

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 24088
[Redacted],)	
)	
Petitioners.)	DECISION
_____)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated April 12, 2011, denying requested refunds in the amounts of \$27 and \$234 plus applicable interest for 2007 and 2008, respectively.

The petitioners, nonresidents of Idaho, were the sole shareholders of [Redacted], [Redacted], an S corporation (the corporation). On August 1, 2004, the corporation sold its assets for \$500,000. The corporation received a down payment in the amount of \$100,000 and an installment agreement for the remaining amount due. Installment payments on this agreement were received during 2004 through 2009, when the purchaser ceased making payments on the obligation. The corporation reported the interest income and the gain from the installments on its 2004 Idaho income tax return. The corporation filed an Idaho corporation return for 2005, however, it did not report the interest income (\$8,251.44) from the installments. This income also was not reported on the 2005 income tax return filed by the petitioners. The installment obligation remained as an asset on the balance sheet of the corporation at the end of 2005. In 2009, when the purchaser of the assets ceased making payments on the installment obligation, the petitioners claimed that the loss from the default generated an Idaho net operating loss in the amount of \$304,759, a portion of which they carried back to 2007 and 2008 to produce refunds for those years. The auditor denied these requested refunds in the NODD referred to above.

12-Month Liquidation

There is a question as to whether the liquidation of the corporation meets the

qualifications for a 12-month liquidation. The taxation of the matter depends largely on whether the liquidation qualifies for the 12-month treatment provided for in Internal Revenue Code § 453(h)(1)(A). Without special rules to the contrary, a corporate liquidating distribution of an installment obligation would result in two taxable events:

- a) any gain inherent in the installment obligation would be taxable at the corporate level (Section 453B), and
- b) the shareholder receiving the liquidating distribution would be taxed on the excess of the adjusted issue price of the installment obligation and the fair market value of other property over the basis of the shareholder's stock. Reg. §§ 1.453-11, 1.1001-1.

If the liquidation does not qualify for the special 12-month treatment, given (a) above, the gain inherent in the installment sale (principal times the gross profit percentage), was to have been reported by the S corporation (and flowed through to the sole shareholder) at the time of the distribution of the installment obligation to Mr. [Redacted]. It is unclear when the installment obligation was distributed to the petitioners. The petitioners claim that it was distributed during 2005. However, the corporate income tax return showed the installment obligation as an asset of the corporation at the end of 2005. This tax return was signed both by Mr. [Redacted] and by the buyer as the preparer of the tax return.

Judging from the forms filed by the corporation, it appears that the liquidation did not occur within the required 12-month period. The sale of the assets is reported to have occurred on August 1, 2004. Presumably, the resolution to liquidate would have occurred at some time prior to this date. At December 31, 2005, the receivable still appeared on the balance sheet of the corporation. Therefore, it appears about 16 months after the sale of the assets, the receivable still had not been distributed to the petitioners for their stock in the corporation. The representatives for the petitioner contend that this was an error and that the receivable had been distributed to the petitioners prior to that date. The Commission finds that the installment obligation was

distributed on December 31, 2005. The receivable was on the balance sheet of the corporation at the end of 2005 and the 2005 income tax return was designated as a final return. Taxpayers who sign their tax returns are presumed to have knowledge of the contents of the returns. 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). Accordingly, the Commission finds that any gain or loss from the disposition of the petitioners' stock occurred at the time of the distribution of the installment obligation to the petitioners.

It appears that the distribution of the installment obligation may have produced a loss on the sale of the petitioners' stock in the corporation. The amount of that loss, if any, depends largely upon the value to be attributed to the installment obligation. In either case, installment reporting does not apply to the reporting of losses. S. Rept. No. 96-1000 (PL 96-471) p.7.

If the petitioners had met the 12-month liquidation parameters, the petitioners must take into account, as the sales price of their stock, the "adjusted issue price" of the installment obligation. Reg. §§ 1.453-11, 1.1001-1. This is also addressed in Regulation § 15a.453-1(d)(2)(ii), in addressing how one is to treat the transaction if the installment method is not used, as follows:

(ii) Fixed amount obligations.

