Current Federal Tax Developments

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SECTION: SCAMS
IRS ISSUES SERIES OF MEMORANDUMS TO EMPLOYEES REGARDING MAKING INITIAL CONTACT BY MAIL RATHER THAN PHONE

Citation: SBSE Memo SBSE-05-0716-0035, 7/18/16, SBSE Memo SBSE-04-0816-0031, 8/1/16, SBSE-04-0816-0031, 9/15/16

Due to identity theft and phone scams, the IRS has been modifying its guidance to employees to move away from making initial contact with a taxpayer via phone calls, instead moving towards requiring IRS employees to first send letters via mail to initiate contact.

In SBSE Memo SBSE-05-0716-0035 the IRS announced a change in procedure related to contacting taxpayers for federal tax deposit (FTD) alerts. Now the IRS will not make phone contact on the matter until a notice of alert is mailed to the affected taxpayer that they will be contacted by phone by the IRS within 15 days.

The following month the same guidance was issued related to payroll exams looking at tip reporting, with SBSE Memo SBSE-04-0816-0031 providing that initial contact in those cases will not be conducted by telephone.

In September of 2016, the IRS issued similar guidance to field employees in SBSE-04-0916-0023. This memorandum now orders field examination employees to make first contact via mail, and has interim revisions of various sections of Internal Revenue Manual 4.10.2.8, 4.10.2.9 and 4.10.2.10.

Fraudulent calls from individuals claiming to be from the IRS have become a major problem, making it very difficult for taxpayers to recognize legitimate phone contacts from the IRS. Unfortunately, one of the reasons why the frauds are effective is because the IRS has resorted to phone contact of taxpayers in the past as initial contacts in certain situations.

Slowly the agency is beginning to recognize that continuing this practice represents a problem, since taxpayers can't simply be told the IRS won't contact them by phone without first having contacted the taxpayer otherwise. This change represents the second such change to procedures in 2016 by the IRS to eliminate a first contact via phone, after earlier eliminating the practice of making initial exam contact by phone.

The first memorandum, which was effective immediately upon publication, provides:

> Field contact is the preferred method of contact on assigned FTD Alerts. However, Revenue Officers retain the discretion to determine the best method of effective initial contact on a case-by-case basis. Effective immediately, all anticipated telephone initial contacts on FTD Alert taxpayers can proceed **AFTER** a notice is sent to the taxpayer informing them that a Revenue Officer (RO) will contact them by phone within 15calendar days of receipt of the FTD Alert.

The "Quick Alert" the ROs will send is described as follows in the memorandum:

> The "Quick Note" should include the following information: (RO's can cut/paste this verbiage directly into the quick note).
>
>> *Dear [Taxpayer Name]:*
>>
>> *We noticed a decrease in your current quarter federal tax deposits (FTD) and are contacting you to ensure you are meeting your deposit requirements. We are sending you this notice to inform you that a Revenue Officer will either call you or visit your place of business to discuss these discrepancies.*
>>
>> ***Your responsibility as an employer***
>>
>> *Trust fund tax is money an employer withholds from employees' wages for income tax and FICA (social security and Medicare tax). As the employer, you must withhold trust fund taxes from*

employees' wages. These taxes are held in trust until paid to the Department of the Treasury by making periodic federal tax deposits.

Penalty for failing to deposit timely

If the taxes are not deposited as required, we may assess penalties of up to 10 percent of the amount not deposited, depending on the number of days the federal tax deposits are late. If the taxes are still unpaid when Form 941, Employer's QUARTERLY Federal Tax Return, is filed, we will assess interest and penalties on any unpaid balance. The percentage may rise to 15 percent for amounts still unpaid after the date of the first notice asking for payment.

While the example "quick note" also notes that a Revenue Officer might visit the taxpayer, the memorandum indicates that the quick note is not required prior to such a visit.

The note also indicates that the notice will go to a representative if there is a valid Form 2848, *Power of Attorney and Declaration of Representative* or Form 8821, *Tax Information Authorization* on file for the taxpayer in question.

The IRS does plan to incorporate the guidance found in the memorandum into the Internal Revenue Manual at IRM 5.7.1, *Trust Fund Compliance—FTD Alerts*, within one year.

