Tempel v. Comm'r, 136 T. C. 341 (U. S. Tax Ct. 2011)

In Tempel v. Comm'r, the U. S. Tax Court ruled that Colorado's transferable conservation easement tax credits are capital assets, but the taxpayers had no basis in them and the gains were short-term. This case clarifies the tax treatment of state tax credit sales, affirming their status as capital assets while denying basis allocation and long-term capital gains treatment due to the short holding period. It sets a precedent for similar state credit transactions nationwide.

Parties

George H. Tempel and Georgetta Tempel (Petitioners) filed a petition against the Commissioner of Internal Revenue (Respondent) in the United States Tax Court, docket number 23689-08.

Facts

In December 2004, George and Georgetta Tempel donated a qualified conservation easement on approximately 54 acres of their land in Colorado to the Greenlands Reserve, a qualified organization. The donation was valued at $836,500, and the Tempels incurred $11,574. 74 in professional fees related to the donation. As a result, they received $260,000 in transferable Colorado income tax credits. In the same month, the Tempels sold $110,000 of these credits to unrelated third parties for a total of $82,500 in net proceeds, after paying $11,000 in broker fees. They also gave away $10,000 of the credits. On their 2004 tax return, the Tempels reported the proceeds from the sale of the credits as short-term capital gains and allocated $4,897 of their professional fees as the basis in the credits sold.

Procedural History

The Commissioner issued a notice of deficiency on June 26, 2008, asserting that the Tempels had no basis in the credits and that the gains from the sales should be taxed as ordinary income. The Tempels timely filed a petition with the U. S. Tax Court. Both parties moved for partial summary judgment on the issues of the character of the gains, the Tempels' basis in the credits, and the holding period of the credits. The court granted in part and denied in part both motions, applying the standard of review for summary judgment under Rule 121 of the Tax Court Rules of Practice and Procedure.

Issue(s)

1. Whether the Colorado income tax credits sold by the Tempels are capital assets under Section 1221 of the Internal Revenue Code?
2. Whether the Tempels have any basis in the Colorado income tax credits they sold?
3. Whether the holding period of the Tempels' Colorado income tax credits qualifies the gains from their sale as long-term capital gains?

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Rule(s) of Law

1. “Capital asset” is defined under Section 1221(a) of the Internal Revenue Code as “property held by the taxpayer,” with exceptions that do not apply to the State tax credits in question.
2. The substitute for ordinary income doctrine excludes from capital asset treatment property that represents a mere right to receive ordinary income.
3. Section 1012 provides that the basis of property is its cost, defined as the amount paid for the property in cash or other property per Section 1. 1012-1(a) of the Income Tax Regulations.
4. Section 1222 specifies that the sale of capital assets held for more than one year results in long-term capital gain or loss.

Holding

1. The Colorado income tax credits sold by the Tempels are capital assets under Section 1221(a) because they are property held by the taxpayer and do not fall into any of the statutory exceptions or the substitute for ordinary income doctrine.
2. The Tempels do not have any basis in the Colorado income tax credits they sold, as they did not incur any cost to acquire the credits and cannot allocate their easement costs or land basis to the credits.
3. The Tempels’ holding period in the Colorado income tax credits is insufficient to qualify the gains from their sale as long-term capital gains, as the credits were sold in the same month they were received.

Reasoning

The court reasoned that the State tax credits, being property rights granted by the state, qualified as capital assets under the broad definition of Section 1221(a), with no applicable exceptions or judicial limitations such as the substitute for ordinary income doctrine. The court rejected the application of the Gladden factors, typically used to analyze the character of contract rights, as inapplicable to the State tax credits, which are not contract rights. The court further held that the Tempels had no basis in the credits because they did not purchase the credits and could not allocate either their easement costs or their land basis to the credits. The holding period issue was resolved by the court finding that the credits were sold within the same month they were received, hence the gains were short-term.
The court’s analysis involved statutory interpretation of the Internal Revenue Code, application of judicial doctrines, and consideration of the Commissioner’s administrative positions as reflected in revenue rulings. The court also addressed policy considerations, noting that capital gains treatment aims to mitigate the effects of inflation and encourage the sale of appreciated assets, but these considerations did not alter the legal conclusions drawn from the statute and judicial precedents.

Disposition

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The court granted in part and denied in part the Commissioner's motion for partial summary judgment and the Tempels' cross-motion for partial summary judgment, concluding that the State tax credits are capital assets but the Tempels have no basis in them and the gains are short-term.

Significance/Impact

Tempel v. Comm'r is significant for establishing that transferable state tax credits can be considered capital assets under federal tax law. This ruling provides clarity on the tax treatment of such credits, particularly in the context of conservation easements, and may influence future cases involving similar state credit transactions. However, the decision also limits the potential tax benefits of selling these credits by denying the allocation of basis and affirming that the holding period begins upon the grant of the credits, likely affecting taxpayer strategies in utilizing and selling state tax credits. Subsequent cases and tax planning will need to account for these holdings, which emphasize the importance of the timing of credit sales and the inability to claim a basis in the credits themselves.

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