Dc8BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of	)	
	)	DOCKET NO. 1-925-030-912
███ ███ █████ ███	)	
	)	
Petitioner.	)	DECISION
	)	

███ ██ ████ ███ (███ ███ protested the Notice of Deficiency Determination (Notice) dated December 13, 2023. The Tax Commission reviewed the matter and hereby issues its final decision to uphold the Notice.

Background

███ ██ filed a Certificate of Organization with the Idaho Secretary of State on ███ ██ ███ and filed partnership returns of income for tax years 2016 through 2020. The principal business activity was truck leasing. On each Idaho return except for tax year 2017, ███ ██ earned investment tax credit (ITC) by purchasing and placing into service qualifying assets. These credits passed through the partnership to ███ ███ two partners: ████ ███ (███ and ███ ███ █ (███ Each partner maintained a 50% ownership interest from 2016 through 2020.

███ ██ filed its 2020 federal and Idaho returns as final returns; the Idaho return did not report any ITC recapture. The Tax Commission's Income Tax Audit Bureau (Audit) selected this return for examination and determined that the ITC ███ ██ earned from 2016 through 2020 was subject to recapture due to early disposition of qualifying assets. Audit issued the Notice, adjusting the 2020 Idaho return to include ITC recapture. In the Notice, Audit wrote, "In 2020, the partnership filed a final return officially dissolving its business. Since the assets weren't held and used in Idaho for the full 5 years, the credit claimed is subject to recapture."

Audit made another adjustment in the Notice to distribute the credit recapture to the partners. In a separate but related matter, Audit learned from ███ ███ appointed representative (Representative) that ███ had purchased ███ interest in the business and continued operations without interruption.

On February 12, 2024, Audit received a protest letter via email from Representative. She stated that ███ ██ did not dissolve but is still operating and is now reporting as a single-member limited liability company (LLC) on ███ individual returns. Additionally, all of ███ ███ ITC assets are still in use in Idaho. Representative argued,

> Idaho's position is that they follow Federal rules for the recapture of credits (IRC 50) [Internal Revenue Code section 50] and that with the partnership's change in ownership of 50%, a technical termination occurred in 2020. However, … the concept of a technical termination for partnerships has been repealed for tax years beginning after December 31, 2017. With the repeal of the technical termination rules, partnerships no longer face technical termination consequences solely as a result of a change in ownership interests. Instead, the entity continues, even with changes in ownership, maintaining their tax elections, basis of assets and depreciation periods unless an actual termination of the business occurs. The entity continues to own and use the credit-qualifying property in the same manner, thus avoiding immediate recapture and changes to the depreciation life.

Representative argued that in the case of ███ ██ there was no disposition of ITC property, the property is being tracked for any future disposition, it is unlikely there will be any disposition during the recapture period, and that ██ still has an at-risk investment in ███ ██ until the full purchase price has been paid.

Audit sent a letter on February 14, 2024, acknowledging the protest and informing Representative and ███ ██ that the case was being transferred to the Tax Commission's Tax Appeals Unit (Appeals) to continue the redetermination process. Appeals sent ███ ██ and Representative letters on March 15, 2024, outlining available options for redetermining a protested Notice.

and Representative participated in an informal hearing with a Tax Appeals Specialist, the Tax Appeals Manager, and a Commissioner on May 28, 2024. Representative began by stating that bought ownership interests in two businesses, and an S-corporation. This was accomplished by executing a promissory note to make monthly payments over ten years, secured by an interest in shares of the S-corporation and member units in Representative stated that, because of the repeal of the technical termination rules, partnerships are not subject to the consequences of a technical termination just because ownership changes. Instead, can maintain their tax elections, basis in assets, and depreciation periods unless an actual termination of the business occurs. In fact, has continued operations without interruption using the same employer identification number (EIN). All ITC property is still actively used in the same business and in the capacity as when the credit was originally earned. the entity, has not changed other than ownership. Representative provided a written statement which included the following:

> The intent behind the ITC is to promote economic activity, investments in equipment, and ultimately, job creation in the State of Idaho. The essential use of the equipment in the business's operations contributes to economic activity and fulfills the purpose of the ITC. The tax code should prioritize the substance of business activities over the formalities of business structure.

and had similar things to say during the hearing. No additional arguments were presented.