The IRS moved on in August of 2016 to expand the ban on initial contact by phone to examinations of tip income. The IRS will modify the Internal Revenue Manual in this area to conform to this "no phone calls to start" rule as follows:

4.23.7.7.2

Employer Tip Examinations

(2) As it is critical that examiners meet with the employer and tipped employees to arrive at the correct tip income and to determine the factors affecting how this income is to be reported on the employer's and employees' tax returns, the examiner should contact the employer to schedule an appointment, using the appropriate initial contact/appointment letter, Letter 3850, Employment Tax Appointment Letter, or Letter 3851, Employment Tax Call-in Appointment Letter. In no instance will initial contact be made by telephone. If the taxpayer proposes a reasonable change to the appointment date/time, the examiner may accommodate the change and follow up with Letter 3253, Taxpayer Appointment Confirmation Letter and Letter 3254, Representative Appointment Confirmation Letter. The examiner must enclose an Information Document Request (IDR) with the examiner's confirmation/appointment letters, Publication 1 and Notice 609. The IDR should be tailored for the particular taxpayer.

The memo also instructs the agent that phone contact can only be made after the taxpayer has had time to respond, with the memo setting that period at 14 days after the mailing of the notice.

The tip memo also goes on to indicate that we'll likely see additional guidance in the same vein from the IRS. The memo continues "[w]e are evaluating our other contacts with taxpayers, outside of the examination context, to determine whether they present risks with respect to phone scams and other such threats."

The memo to field examiners includes interim changes to the Internal Revenue Manual to implement the new procedures. It notes:

Effective May 20, 2016, ALL initial taxpayer contacts to commence an examination must be made by mail using approved form letters. Although we recognize making initial contact by telephone has been a long-standing policy, we are changing our practice in response to today's environment of phone scams, phishing, and identity theft. Please ensure this information is distributed to all affected employees within your organization.

The date provided in the memorandum for this program to start is actually four months before the date the memo was issued. A broader agency wide memorandum was issued at that time, and presumably field agents have been following that "contact first by mail" directive since that time.

As with the payroll tax memorandums, this memo also contains a 14-day waiting period before follow-up contact. The memo notes:

> Examiners (revenue agents and tax compliance officers) will use the appropriate initial contact letters (i.e., call-back or firm appointment) listed in IRM 4.10.2, *Pre-Contact Responsibilities*, to notify the taxpayer their return was selected for examination, and will not make initial contact by telephone. After mailing the initial contact letter and allowing sufficient time for the taxpayer to respond (14 calendar days from mailing the letter), employees can then initiate contact by telephone with the taxpayer as needed. When a valid Form 2848, *Power of Attorney and Declaration of Representative*, or Form 8821, *Tax Information Authorization*, is on file for the taxpayer, the appropriate initial contact letter will be mailed to the taxpayer and a copy of the letter will be mailed to the representative with Letter 937, *Transmittal Letter for Power of Attorney*.

SECTION: 105
PAYMENT NOT MADE UNDER §105 ACCIDENT AND HEALTH PLAN, RATHER REPRESENTED DEFERRED COMPENSATION

Citation: Estate of Barnhorst v. Commissioner, TC Memo 2016-177, 9/20/16

An unusual arrangement that provided disability benefits was at issue in the case of *Estate of Barnhorst v. Commissioner*, TC Memo 2016-177. The key issue was whether the benefit paid by the program in 2010 represented payments under an accident or health plan under IRC §105(a) and, if so, did the benefits received represent payments not related to the absence from work under IRC §105(c). The IRS claimed that, in reality, this was simply a deferred compensation plan and should be taxed as such.

The plan was a unique one set up by Mr. Barnhorst for his law firm. As the Court noted:

> Early in his career, Howard met another attorney, Ernest Ryder. Ryder specializes in tax planning and retirement benefits and was United States counsel for American Specialty Insurance Group, Ltd. (American Specialty), a company organized under the laws of the Turks and Caicos Islands. BSG hired Ryder to write a policy to insure Howard. The policy was called Policy Number 1994-004. Ryder opened a Charles Schwab account under the name American Specialty Insurance Group, Ltd. Policy No. 1994-004 and had signature authority over it.
>
> He also billed BSG for policy fees. It is this unusual feature—an insurance policy with its own brokerage account—that the reader should focus on, because neither the IRS nor the Court has ever seen the policy itself.

The program offered various benefits to Mr. Barnhorst, but the one in question in this case related to payment to him for "catastrophic disability." The policy provided for payments of apparently varying based on different types of disability, though always capped at no more than 97% of the cash value of the policy.

