediate payment of the foregoing amount is hereby made and given.

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.  
  
\_\_\_\_\_