BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NOS. 25339 & 25340
[Redacted],	)	
	)	
Petitioners.	)	DECISION
	)	

The petitioners protest the Notices of Deficiency Determination dated September 12, 2012, denying refunds in the amounts of $62,400 and $6,849 plus applicable interest for 2010 and 2011, respectively. The Notices of Deficiency were issued responding to amended returns requesting the refunds.

These dockets are only about the characterization of certain distributions to the shareholders of [Redacted], a closely held C corporation. The distributions were originally reported by the petitioners as ordinary dividends. Later, they filed amended returns recharacterizing the payments as liquidating distributions, in essence the purchase of the stock of the petitioner. The amended returns claimed refunds which the auditor denied.

The facts are as follows:

June 18, 2010, [Redacted] paid [Redacted]. “Transfer” was noted on the check as the purpose for the payment. The check was recorded as a Note receivable. A promissory note was signed (at some point in time), with [Redacted] signing as attorney-in-fact for [Redacted].

On October 7, 2010, [Redacted] died.

On December 31, 2010, a journal entry reclassified the “loan” as a dividend.

On January 1, 2011, the dividend entry was closed to retained earnings.

On January 4, 2011, the accountants for [Redacted] prepared two 1099-DIV forms showing $400,000 of ordinary dividend distributions from [Redacted] to [Redacted] and $400,000 to [Redacted].

On February 28, 2011, the accounting firm signed the joint income tax return (for [Redacted]) as preparer, reporting the $800,000 as ordinary dividend income from [Redacted]. [Redacted] signed the return and filed it as surviving spouse.

On December 27, 2011, [Redacted] paid [Redacted] $165,000. "Dividends" was noted on the check as the purpose for the payment. The check was recorded as "dividends."

On January 24, 2012, the accountants prepared a Form 1099-DIV showing $165,000 of ordinary dividend income paid by [Redacted] to [Redacted].

On February 7, 2011, the [Redacted] Idaho income tax return for the fiscal year ended November 30, 2010, was received by the Tax Commission. On that return there was a question, "[i]s this a final return?" The question was answered in the negative. The return appears to have been signed by [Redacted] as "owner" and by the paid return preparer.

On February 27, 2012, 2011 federal and state income tax returns were filed, reporting $165,000 of ordinary dividend income from [Redacted].

On March 5, 2012, the [Redacted] Idaho income tax return for the fiscal year ended November 30, 2011, was received by the Tax Commission. On that return, there was a question, "[i]s this a final return?" The question was answered in the negative. The return appears to have been signed by [Redacted] and by the paid return preparer.

On March 26, 2012, the Tax Commission received amended 2010 and 2011 income tax returns for the petitioners claiming that the amounts reported as taxable dividend income were actually distributions made under a plan of liquidation. The returns included "corrected" Forms 1099-DIV, claiming that the amounts paid were liquidation distributions. The amended returns eliminated the dividend income from [Redacted] and re-characterized the payments as nontaxable payments for [Redacted] stock due to a stepped-up basis following [Redacted] death.

On June 27, 2012, [Redacted] signed a Form 966[1] (Corporate Dissolution or Liquidation). That form indicated that the date a resolution or plan of complete or partial liquidation was adopted was May 15, 2010.

The petitioners have committed quite some effort into trying to establish that the distributions here in question could have been treated as liquidating distributions. They contend that the late filing of Form 966 is not dispositive of the issue, and they are correct in this argument. They contend that it was the intent of the shareholders to terminate the activities of PFS, and they may be correct in that argument.

The ultimate question to be resolved is probably not whether the payments could have been treated as liquidating distributions. The question before us is whether the petitioners, once

[1] Instructions for Form 966 state, in part: When To File - File Form 966 within 30 days after the resolution or plan is adopted to dissolve the corporation or liquidate any of its stock.

having chosen a structure for their transactions, may choose another if they find a more beneficial treatment. As set forth by the U. S. Supreme Court:

> 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 various courts have enforced this principle under a number of different circumstances. In one matter, the Tax Court addressed it as follows:

> Although he originally reported the transactions at issue as liquidations, petitioner now seeks to disavow his original form. Taxpayers are free to structure their transactions in a manner that will result in their owing the least amount of tax possible. This is the essence of effective tax planning. However, as the Supreme Court observed in Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 149 (1974):
>
>> 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 *** and may not the [sic] enjoy the benefit of some other route he might have chosen to follow but did not. *** [Citations omitted.]
>
> See also Higgins v. Smith, 308 U.S. 473, 477 (1940); Estate of Durkin v. Commissioner, 99 T.C. 561, 571 (1992). "It would be quite intolerable to pyramid the existing complexities of tax law by a rule that the tax shall be that resulting from the form of transaction taxpayers have chosen or from any other form they might have chosen, whichever is less." Television Indus., Inc. v. Commissioner, 284 F.2d 322, 325 (2d Cir. 1960), affg. 32 T.C. 1297 (1959). We have observed that '"the taxpayer may have less freedom than the Commissioner to ignore the

> transactional form that he has adopted.'" Illinois Power Co. v. Commissioner, 87 T.C. 1417, 1430 (1986) (quoting Bolger v. Commissioner, 59 T.C. 760, 767 n.4 (1973)).

