BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 0-845-559-808
	)	
	)	
Petitioners.	)	DECISION
	)	

The Income Tax Audit (Bureau) of the Idaho State Tax Commission (Tax Commission) issued a Notice of Deficiency Determination (Notice) to (Petitioners). Petitioners filed a timely appeal and petition for redetermination of the Notice. Petitioners participated in an informal hearing and submitted additional documentation for review. The Tax Commission has reviewed the file and hereby issues its decision to modify the Notice.

BACKGROUND

The Bureau determined Petitioners had income tax deficiencies of $398,320, and $28,856, and $22,556 for tax years 2017, 2018, and 2019, respectively.[1] Petitioners filed a timely appeal and submitted additional documentation for review.

The Bureau reviewed the information, accepted the information in part, and partially reduced the tax assessed. Based on the new information, the Bureau determined Petitioners had income tax deficiencies of $98,758, $13,871, and $14,738 for 2017, 2018, and 2019, respectively.

Petitioners did not agree with the results of the audit redetermination and the Bureau transferred the case to the Tax Appeals Unit. Petitioners participated in an informal hearing and submitted additional documentation for review. The primary issue remaining for decision involves

[1] The Bureau determined Petitioners were due an additional refund of $888 for tax year 2016. This item is not in dispute.

the classification of certain property as section 1245 property subject to recapture in the amount of $2,760,186.

In a 1031 exchange, Petitioners exchanged approximately 1,000 acres of farm and cattle property for commercial property. The Bureau determined Petitioners had section 1245 property subject to recapture in the exchange. Petitioners appealed contending the items in dispute are not section 1245 property, stating:

> …Based on the IRS Code for Section 1245 Property building or structural components are not considered to be 1245 Property. Much of what was included in the gain were buildings or structural components. Other real property that was included for gain and excluded from the 1031 were cement floors, corrals, concrete feeders, that are actually a part of the barn.
>
> It is not reasonable nor with the IRS code to expect that a farm would not include the ditches, ponds or wells as part of the real property. These are absolutely not personal property and should not be treated as such…

INHERENTLY PERMANENT

From a regulatory standpoint, the primary test for determining whether an asset is section 1245 property is to ascertain that it is not a building or other inherently permanent structure, including items which are structural components of such buildings or structures. In other words, if an asset is not a building or a structural component of a building, then it can be deemed to be section 1245 property. The determination of structural component hinges on what constitutes an inherently permanent structure, how permanently the asset is attached to such a structure and whether it relates to the operation or maintenance of the structure. See Treas. Reg. sections 1.48-1(c)-(e).

Treas. Reg. § 1.1245-3 defines "tangible personal property," "other tangible property," "building," and "structural component" by reference to Treas. Reg. § 1.48-1.

Treas. Reg. § 1.48-1(c) defines 'tangible personal property' as any tangible property except land and improvements thereto, such as buildings or other inherently permanent structures (including items which are structural components of such buildings or structures). Thus, buildings, swimming pools, paved parking areas, wharves and docks, bridges, and fences are not tangible personal property. Tangible personal property includes all property (other than structural components) which is contained in or attached to a building. Thus, such property as production machinery, printing presses, transportation and office equipment, refrigerators, grocery counters, testing equipment, display racks and shelves, and neon and other signs, which is contained in or attached to a building constitutes tangible personal property for purposes of the income tax credit (ITC). Further, all property that is in the nature of machinery (other than structural components of the building or other inherently permanent structure) is considered tangible personal property even though located outside a building. Thus, for example, a gasoline pump, hydraulic car lift or automatic vending machine, although annexed to the ground, is considered tangible personal property.

Treas. Reg. § 1.48-1(c) also provides that local law is not controlling for purposes of determining whether property is or is not “tangible” or “personal”. Thus, the fact that under local law property is held to be personal property or tangible property is not controlling. Conversely, property may be personal property for purposes of the ITC even though under local law the property is considered to be a fixture and therefore real property.

Treas. Reg. § 1.48-1(d) provides that in addition to tangible personal property, any other tangible property (but not including a building and its structural components) used as an integral part of manufacturing, production, or extraction, or as an integral part of furnishing transportation, communications, electrical energy, gas, water, or sewage disposal services by a person engaged in

a trade or business of furnishing any such service, or which constitutes a research or storage facility used in connection with any of the foregoing activities, may qualify for the ITC. This regulation essentially provides that inherently permanent structures (but not a building and its structural components) used in certain business activities will be deemed eligible for the ITC.

