CRI-Leslie, LLC v. Commissioner, 147 T. C. No. 8, 2016 U. S. Tax Ct. LEXIS 24 (U. S. Tax Court 2016)

In CRI-Leslie, LLC v. Commissioner, the U. S. Tax Court ruled that forfeited deposits from a canceled sale of business-use real property do not qualify for capital gain treatment under I. R. C. Section 1234A. The court clarified that Section 1234A applies only to capital assets, not to Section 1231 property used in a trade or business. This decision underscores the distinction between capital assets and business-use property for tax purposes, impacting how similar transactions are treated under the tax code.

Parties

CRI-Leslie, LLC, with Donald W. Wallace as the Tax Matters Partner (TMP), was the petitioner. The respondent was the Commissioner of Internal Revenue. The case was brought before the United States Tax Court.

Facts

CRI-Leslie, LLC, a Florida limited liability company treated as a TEFRA partnership for federal income tax purposes, owned the Radisson Bay Harbor Hotel in Tampa, Florida, which it acquired in 2005 for $13. 8 million. The hotel was used in CRI-Leslie's trade or business, and the company reported deductions for operating expenses and depreciation related to the hotel on its 2008 tax return. In 2006, CRI-Leslie entered into a purchase and sale agreement with RPS, LLC, to sell the hotel for $39 million, later amended to $39. 2 million. RPS, LLC, failed to close the purchase, and the agreement terminated in 2008, resulting in CRI-Leslie retaining $9,700,000 in forfeited deposits. CRI-Leslie reported these deposits as net long-term capital gain on its 2008 tax return. The Commissioner issued a notice of final partnership administrative adjustment (FPAA) recharacterizing the gain as ordinary income.

Procedural History

The Commissioner issued the FPAA to CRI-Leslie's partners on November 20, 2013, for the 2008 tax year, adjusting the partnership's income by increasing ordinary income and decreasing net long-term capital gain by $9,700,000. CRI-Leslie petitioned the U. S. Tax Court for review. The case was submitted fully stipulated under Tax Court Rule 122, and the court's jurisdiction was appealable to the Court of Appeals for the Eleventh Circuit.

Issue(s)

Whether CRI-Leslie, LLC, is entitled to capital gain treatment under I. R. C. Section 1234A for the $9,700,000 in forfeited deposits from the canceled sale of the Radisson Bay Harbor Hotel, a property used in its trade or business, in the 2008 tax year?

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Rule(s) of Law

I. R. C. Section 1234A provides that gain or loss from the termination of a right or obligation with respect to property that is a capital asset in the hands of the taxpayer shall be treated as gain or loss from the sale of a capital asset. I. R. C. Section 1221(a) defines a capital asset but excludes property used in the taxpayer's trade or business, including real property, from this definition. I. R. C. Section 1231 covers gains and losses from the sale or exchange of certain property used in a trade or business but treats such gains as long-term capital gains if there is a net gain.

Holding

The U. S. Tax Court held that CRI-Leslie, LLC, is not entitled to capital gain treatment under I. R. C. Section 1234A for the $9,700,000 in forfeited deposits because the Radisson Bay Harbor Hotel was Section 1231 property used in its trade or business, not a capital asset as required by Section 1234A.

Reasoning

The court's reasoning was based on the plain meaning of Section 1234A, which applies only to capital assets, as defined in Section 1221(a). The court noted that the hotel property, being used in CRI-Leslie's trade or business, was explicitly excluded from the definition of a capital asset under Section 1221(a)(2). The court rejected CRI-Leslie's argument that Congress intended Section 1234A to apply to Section 1231 property, finding no evidence in the legislative history to support such an interpretation. The court emphasized that if Congress had intended to include Section 1231 property within the scope of Section 1234A, it could have used language similar to that in Sections 1234 and 1234B, which apply to property with the same character as the underlying asset. The court also reviewed relevant caselaw and found no support for extending Section 1234A to Section 1231 property. The court concluded that the plain meaning of the statute must govern, and thus, the forfeited deposits were to be treated as ordinary income.

Disposition

The court entered a decision for the respondent, the Commissioner of Internal Revenue, affirming the recharacterization of the $9,700,000 in forfeited deposits as ordinary income rather than capital gain.

Significance/Impact

The CRI-Leslie decision clarifies the scope of I. R. C. Section 1234A, limiting its application to capital assets and excluding Section 1231 property used in a trade or business. This ruling impacts how taxpayers treat gains from the termination of rights or obligations related to business-use property, potentially affecting tax planning strategies and the characterization of income from similar transactions. The decision reinforces the importance of statutory interpretation based on the plain

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meaning of tax code provisions and underscores the distinction between capital assets and Section 1231 property for tax purposes. Subsequent courts have followed this interpretation, solidifying the precedent in tax law.

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