However, the Court noted that this wasn't exactly the case, as not only was 97% the maximum benefit, it also was the minimum:

> These different categories of catastrophic injuries would seem to trigger different payouts (depending on the value of the policy and what he was making at BSG) -- except for one important clause. Provision 2.4(e) stated that "to the extent 97% of the cash value of the policy exceeds [Howard's] catastrophic disability benefit as based on a multiple of [Howard's] highest annual earnings * * * such excess shall be divided by the number of months in the maximum benefit period, and the resulting amount shall thereupon become the monthly disability income benefit." In other words, if Howard didn't get the full

> 97% cash value from a lump-sum payment from any type of catastrophic injury, he'd get the rest of it in monthly installments over the course of the benefit period, regardless of the type of "catastrophic disability" he suffered.

As well, if Howard was not disabled he ended up with the same 97% of cash value benefit, as the Court noted:

> The policy had another important clause: It would terminate upon the earliest of: (1) Howard's turning 60; (2) his death; or (3) is no longer being an employee of BSG. If the policy terminated for either the first or third reason, Howard had the right to convert the coverage into a life-insurance policy with a cash surrender value equal to 97% of the cash value of the disability policy on the date of termination. Termination for the second reason would result in an immediate payout of 97% of the cash value to Howard's beneficiaries. Howard turned 60 in October 2008, thus presumably triggering a termination. But American Specialty continued to send renewal riders through a policy period ending February 1, 2010.

The opinion notes that the following standards are generally applied in case law for determining if a program is a health and benefit plan under IRC §105(a). These are:

- A statement in a written plan that its purpose is to qualify as an accident or health plan within the meaning of the Code and that the benefits are eligible for income tax exclusion;
- Specification in a plan that the benefits payable are those amounts incurred for medical care in the event of personal injury or sickness;
- Terms in a plan that the benefits payable are limited to legitimate medical expenses; and
- A provision allowing an employee to be compensated for specific injuries or illness, such as the loss of a limb.

There was no doubt the plan stated it intended to qualify as a plan under IRC §105, but the Court was more skeptical about the plan's qualification under the second two provisions, noting:

> The second and third factors—which are so similar that we'll treat them together—are a bit more complicated. Assuming the policy didn't terminate, Marnie is right that the only way Howard could get money out of the policy was if he sustained some kind of injury or illness. This is in stark contrast to a typical deferred-compensation plan that might involve some vesting and that could be paid out for non-health-related reasons. But payouts under this policy had no correlation with Howard's actual medical expenses—under its terms he would receive either a lump sum or a fixed monthly benefit. The amount of this payment had nothing to do with his actual expenses. He would, for example, be entitled to the same amount if he lost hearing in one ear or the use of both his kidneys. Medical expenses for these two conditions would quite likely be different, but payout under the policy would be the same.
>
> That's a crucial distinction. The cases tell us to ask whether a plan pays for actual medical expenses, not whether its payee suffers from some triggering condition. In *Berman*, the court said we look to see if the plan covers expenses "*incurred* for medical care."4 925 F.2d at 939 (emphasis added). *Berman* itself dealt with a plan that had a "triggering event" and found it to be only a deferred-compensation plan. Id. at 940. In Estate of Hall, we similarly concluded "that the disability provision in the * * * plan was merely one of several events that could trigger a participant's claim to accrued retirement benefits." 1996 WL 89625, at *5. In discussing these same factors, the Second Circuit in *Caplin v. United States,* 718 F.2d 544, 549 (2d Cir. 1983), stated the plan "could also specify that the benefits payable *be limited to those amounts incurred for medical care in the event of personal injury or sickness, and provide for the specific reimbursement of such expenses.*" (Emphasis added.) The disability policy here distinguished between partial and total disability in its definitions, but once Howard suffered either condition, the payout to his family would be the same. Therefore, we find this factor to favor the Commissioner.

As well, the court notes both that, under the terms of the plan, the policy should have terminated at age 60 but was extended without an additional premium for additional years of coverage and that he no longer practiced law in the firm that sponsored the plan, and that entity no longer conducted any significant business. While the Court stated it did not use these considerations specifically to find that this was not a §105(a) plan, it did "sway" the Court in the IRS's direction.

The Court went on to note that, as well, the payment did not meet the requirement of an excludable benefit under IRC §105(c)(2). Such a benefit must be one computed with regard to the type of injury—but in this case, while the type of disability might affect the timing of payments, it ultimately had no effect on the total amount of benefit, as it would always end up at 97% of the cash value.