Treas. Reg. § 1.48-1(e)(1) defines a "building" as any structure or edifice enclosing a space within its walls, and usually covered by a roof, the purpose of which is, for example, to provide shelter or housing, or to provide working, office, parking, display, or sales space. The term includes, for example, structures such as apartment houses, factory and office buildings, warehouses, barns, garages, railway or bus stations, and stores. Such term includes any such structure constructed by, or for, a lessee even if such structure must be removed, or ownership of such structure reverts to the lessor, at the termination of the lease.

Specifically excluded from the definition of the term "building" are: (i) a structure which is essentially an item of machinery or equipment, or (ii) a structure which houses property used as an integral part of an activity specified in former § 48(a)(1)(B)(i) if the use of the structure is so closely related to the use of such property that the structure clearly can't be expected to be replaced when the property it initially houses is replaced. Factors which indicate that a structure is closely related to the use of the property it houses include the fact that the structure is specifically designated to provide for the stress and other demands of such property and the fact that the structure could not be economically used for other purposes. Thus, the term "building" does not include such structures as oil and gas storage tanks, grain storage bins, silos, fractionating towers, blast furnaces, basic oxygen furnaces, coke ovens, brick kilns, and coal tipples.

Treas. Reg. § 1.48-1(e)(2) provides that "structural components" includes such parts of a building as walls, partitions, floors, and ceilings, as well as any permanent coverings therefor such

as paneling or tiling; windows and doors; all components (whether in, on, or adjacent to the building) of a central air conditioning or heating system, including motors, compressors, pipes and ducts; plumbing and plumbing fixtures, such as sinks and bathtubs; electric wiring and lighting fixtures; chimneys; stairs, escalators, and elevators, including all components thereof; sprinkler systems; fire escapes; and other components relating to the operation or maintenance of a building.

In Revenue Ruling 75-178, 1975-1 C.B. 9, the IRS stated, "the problem of classification of property as 'personal' or 'inherently permanent' should be made on the basis of the manner of attachment to the land or the structure and how permanently the property is designed to remain in place." Thus, the test to be used to determine whether an asset is tangible personal property is the inherently permanent test.

The seminal case involving the determination of whether an asset is inherently permanent is *Whiteco Industries, Inc. v. Commissioner,* 65 T.C. 664 (1975). The Tax Court noted that "tangible personal property" is not intended to be defined narrowly, nor to follow the rules of State law where fixation to the land is a basis for distinguishing personal property from other property. It further stated that assets accessory to the operation of a business, such as machinery, printing presses, office equipment, individual air-conditioning units, display racks and shelves, etc., generally constitute tangible personal property for purposes of section 48, even though such assets may be termed fixtures under local law. Based on an analysis of prior case law, the Tax Court put forth six questions designed to ascertain whether a particular asset qualifies as tangible personal property. These questions, also referred to as the "Whiteco factors," are:

1. Is the property capable of being moved, and has it in fact been moved?
2. Is the property designed or constructed to remain permanently in place?
3. Are there circumstances, which tend to show the expected or intended lengths of affixation, i.e., are there circumstances, which show that the property may or will have to be moved?

4. How substantial of a job is the removal of a property and how time-consuming is it? Is it "readily removable"?
5. How much damage will the property sustain upon its removal?
6. What is the manner of affixation of the property to the land?

It should be noted that movability is not determinative in measuring permanence. The court in Whiteco held that affixation to land does not per se exclude the property from the category of tangible personal property. Additionally, in *L.L. Bean, Inc. v. Commissioner, T.C. Memo*. 1997-175, aff'd, 145 F.3d 53 (1st Cir. 1998), the court held that the mere fact that a structure is theoretically capable of being moved does not conclusively establish that it is not inherently permanent.

DISCUSSION

There is no bright-line test by which assets could be readily classified as always being permeant land improvements or farm machinery or equipment. For example, an above ground-irrigation system would likely be classified as machinery equipment, whereas one buried under ground would more likely be classified as a permanent land improvement. In each instance of an asset that is not clearly in one category or another, we must consider these factors on an ad hoc basis.

The Tax Commission does not consider non protested issues. For example, Petitioners didn't dispute adjustments to tax years 2016, 2018 and 2019. Additionally, Petitioners didn't dispute tools, radio, blades, sprayers and other items were machinery or equipment.

The Tax Commission having considered the documentary evidence submitted by both Petitioner and the Bureau in support of their respective positions, hereby enters the following conclusions.