During the hearing, Appeals asked for a copy of the sale and purchase contract between and Representative provided copies of the requested documents on May 31, 2024. No other documentation was requested or provided during the hearing.

Law & Analysis

Cessation of Partnership Activities

In this case, Representative places much weight in her argument that the concept of a technical termination was repealed with the passage of the Tax Cuts and Jobs Act of 2017. IRC section 708(a) reads, "For purposes of this subchapter, an existing partnership shall be considered as continuing if it is not terminated." Prior to passage of the Tax Cuts and Jobs Act of 2017, IRC section 708(b)(1) stated:

> For purposes of subsection (a), a partnership shall be considered as terminated only if— (A) no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership or (B) within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

IRC section 708(b)(1)(B) was the technical termination Representative refers to. Currently, and at the time ███ purchased ███ partnership interest, IRC section 708(b)(1) reads, "For purposes of subsection (a), a partnership shall be considered as terminated only if no part of any business, financial operation, or venture of the partnership continues to be carried on by any of its partners in a partnership." In essence, what IRC section 708(b)(1)(A) was, is now IRC section 708(b)(1).

Treasury Regulation section 301.7701-2(c)(1) states that a partnership is a business entity that is not a corporation and that has at least two members. Because ███ bought all of ███ partnership interest and did not bring in a new partner, the partnership's business – even though ███ continues it without interruption – is no longer conducted in partnership form.

Representative contends that the LLC has continued the same business practices without interruption, just under a new ownership structure. According to the IRS, an LLC is an entity created by state statute and does not have a separate tax classification. Instead, the IRS uses the

same tax entity classifications it has always used for businesses. An LLC is always classified as a corporation, a partnership, or a "disregarded entity."

Treasury Regulation section 301.7701-2(a) states,

> For purposes of this section and [Treasury Regulation section] 301.7701-3, a business entity is any entity recognized for federal tax purposes (including an entity with a single owner that may be disregarded as an entity separate from its owner under [Treasury Regulation section] 301.7701-3) that is not properly classified as a trust under [Treasury Regulation section] 301.7701-4 or otherwise subject to special treatment under the Internal Revenue Code. A business entity with two or more members is classified for federal tax purposes as either a corporation or a partnership. A business entity with only one owner is classified as a corporation or is disregarded; if the entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner.

Treasury Regulation section 301.7701-3(a) states,

> A business entity that is not classified as a corporation … can elect its classification for federal tax purposes as provided in this section. An eligible entity with at least two members can elect to be classified as either an association (and thus a corporation …) or a partnership, and an eligible entity with a single owner can elect to be classified as an association or to be disregarded as an entity separate from its owner. Paragraph (b) of this section provides a default classification for an eligible entity that does not make an election.

Treasury Regulation section 301.7701-3(b) reads, "Except as provided in paragraph (b)(3) of this section, unless the entity elects otherwise, a domestic eligible entity is— (i) A partnership if it has two or more members; or (ii) Disregarded as an entity separate from its owner if it has a single owner."

Treasury Regulation section 301.7701-3(f)(2) states, "An eligible entity classified as a partnership becomes disregarded as an entity separate from its owner when the entity's membership is reduced to one member."

Treasury Regulation section 301.6109-1(h)(2)(i) states, "Except as otherwise provided in regulations or other guidance, a single owner entity that is disregarded as an entity separate from its owner under [Treasury Regulation section] 301.7701-3, must use its owners'

taxpayer identifying number (TIN) for federal tax purposes." Based on this, [redacted] could not have continued to use [redacted] [redacted] EIN for tax filing purposes.

When [redacted] bought [redacted] interest in the LLC, the partnership terminated. [redacted] [redacted] went from having two members to only one, meaning a partnership was no longer a valid option. Since it didn't incorporate, the only option left was to become disregarded as an entity separate from its owner. The partnership that was [redacted] [redacted] [redacted] [redacted] terminated when [redacted] and [redacted] signed their contracts.