Murphy v. Commissioner, T.C. Memo 1996-59.

The United States Circuit Court of Appeals for the second circuit addressed such a case as follows:

> Tax Consequences of the Nestlé-NSA Sale. Nestlé claims that the excess of price over fair market value paid by NSA for the intangibles should be treated as a capital contribution. However, such treatment would constitute a retroactive change in the form of the transaction with NSA. When it initially structured this transaction, Nestlé believed that it would be able to step up the basis of the intangibles to an amount in excess of their fair market value, and then claim a capital loss on the sale to NSA. Now that the second-tier step-up has been denied-a decision that Nestlé does not challenge on appeal-and it faces a capital gain, Nestlé seeks to recharacterize a portion of its transaction with NSA as a capital contribution.
>
> Such a recharacterization is contrary to the rule that "a taxpayer is free to organize his affairs as he chooses, [but] once having done so, ... he must accept the tax consequences of his choice, whether contemplated or not." (citing Higgins v. Smith, 308 U.S. 473, 477, 60 S.Ct. 355, 84 L.Ed. 406 (1940)) Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134, 149, 94 S.Ct. 2129, 40 L.Ed.2d 717 (1974); *see also* Consolidated Edison Co. v. United States, *10 F.3d 68, 72 (2d Cir.1993)* ("[W]hen 'knowledgeable parties cast their transaction voluntarily into a certain formal structure,... they should be and are, bound by the tax consequences of the particular type of transaction which they created.' ") (quoting Federal Bulk Carriers, Inc. v. Commissioner, 558 F.2d 128, 130 (2d Cir.1977)); Estate of Durkin v. Commissioner, 99 T.C. 561, 574-75, 1992 WL 335900 (1992). The Commissioner, on the other hand, is not required "to acquiesce in the taxpayer's election of that form" but may challenge the chosen form as a sham. Higgins, 308 U.S. at 477, 60 S.Ct. 355;*see also* Newman v. Commissioner, 902 F.2d 159, 162-63 (2d Cir.1990).

Nestle Holdings, Inc. v. Commissioner, 152 F.3d 83 (2d cir. 1998).

In a case involving dividend distributions which the taxpayers sought to recharacterize, the Tax Court addressed the matter as follows:

> Petitioner has also sought to recharacterize four payments totalling $15,260 from, dividend distributions as reported on the original returns, to loan repayments, as reported on the amended returns. Based on the record herein, we believe that the original returns properly reported the four payments to petitioner and that petitioner's attempts to recharacterize the income distributions is an ex post facto effort merely to avoid the deficiency determined by respondent

[footnote omitted]. As petitioner stated on brief, "when faced with the proposed assessment supported by authority which had been proffered by the Government, any taxpayer would be provided with the incentive to carefully assess and reanalyze all entries and information which might mitigate the effect of the proposed assessment." This, clearly, is what petitioner has attempted to do, and equally clearly, is what the Supreme Court sought to prohibit in Pacific National Co. v. Welch, 304 U.S. 191 (1938).

The issue in Pacific National was whether the taxpayer, who employed the deferred payment method to compute sales profit on his original return, was entitled to file a claim for refund two years later utilizing the installment method. In holding the taxpayer was bound by the reporting method reflected on his original return, the Supreme Court stated:

Change from one method to the other, as petitioner seeks, would require recomputation and readjustment of tax liability for subsequent years and impose burdensome uncertainties upon the administration of the revenue laws. It would operate to enlarge the statutory period for filing returns (sec. 53(a)) to include the period allowed for recovering overpayments (sec. 322(b)). There is nothing to suggest that Congress intended to permit a taxpayer, after expiration of the time within which return is to be made, to have his tax liability computed and settled according to the other method. [Pacific National Co. v. Welch, supra at 194.]

Both of the reasons cited by the Supreme Court for the denial of the taxpayer's attempt to change the method of reporting sales income are applicable in the instant case. To allow petitioner to reclassify income distributions as loan repayments or to treat the $18,400 bonus as an advance which chameleonically becomes a bonus in a subsequent tax year, would impose tremendous uncertainty in the administration of the revenue laws. When petitioner's and Automotive's returns were filed petitioner had chosen to characterize four payments as income distributions. To allow petitioner to alter this treatment merely because it would mitigate the deficiency determined by respondent would subject the Commissioner to endless disputes with taxpayers over the proper characterization of any payment that could subsequently be recharacterized to the taxpayer's benefit. Moreover, the changes attempted by petitioner would affect petitioner's taxable income for both 1975 and 1976 because they alter the amount of taxable income earned by Automotive during each of those years, which income petitioner must report in his individual return pursuant to section 1373. Consequently, petitioner may not file amended returns for himself or Automotive and respondent's deficiency determination must be sustained.