Buildings, Farmhouse, Shops, Barns, and Sheds

In general, buildings are not 1245 property. However, storage sheds and single purpose agricultural/livestock or horticultural structures can be 1245 property. See *A.C. Monk & Co. v. United States*, 686 F.2d 1058 (4th Cir. 1982), aff'g in part and rev'g in part, E.D.N.C. No. 78-126-CIV-4 (August 4, 1981), on remand to 577 F.Supp. 4 (E.D.N.C. 1983). The term "single purpose livestock structure" means any enclosure or structure specifically designed, constructed, and used for housing, raising, and feeding a particular type of livestock and their produce, and for housing, raising, and feeding a particular type of livestock and their produce.

The Tax Commission finds several of the buildings in this case are clearly not 1245 property. However, there is a question if some of the buildings are single purpose agricultural or horticultural structures. The Tax Commission has no facts showing any of the structures are single purpose livestock structures. However, considering the general rule that buildings or structural components are excluded from tangible personal property and the Whiteco factors, the Tax Commission finds in favor of Petitioners on these assets.

Concrete Floors, Slabs, Ditches, Feeders and Feedlot Improvements

In general, concrete floors, slabs, ditches, feeders and feedlot improvements are not section 1245 property. These are structural components of buildings or inherently permanent structures. *L.L. Bean, Inc. v. Commissioner*, 145 F.3d 53 (1st Cir. 1998), aff'g T.C. Memo. 1997-175, *La Petite Academy v. United States*, 95-1 USTC ¶ 50,193 (W.D.Mo. 1995), aff'd without published opinion, 72 F.3d 133 (8th Cir. 1995). There are however exceptions. See *Texas Instruments Inc. v. Commissioner,* T.C. Memo. 1992-306.

Considering the general rule that concrete floors, slabs, ditches, feeders and feedlot improvements are structural components of buildings or inherently permanent structures, the Tax Commission finds in favor of Petitioners on these assets.

Fences and Corrals

In general, fences and corrals are not section 1245 property. Treas. Reg. § 1.48-1(c), provides "fences are not tangible personal property." However, Treas. Reg. § 1.48-1(d)(4), provides fences used to confine livestock are an integral part of raising livestock and are considered other tangible personal property.

In this case, the difficulty is determining, based on the information available, what portion of the fences/corrals fall under Treas. Reg. § 1.48-1(c) vs Treas. Reg. § 1.48-1(d)(4). Considering part of the property was used for cattle, the Tax Commission finds some proportion of the fences/corrals most likely falls into other tangible personal property. However, since the amount at issue is minimal compared to other items, the Tax Commission concedes this issue.

Buried Pipes, Mainlines, & Wires

In general, the courts have held irrigation systems buried underground are more likely to be considered a land improvement. Whereas, as an above ground irrigation system is more likely to be classified as machinery or equipment. See *Trentadue v. Commissioner* 128 T.C. 91 (2007). As noted by Petitioners in their appeal, underground irrigation systems cannot be easily removed from the ground without causing extensive damage. On appeal, the Tax Commission agrees with Petitioners on this issue.

Center Pivots, Wheel Lines, Water Wheels

As noted above, in general, the courts have held above ground irrigation systems are more likely to be classified as machinery or equipment. Petitioners argue the pivots were designed and

engineered for the specific field and permanently attached to the land. Similarly, Petitioners argue wheel lines are inherently permanent, and they are built and pressurized for their specific farm field.

The Tax Commission disagrees. Moving center pivots, wheel lines, and water wheels from one field to another is a common practice. Many farmers move these items from field to field because of the high-cost association with these systems. There are numerous YouTube videos showing farmers moving these items from one field to another, in towns, and down highways. There are many companies that sell and move center pivot irrigation systems. Therefore, the Tax Commission agrees with the Bureau on this issue.

CONCLUSION

The Bureau added interest and penalty to the income tax deficiency. The Tax Commission has reviewed those additions, found both to be appropriate per Idaho Code sections 63-3045 and 63-3046, and has updated penalty and interest accordingly. Interest is calculated through May 15, 2023 and will continue to accrue at the rate set forth in Idaho Code section 63-3045(6) until paid.

THEREFORE, the Modified Notice of Deficiency Determination dated August 21, 2021, is hereby FURTHER MODIFIED, in accordance with the provisions of this decision, and is AFFIRMED and MADE FINAL.

IT IS ORDERED that Petitioners pay the following tax, penalty, and interest.

YEAR	TAX	PENALTY	INTEREST	TOTAL
2016	($768)	0	($169)	($937)
2017[2]	0	0	0	0
2018	12,171	609	1,756	14,536
2019	13,490	675	573	14,738
				$27,714

[2] Petitioners' investment tax credit offsets any additional taxes due for tax year 2017.

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

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

DATED this _____ day of _____ 2023.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this _____ day of _____ 2023, 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:

Receipt No.

_____

_____