Jason B. Sage v. Commissioner of Internal Revenue, 154 T. C. No. 12 (2020)

In *Jason B. Sage v. Commissioner of Internal Revenue*, the U. S. Tax Court ruled that Sage's real estate company could not claim losses from transferring properties to liquidating trusts in 2009. The court held that the company remained the owner of the trusts under the grantor trust rules, as the trusts' proceeds were used to discharge the company's liabilities in subsequent years. This decision impacts how liquidating trusts are treated for tax purposes, clarifying that such trusts are not automatically separate taxable entities.

Parties

Jason B. Sage, the Petitioner, was the taxpayer and real estate developer. The Respondent was the Commissioner of Internal Revenue. At the trial level, Sage was represented by attorneys Craig R. Berne, Milton R. Christensen, and Dan Eller. The Commissioner was represented by Nhi T. Luu, Kelley A. Blaine, and Janice B. Geier.

Facts

Jason B. Sage, an Oregon real estate developer, owned three parcels of land through his wholly owned subchapter S corporation, Integrity Development Group, Inc. (IDG), and its single-member limited liability company, Gales Creek Terrace LLC. Facing financial difficulties due to the 2008 economic recession, Sage transferred these parcels in December 2009 to three liquidating trusts established for the benefit of the mortgage holders, Sterling Savings Bank and Community Financial Corp. The trusts were set up to liquidate the properties and distribute the proceeds to the mortgage holders. Between 2010 and 2012, the trusts disposed of the properties, and the proceeds were applied to discharge IDG's and Gales Creek Terrace LLC's liabilities. Sage claimed significant losses from these transactions on his 2009 tax return, leading to a net operating loss (NOL) that he carried back to 2006 and forward to 2012. The IRS disallowed these losses, resulting in deficiencies for 2006 and 2012.

Procedural History

The IRS issued statutory notices of deficiency to Sage for the tax years 2006 and 2012, disallowing the losses reported by IDG and claimed by Sage for 2009. The IRS's initial basis for disallowance was that the losses were attributable to nonbusiness expenses. However, at trial, the IRS presented a new theory that the 2009 transactions were not closed and completed, thus not producing realizable losses for that year. Sage timely filed a petition in the U. S. Tax Court seeking redetermination of the deficiencies and an accuracy-related penalty for 2012.

Issue(s)

Whether the transfers of the real estate parcels to the liquidating trusts in 2009 constituted closed and completed transactions that produced bona fide losses for that year under I. R. C. sections 165 and 671-679 and the accompanying regulations?

Rule(s) of Law

Under I. R. C. section 165(a), a deduction is allowed for any loss sustained during the taxable year and not compensated for by insurance or otherwise. Section 1. 165-1(b) of the Income Tax Regulations specifies that such a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year. The grantor trust rules (I. R. C. sections 671-679) treat the grantor as the owner of any portion of a trust if certain conditions are met, including if trust income is used to discharge a legal obligation of the grantor (section 1. 677(a)-1(d), Income Tax Regs.).

Holding

The court held that IDG and Gales Creek Terrace LLC were the owners of the respective liquidating trusts beyond the close of the 2009 taxable year under the grantor trust rules, as the trusts' proceeds were used to discharge the companies' liabilities between 2010 and 2012. Consequently, the transfers to the trusts did not produce bona fide losses in 2009, and the deductions claimed were properly disallowed.

Reasoning

The court's reasoning was based on the application of the grantor trust provisions, specifically section 677(a)(1) and its regulations. The court found that IDG and Gales Creek Terrace LLC remained liable for the loans secured by the properties even after transferring them to the trusts. When the trusts disposed of the properties in subsequent years, the proceeds were used to discharge these liabilities, triggering the grantor trust rules. The court rejected Sage's arguments that the nature of liquidating trusts or the beneficiaries' status as grantors under the regulations should alter this outcome. The court emphasized that the grantor trust rules apply regardless of the existence of a bona fide nontax reason for creating the trust, and that the trusts were not separate taxable entities from IDG and Gales Creek Terrace LLC during the relevant years. The court also noted that the IRS's new theory at trial shifted the burden of proof to the Commissioner, but found the evidence supported the application of the grantor trust rules.

Disposition

The court sustained the IRS's deficiency determinations for Sage's 2006 and 2012 taxable years, as modified by the Commissioner's concession. The court also upheld the accuracy-related penalty for 2012, which Sage had conceded would apply if the court resolved the loss issue in the Commissioner's favor.

Significance/Impact

The *Sage* decision clarifies the application of the grantor trust rules to liquidating trusts, particularly when the trust's proceeds are used to discharge the grantor's liabilities. This ruling has significant implications for taxpayers using liquidating trusts as part of their financial strategies, as it underscores that such trusts may not automatically be treated as separate taxable entities. The case also highlights the importance of the timing and completeness of transactions in claiming tax deductions, and the potential for the IRS to introduce new theories at trial, shifting the burden of proof. The decision may influence future tax planning involving liquidating trusts and reinforce the IRS's ability to challenge such arrangements under existing tax laws and regulations.