

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

In the Matter of the Protest of )  
[Redacted], ) DOCKET NO. 24993  
 )  
 )  
Petitioners. ) DECISION  
 )  
\_\_\_\_\_ )

On March 2, 2012, the Income Tax Audit Bureau (Bureau) of the Idaho State Tax Commission (Commission) issued a Notice of Deficiency Determination (NODD) to [Redacted](taxpayers) proposing income tax and interest for taxable years 2005, 2006, 2007, and 2008 in the total amount of \$13,742.

On May 3, 2012, the taxpayers filed a timely protest and petition for redetermination. The taxpayers did not respond to a letter outlining their alternatives for redetermining a protested NODD, nor did they request a hearing. The Commission, having reviewed the file, hereby issues its decision based on the information in the file.

**ISSUE**

There are two matters to be addressed in this decision. The first matter deals with the treatment of a disposition of an installment obligation which affects the taxpayers' 2006 and 2007 returns. The second matter addresses how an abandonment loss from a pass through entity is reported which impacts the taxpayers' 2008 return.

**BACKGROUND**

In 2006, the taxpayers sold real property and reported the sale on the installment method. The majority of the sales price was received in 2006, with a small payment following in 2007. In 2006, the purchaser of the property defaulted on his obligation, and in 2007 the property was foreclosed on by the bank. Since the taxpayers had subordinated their rights to the bank and held

an unsecured note, they did not receive the property back as in a true foreclosure. The taxpayers filed a 2007 Idaho income tax return reporting a gain from the receipt of a payment on the installment note, and a loss from the disposition of the same installment note. The disposition of the note arose from the debtor's failure to pay on the note, and the subsequent foreclosure by the bank. These actions made the note unenforceable. On their 2007 tax return, the taxpayers reported this disposition as a renegotiation of the sales price; however, none of the documentation provided indicates that the sales price was reduced.

Sometime during 2008, the taxpayers became members [Redacted]. In 2008, [Redacted], flowed through a loss to its members from the abandonment of property, which the taxpayers reported on their 2008 return. Beginning in 2010, an examination was conducted by the Income Tax Audit Bureau of the Idaho State Tax Commission on the loss claimed by [Redacted]. That loss was denied on the grounds that there had not been an identifiable event allowing the loss. In 2012, a legal decision by the Idaho State Tax Commission was issued [Redacted], disallowing the abandonment loss. That decision was appealed to the Board of Tax Appeals by the managing member of [Redacted]. The Board of Tax Appeals upheld the Commission's decision.

The taxpayers also claimed a capital loss for the balance remaining in their [Redacted], capital account. No documentation was provided to support that the taxpayers completely withdrew from the LLC, and K-1's were received by the taxpayers for subsequent years.

### **LAW & ANALYSIS**

With regard to the installment sale issue, Internal Revenue Code Section 453B(a) defines a disposition of an installment obligation as an obligation that is satisfied at other than its face value, distributed, transmitted, sold, or otherwise disposed of. Internal Revenue Code Section

453B(f)(1) states that if an installment obligation becomes unenforceable, it is treated as if it were a disposition in a transaction other than a sale or exchange and gain or loss is determined under the disposition rules. Under this scenario, the distribution rules state that the gain or loss from the disposition is the difference between the basis in the obligation and its fair market value at the time it becomes unenforceable.

In the present case, the taxpayers' representative stated that in 2007 the property was foreclosed upon, the taxpayer received only \$183,000, and would receive no further payments nor would he receive the property back as in a true foreclosure. The representative also stated that under these circumstances, this is considered a renegotiation of the sales price for tax purposes.

According to the Internal Revenue Code, if an installment obligation becomes unenforceable, it is treated as a disposition other than a sale or exchange, and the gain or loss is computed as the difference between the basis in the obligation and its fair market value at the time it becomes unenforceable. It is not a reduction in the selling price.

Regarding the abandonment loss issue, Internal Revenue Code section 165 allows a deduction for a loss sustained during the taxable year, and not compensated for by insurance or otherwise. To be allowable, a loss must be evidenced by closed and completed transactions which are fixed by identifiable events and actually sustained during the taxable year. Federal Treasury Regulation 1.165-1(b) and (d). Abandonment is described as voluntarily and permanently giving up possession and use of property with the intention of ending your ownership, but without passing it on to anyone else. Whether an abandonment has occurred is determined in light of all the facts and circumstances. Both an intention to abandon and affirmative actions to abandon are necessary.

Federal Treasury Regulation 1.165-2(a) states that a 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.

### **CONCLUSION**

According to Internal Revenue Code Section 453B(a), a disposition of an installment obligation generally includes a sale, exchange, cancellation, bequest, distribution or transmission. Internal Revenue Code section 453B(f)(1) further states that if an installment obligation becomes unenforceable, it is treated as a disposition other than a sale or exchange, and the gain or loss is the difference between the basis in the obligation and its fair market value at the time it becomes unenforceable. In the present case, the debtor's failure to pay and subsequent foreclosure by the bank made the note held by the taxpayers unenforceable; therefore, it is treated as if it were a disposition, not a reduction of the selling price.

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 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. 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 taxpayers have provided nothing to prove that the installment sale price was reduced; therefore, the gain or loss is determined under the disposition rules. The taxpayers’ entitlement to the abandonment loss claimed, nor their withdrawal from [Redacted], has been proven. The adjustments made resulted in additional tax due for taxable years 2006 and 2008 only.

THEREFORE, the Notice of Deficiency Determination dated March 2, 2012, and directed to [Redacted] is APPROVED.

IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following tax and interest:

| <u>YEAR</u> | <u>TAX</u>     | <u>INTEREST</u> | <u>TOTAL</u>    |
|-------------|----------------|-----------------|-----------------|
| 2006        | \$7,770        | \$2,486         | \$10,256        |
| 2008        | <u>\$3,359</u> | <u>\$ 624</u>   | <u>\$ 3,983</u> |
|             | \$11,129       | \$3,110         | \$14,239        |

Interest is calculated through August 30, 2013.

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

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

DATED this \_\_\_\_\_ day of \_\_\_\_\_ 2013.

IDAHO STATE TAX COMMISSION

\_\_\_\_\_  
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this \_\_\_\_\_ day of \_\_\_\_\_ 2013, 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.  
  
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