As the Court notes:

> We do not doubt that Howard's cancer and surgery might have qualified him for income exclusion under an accident or health plan that met all of the requirements of section 105(c). But that is irrelevant—we have to see if the policy by its terms qualifies. See *Rosen v. United States,* 829 F.2d 506, 509 (4th Cir. 1987) ("[F]or payments to be excludible from income under section 105(c), the instrument or agreement under which the amounts are paid must itself provide specificity as to the permanent loss or injury suffered and the corresponding amount of payments to be provided. * * * The actual permanency of injury is not alone determinative of whether the amounts paid qualify for exclusion"); *Estate of Hall v. Commissioner*, T.C. Memo. 1996-93 (citing *Rosen* and holding the same).

SECTION: 419A
TAXPAYER FAILS TO PROVE PLAN MET REQUIREMENTS TO BE A §419A PLAN EXEMPT FROM QUALIFIED COST LIMITS

Citation: Schechter v. Commissioner, TC Memo 2016-174, 9/19/16

One of the more aggressively promoted types of shelters pushed onto small businesses related to purported 10 or more employer welfare benefit plans established pursuant to IRC §419A(f)(6). In the case of *Schechter v. Commissioner*, TC Memo 2016-174 the Tax Court found that, regardless of the possible propriety of the plan, the taxpayer simply failed to produce evidence necessary to show compliance with the requirements that provision.

The issue involved a $450,000 payment made by the S corporation in which Mr. Schechter held a 100% interest for the year in question. The $450,000 was paid to the company's "Sickness, Accident & Disability Indemnity Trust 2007" of which $427,500 was used to purchase a single premium life insurance policy on Mr. Schechter's life.

The plan was intended to qualify under IRC §419A(f)(6) as a ten or more employer plan on which does not maintain an experience rating with respect to individual employees. If that qualification is met, the deduction for amounts paid to fund the plan are not limited to the plan's "qualified cost" under IRC §419(b), though the payment would generally need to meet the "ordinary and necessary" test under IRC §162.

The IRS contended that this plan was not a more than 10 employer plan, that the plan maintained experience ratings and, regardless of any of those facts, the payment made was so vastly in excess of the benefits made available that it was not an ordinary and necessary business expense.

The taxpayer agreed that the "qualified expense" amount under §419(b) for the year would compute to zero, so if the plan did not meet the requirements of IRC §419A(f)(6) that the entire deduction would be disallowed. The Tax Court decided the case based solely on this issue, not needing to look at the "ordinary and necessary" expense issue.

The Tax Court noted that the plan provided that the plan sponsor had the right to obtain records from the plan administrator to provide information on the participants—but the taxpayer did not request that information or provide it to the Court. The taxpayer countered that the administrator had agreed to insure more than 10 employers were always participating in the plan, but the Court found that showing there is an agreement by someone to do something is not the same as showing that party actually did it.

Thus the Court found that the taxpayer had not carried its burden to show that the plan had more than 10 employers participating in the plan, so the §419(b) limitation applied—and no deduction was allowed.

The Court also found that a provision in the plan that would reduce any death benefit paid to a participant by the amount of any disability payments received amounted to proscribed experience rating in the plan—a second reason why the plan failed to qualify as a §419A(f)(6) plan exempt from the qualified expense limits of IRC §419(b).

This result is in line with a series of such cases over the years. Certainly the experiences of small employers adopting such a plan and then using the "unlimited" funds to primarily buy life insurance on the owner of the sponsor has generally not been good ones at trial.

SECTION: 1031
TAXPAYER DENIED §1031 TREATMENT FOR SILO TRANSACTION

Citation: Exelon Corp. et al. v. Commissioner, 147 T.C. No. 9, 9/19/16

The taxpayer in the case of *Exelon Corp. et al. v. Commissioner*, 147 T.C. No. 9 had a major gain that it did not want to pay current tax on—almost $1.6 billion. The gain would occur when an acquired entity disposed of its fossil fuel power plants.

The taxpayer was approached with a potential solution—engage in a purported §1031 exchange. The taxpayer acquired power plants from tax exempt public utility companies as the claimed replacement property, plants which they then leased back to those entities. Referred to as a "sale in, lease out" (SILO) transaction, it was a packaged transaction sold to the taxpayer.

The IRS complained that, in reality, the taxpayer never obtained the benefits and burdens of ownership of these plants—and so didn't actually acquire true ownership of the plants. Rather, this amounted to an exchange of their old power plants for secured loans to the public utilities.

The reason the IRS viewed the matter this way was due to the nature of the leases entered into, arguing that, in fact, the public utilities that "sold" their plants to the taxpayer in the Section 1031 exchange had effectively entered into a transaction knowing full well they would have no realistic choice at the end of the lease to "buy back" the property.