Item 1 of the Member Interest Transfer Agreement made and entered into on September 30, 2020, and signed by [redacted] and [redacted] reads, "[redacted] does hereby transfer to [redacted] his respective fifty percent (50%) interest in [redacted] [redacted] with the result that [redacted] shall be the holder and owner of 100% of the member units of [redacted] [redacted] (the 'Units'). The books of [redacted] [redacted] shall be amended to reflect said transfer." Item 2 reads, "The Units transferred hereunder shall be accomplished at Closing, or at such other place or such other date as the parties may mutually agree." No documentation was provided to indicate that any other date or place was mutually agreed upon for the transfer of the Units. Therefore, effective September 30, 2020, [redacted] no longer owned any interest in [redacted] [redacted]

The facts in *Siller Brothers, Inc. v. Commissioner, 89 TC 256*, are strikingly similar to those in this case. In *Siller Brothers*, Siller Brothers, Inc. (SBI) and Louisiana Pacific, Inc (LPI) were each 50% partners in Tri-Eagle Co. (TEC). On March 17, 1980, SBI purchased LPI's 50% interest in TEC. SBI continued the operations of the partnership uninterrupted, including the business use of TEC's investment credit property. The Tax Court determined that, as a result of

the sale, the partnership terminated pursuant to both IRC section 708(b)(1)(A) and IRC section 708(b)(1)(B).[1] The Court wrote:

> As a result of the contract dated Mar. 17, 1980, Tri-Eagle was terminated under sec. 708(b)(1)(A) because only one partner remained and the business could no longer "be carried on by any of its partners in a partnership." Tri-Eagle was also terminated under sec. 708(b)(1)(B) because Louisiana-Pacific sold its 50-percent partnership interest to petitioner. *We need not decide whether one subsection takes precedence over the other because each has the same effect for Federal income tax purposes*. A termination under sec. 708(b)(1)(A) causes an *actual* liquidation of the partnership resulting in recognition of gain or loss by the partners pursuant to sec. 731 and basis adjustments pursuant to sec. 732(b). A termination under sec. 708(b)(1)(B) results in a *deemed* liquidation to which sec. 731 and sec. 732 apply. [emphasis added]

Representative has argued that because IRC section 708(b)(1)(B) was repealed, partnerships no longer face technical termination consequences just because ownership has changed. She also argued that the entity would continue even with the changes in ownership, and that the business would maintain its tax elections, basis of assets, and depreciation periods "unless an actual termination of the business occurs." The *Siller Brothers* decision makes it clear that the same tax consequences would occur in cases of a technical partnership termination and an actual partnership termination.

Based on the foregoing analysis, the Tax Commission determined that the partnership terminated, not as a technicality because of the change in ownership percentage as described in the repealed IRC section 708(b)(1)(B), but in actuality because only one owner remains, and a partnership cannot exist with only one owner. Further, this resulted in the termination of the *partnership* business activities.

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[1] Recall that what is now IRC section 708(b)(1) was at the time of the *Siller Brothers* decision IRC section 708(b)(1)(A) and that IRC section 708(b)(1)(B) has been repealed.

Representative stated during the informal hearing that [redacted] still has an at-risk investment until the promissory note is paid in full. While this may be true, having an at-risk investment does not mean that [redacted] is still a partner. Instead, [redacted] is now essentially a creditor to [redacted] [redacted] until [redacted] has made all agreed upon payments. This does not negate the cessation of partnership business activities.

Investment Tax Credit Recapture Requirement

Idaho Code section 63-3029B states that a taxpayer shall be allowed to claim a credit – ITC – against income tax equal to the sum of credit carryovers and the credit for the current year. The maximum current year credit is equal to 3% of the amount of qualified investments made during the tax year. Any recapture of the credit on property that is disposed of or ceases to qualify prior to the end of the recapture period shall be determined in accordance with the recapture provisions of IRC.

Idaho Income Tax Administrative Rule 715 states that if a taxpayer claimed ITC for property that is sold or otherwise ceases to qualify prior to being held five full years, the credit must be recomputed pursuant to the provisions in IRC and Treasury Regulations. The recapture amount is calculated by multiplying the credit earned on the asset by the appropriate recapture percentage, depending on how long the asset has been in service:

- If less than one year, 100% of the credit earned is recaptured.
- If at least one year but less than two years, 80% is recaptured.
- If at least two years but less than three years, 60% is recaptured.
- If at least three years but less than four years, 40% is recaptured.
- If at least four years but less than five years, 20% is recaptured.