(A) A fixed amount obligation means an installment obligation the amount payable under which is fixed. Solely for the purpose of determining whether the amount payable under an installment obligation is fixed, the provisions of section 483 and any "payment recharacterization" arrangement (as defined in paragraph (c)(2)(ii) of this section) shall be disregarded. If the fixed amount payable is stated in identified, fungible units of property the value of which will or may vary over time in relation to the United States dollar (*e.g.*, foreign currency, ounces of gold, or bushels of wheat), such units shall be converted to United States dollars at the rate of exchange or dollar value on the date the installment sale is made. A taxpayer using the cash receipts and disbursements methods of accounting shall treat as an amount realized in the year of sale the fair market value of the installment obligation. In no event will the fair market value of the installment obligation be considered to be less than the fair market value of the property sold

(minus any other consideration received by the taxpayer on the sale).
(Underlining added.)

In addressing a taxpayer's structuring of their transactions, the U. S. Supreme Court stated, in part:

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 transactions were effectively structured through two specific acts. The corporation sold the assets on August 4, 2004. The receivable was still on the corporate balance sheet at the end of 2005.

IDAHO SOURCE INCOME

Idaho Code § 63-3026A defines what will be treated as Idaho source income. It stated [2005], in part:

Computing Idaho taxable income of part-year or nonresident individuals, trusts and estates. -- (1) For nonresident individuals, trusts, or estates the term "Idaho taxable income" includes only those components of Idaho taxable income as computed for a resident which are derived from or related to sources within Idaho. This is to be computed without the deductions for either the standard deduction or itemized deductions or personal exemptions except as provided in subsection (4) of this section.

* * *

- (3) For the purposes of subsections (1) and (2) of this section:
- (a) Income shall be considered derived from or relating to sources within Idaho when such income is attributable to or resulting from:
- (i) Any business, trade, profession or occupation conducted or carried on in this state, including the distributive share of partnership income and deductions, and the pro rata share of S corporation income and deductions;
 - (ii) The ownership or disposition of any interest in real or tangible personal property located in this state;
 - (iii) The ownership or disposition of any interest in intangible personal property only to the extent that such property is employed in a business, trade, profession or occupation conducted or carried on in this state. Provided however, that interest income from an installment sale of real or tangible personal property shall constitute income from sources within this state to the extent that the property sold was located within this state. Provided further, that interest income received by a partner or shareholder of a partnership or S corporation from such partnership or S corporation shall constitute income from sources within this state to the extent that the partnership or S corporation is transacting business within this state;
 - (iv) A resident estate or trust;
 - (v) A nonresident estate or trust to the extent the income and deductions of the nonresident estate or trust were derived from or related to sources within this state;
 - (vi) The conduct of pari-mutuel wagering, charitable gaming or any other form of gambling taking place within this state, except as expressly limited in section 67-7439, Idaho Code.
 - (vii) Gains or losses realized from the sale or other disposition of a partnership interest or stock in an S corporation to the extent of the partnership's or S corporation's Idaho apportionment factor in the taxable year immediately preceding the year of sale.

Generally, gains and losses from the disposition of intangibles by a nonresident would not be deemed to have been from an Idaho source. However, since the gain or loss from the sale of the stock would be deemed to have been from an Idaho source pursuant to Idaho Code § 63-3026A (above), there would be a gain or loss from the disposition of the stock on December 31, 2005. After that time, the only asset held by the petitioners was an interest bearing note. Any gain or loss from the disposition of this note would not have an Idaho source, but would instead be deemed to be sourced to the domicile of the owner, in this case [Redacted]. Accordingly, the Commission finds that the default on the note in 2009 did not give rise to an Idaho source loss of any kind.

Due to the Commission's finding that any loss on the interest bearing note was not from an Idaho source, several issues need not be decided here, but may need to be visited should there be an ultimate finding that the loss was from an Idaho source. These include:

1. Whether there was a deductible loss,
2. If there was a deductible loss, the proper amount of any such loss, and
3. The character of any such loss.

THEREFORE, the Notice of Deficiency Determination dated April 12, 2011, is hereby APPROVED, AFFIRMED, and MADE FINAL.

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

DATED this _____ day of _____ 2014.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2014, 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.