Coons v. Commissioner, T.C. Memo 1983-777.

In another case, the Tax Court stated:

Petitioner must accept the tax consequences of the transactions as they were structured. Commissioner v. National Alfalfa Dehydrating & Milling Co., 417

U.S. 134, 149 (1974); Whitcomb v. Commissioner, 733 F.2d 191 (1st Cir. 1984), affg. 81 T.C. 505 (1983); Wolter Construction Co. v. Commissioner, 634 F.2d 1029, 1036-1039 (6th Cir. 1960), affg. 68 T.C. 39 (1977); Paula Construction Co. v. Commissioner, 58 T.C. 1055 (1972), affd. by unpublished opinion 474 F.2d 1345 (5th Cir. 1973); Joyce v. Commissioner, 42 T.C. 628, 636- 637 (1964). In Paula Construction Co., the taxpayer elected to be treated as a Subchapter S corporation. In 1965 and 1966, when the taxpayer believed that its Subchapter S election was still in effect, the taxpayer made distributions to its shareholders, which both the corporation and shareholders treated as dividend distributions. Two of the shareholders had performed substantial services for the taxpayer which would have justified the payment of compensation. Subsequently, when the taxpayer became aware that its Subchapter S status had been terminated for 1965 and 1966, it attempted to recharacterize the 1965 and 1966 distributions as compensation payments. The court held that, because no amounts were originally paid as compensation, the taxpayer was not entitled to recharacterize the distributions as compensation in order to claim a deduction under section 162.

The question is what was the intent of the parties when the distributions were made * * *. None of the evidence indicates that at the time those payments were made they were intended to be compensation for services performed. Paula Construction Co. v. Commissioner, supra at 1059-1060.

In this case, both petitioner and Equipment were unaware that Equipment had lost its DISC status when the 1981 and 1982 distributions were made. Equipment intended to make actual distributions of earnings to petitioner as sole shareholder. The fact that the tax impact of the distribution was different from that expected cannot be a basis for recharacterization. See Paula Construction Co. v. Commissioner, supra.

Petitioner argues that mistake of fact, i.e., its improper payment of commissions, requires that Equipment's distributions be treated as repayments of commissions. Petitioner asserts that Equipment had an obligation to repay the 1981 and 1982 commissions that petitioner paid to Equipment. Throughout 1981 and 1982, however, Equipment had accumulated earnings and profits in excess of the distributions and it is clear that both petitioner and Equipment intended to make a distribution to petitioner out of Equipment’s earnings and profits. They both treated the payments by Equipment as distributions to petitioner. A case must be decided on what is actually done and, even though a taxpayer is mistaken about the tax treatment of a transaction, the treatment of the payment cannot be changed retroactively. See Joyce v. Commissioner, supra. The principal mistake of fact was the miscalculation of Equipment’s previously taxed income. Petitioner intended that the distributions not exceed available previously taxed income. Despite Equipment's disqualification as a DISC, the amount of the distribution from Equipment to petitioner in fiscal year ended November 30, 1981 was in fact

> less than the available amount of previously taxed income. In fiscal year 1982, a substantial portion of Equipment's distribution to petitioner did not exceed available previously taxed income. Although the distributions or their amounts may have been made based upon an erroneous presumption, they are nonetheless distributions to petitioner. Accordingly, Equipment's 1981 and 1982 distributions to petitioner must be treated as actual distributions in accordance with petitioner's and Equipment's treatment of the transactions when they occurred.

Foley Machinery Co., v. Commissioner, 91 T.C. 434, 439-441 (1988).

As in Foley, the petitioners argue that the 1099-DIVs and the petitioners returns were filed in error. Taxpayers who sign their tax returns are presumed to have knowledge of the contents of the returns. Cousins v. Commissioner, T. C. Memo 1995-129; Hayman v. Commissioner, 992 F.2d 1256, 1262 (2d Cir. 1993), affg. T.C. memo. 1992-228; Terzian v. Commissioner, 72 T.C. 1164, 1171 (1979); Pettinato v. Commissioner, T.C. Memo 1995-85.

The Tax Court addressed such a matter as follows:

> In attempting to minimize the weight to be given his own, the estate's, and the partnership's income tax returns, Hubert testified that he merely signed them as prepared by a certified public account, and petitioner contends, on reply brief, that Hubert was 'firmly in the hands of not too capable advisors.' Even if this is so, the fact remains that Hubert did sign these returns and we cannot presume that he was completely oblivious to their content and representations.

Estate of Ethel M. Bullock v. Commissioner, T.C. Memo 1960-204.

The Commission finds that the petitioners chose the structure of their transaction and may not now disavow their chosen treatment in favor of another structure. Accordingly, the Commission finds it unnecessary to resolve whether [Redacted] was in the process of liquidation.

THEREFORE, Notice of Deficiency Determination dated September 12, 2012, is hereby APPROVED, AFFIRMED, AND MADE FINAL.

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

DATED this ________ day of ____________________ 2013.

IDAHO STATE TAX COMMISSION

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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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