IRC section 50 governs the recapture of ITC. IRC section 50(a)(1)(A) states that if investment credit property is disposed of or otherwise ceases to be investment credit property with respect to the taxpayer before the end of five full years from being placed in service, then credit

must be recaptured. IRC section 50(a)(6) states that the recapture provision does not apply to a transfer by reason of death or certain corporate acquisitions. It also says that property shall not be treated as ceasing to be investment credit property with respect to the taxpayer because of a mere change in the form of conducting a trade or business, as long as the property is retained in the trade or business and the taxpayer retains a substantial interest in the trade or business.

The question that must now be answered is, "Who is the taxpayer that must retain a substantial interest in the trade or business not to trigger credit recapture?" IRC section 7701(a)(14) defines a taxpayer as "any person subject to any internal revenue tax." IRC section 701 specifically exempts a partnership from income tax liability but does not exempt a partnership from other taxes imposed by the Internal Revenue Code. Idaho Code section 63-3009 defines a taxpayer as "any person subject to a tax imposed by this act or required by the provisions of this act to file an income tax return, report income or pay a tax." Both definitions use the term "person" in their descriptions of what a taxpayer is. Both IRC section 7701(a)(1) and Idaho Code section 63-3005 include the following in their definitions of "person:" individual; trust; estate; partnership; association; and corporation. IRC section 7701(a)(1) also includes the term "company," whereas Idaho Code section 63-3005 specifies "limited liability company." Idaho Code section 63-3006A states that an LLC classified as a partnership pursuant to IRC shall be treated as a partnership for Idaho income tax purposes as well.

Based on the above definitions, the Tax Commission has determined that ███ ██ – the partnership – was a taxpayer from 2016 through 2020, because the partnership was required to report income on returns filed with the IRS and the State of Idaho. ███ ██ – the business entity – is not a taxpayer, because the business entity is not required to file returns separate from the current single owner; the only reason ███ ██ was required to file returns was because it was a

partnership. Obviously, ███ and ██ – the former partners – are taxpayers, as they are individuals required to file income tax returns.

In *Siller Brothers*, SBI argued that the partner – not the partnership – is considered the taxpayer for investment credit recapture purposes and that no change in ownership had occurred with respect to SBI's interest in the investment credit property it continued using after acquiring LPI's 50% interest in TEC. The Court found otherwise. SBI sought to use an aggregate approach to investment credit recapture, but the Court adopted the entity approach, as it had in several prior cases involving investment credit issues.[2] The Court cited *Southern v. Commissioner, 87 TC 49, 54 (1986)*: "It is the partnership which places the property in service … Therefore, the focus of the investment credit provisions is initially on the partnership as an entity, and the investment credit is a partnership item for which each partner must report a distributable share."

The *Siller Brothers* Court decided that, because TEC disposed of its property early, investment credit recapture was required unless an exception applied due to a mere change in the form of conducting the trade or business. The Court went on to explain that this exception did not apply because of the basis adjustments required by IRC section 732 upon termination of the partnership.

Based on this analysis, the Tax Commission finds that ███ ██ was subject to ITC recapture in the following amounts upon termination of the partnership in 2020:

[2] For example, *Moradian v. Commissioner*, 53 TC 207, 212 (1969); *Holloman v. Commissioner*, TC Memo 1975-309 (October 18, 1975), aff'd., 551 F2d 987 (5th Cir 1977); *Kipperman v. Commissioner*, TC Memo 1977-32, aff'd 662 F2d 431 (9th Cir 1980); *Southern v. Commissioner*, 87 TC 49, 54 (1986).

Year ITC earned	Amount to recapture in 2020
2016	$300
2018	$6,660
2019	$19,649
2020	$34,008
Total	$60,617

The total recaptured at the partnership level is flowed through to the individual partners in proportion to their ownership percentages in the year when the ITC was earned.

Conclusion

The actual termination of the [redacted] [redacted] partnership resulted in the liquidation of all partnership assets. This liquidation included the disposition of the partnership's ITC assets. Since disposition occurred before the end of the recapture period, ITC recapture was required. The partnership is responsible for calculating the recapture amount and reporting to the partners their distributable share.

THEREFORE, the Notice dated December 13, 2023, and directed to [redacted] [redacted] [redacted] [redacted] is hereby UPHELD and MADE FINAL. As no additional tax is due at the entity level, no demand for payment is made.

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

DATED this ________ day of ___________________ 2024.

IDAHO STATE TAX COMMISSION

CERTIFICATE OF SERVICE

I hereby certify that on this ________ day of ______________________________ 2024, 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.

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