The Tax Court noted that SILO transactions have not fared well in the Courts—with one major exception. As the Court noted:

> The courts considering SILO/LILO transactions have almost universally concluded that the taxpayers never obtained the benefits and burdens of ownership or attributes of a traditional lessor and, thus, were not entitled to claim various associated deductions. See *ConEd II*, 703 F.3d at 1381-1382 (finding that the LILO was not a genuine lease and sublease); *Altria Grp., Inc. v. United States*, 658 F.3d at 291 (affirming jury finding that a series of LILO and other transactions failed the substance over form inquiry); *Wells Fargo*, 641 F.3d at 1330 (sustaining the trial court's conclusion that the SILO transactions ran afoul of the substance over form doctrine); *BB & T Corp. v. United States*, 523 F.3d 461, 464 (4th Cir. 2008) ("[A]lthough the [transaction] form * * * involved a lease financed by a loan, BB & T did not actually acquire a genuine leasehold interest[.]"); *John Hancock Life Ins. Co. (U.S.A.) v. Commissioner*, 141 T.C. at 109-110, 145 (concluding that all LILO transactions and some SILO transactions at issue were in substance financial instruments, loans); *UnionBanCal Corp. v. United States*, 113 Fed. Cl. 117, 136 (2013) (concluding that the taxpayer did not obtain the requisite ownership interest to claim the deductions); *AWG Leasing Tr. v. United States*, 592 F. Supp. 2d 953, 981-982 (N.D. Ohio 2008) (finding

> that a SILO transaction involving an interest in a German waste-to-energy plant did not convey an ownership interest to the taxpayer to justify the deductions). The only notable exception is the SILO transactions analyzed in *John Hancock Life Ins. Co. (U.S.A.) v. Commissioner*, 141 T.C. at 111-137, where this Court concluded that because exercising the purchase option at the end of the sublease was not the only economically viable option for the original property owners and John Hancock was exposed to more than de minimis risk after the end of the sublease period, John Hancock acquired a future ownership interest in the underlying properties.

So the question to be decided was whether this SILO transaction was not one where the only economically viable option at the end of the sublease was for the tenant to exercise the option to reacquire the property.

A key factor, as the Court noted analyzing the structure:

> We next consider whether petitioner acquired the benefits and burdens of ownership in the light of the options available to petitioner and CPS at the end of the Spruce sublease period. First, we decide whether CPS was reasonably expected to exercise its cancellation option at the end of the Spruce sublease period. If it was, petitioner's profit was fixed at the outset of the Spruce transaction and petitioner did not acquire any benefits and burdens of ownership with respect to the Spruce station. See J*ohn Hancock Life Ins. Co. (U.S.A.) v. Commissioner*, 141 T.C. at 139-143.

One key factor is that if the tenant did not exercise its option to reacquire the property it would have to incur costs to get the plant into a specified condition—and those costs would not be insubstantial.

The Court found that the math simply argued strongly in favored of the exercise of this option:

> Under the circumstances, we find it significantly more likely that CPS, should it attempt to walk away from the transaction and return the Spruce station to Exelon, would face substantial economic losses. Accordingly, we find that the range of scenarios under which CPS would decide to exercise its cancellation option is significantly broader than expected by petitioner's experts, including Prof. Myers.
>
> We also find that both petitioner and CPS, experienced power plant operators having the benefit of professional legal and other advice, understood that the terms of the Spruce transaction were inconsistent with the Deloitte appraisal and the projected future value of the Spruce station. The parties understood that it would be very difficult, if not impossible, for CPS to return the Spruce plant at the end of a 32-year sublease in almost the same condition in which CPS received it in 2000 without significant investment. Thus, the parties understood and reasonably expected at the time of entering into the Spruce transaction that CPS would exercise the cancellation option at the end of the sublease because meeting the return conditions would be extremely burdensome. According to Prof. Myers' analysis, with the required capacity factor of 82% in 2032, more than 20% higher than projected in the Spruce appraisal, it would be economically beneficial for CPS to exercise its cancellation option.
>
> Moreover, we note that when the City of San Antonio brought suit in court to obtain a declaratory judgment of the continued validity of certain covenants in its outstanding public securities -- thereby allowing CPS to enter into the transaction with petitioner -- in its initial draft of the petition the city represented that it intended to exercise the cancellation option. Even though this representation was subsequently deleted at the suggestion of Winston & Strawn and PwC, this Court infers an understanding among the parties that CPS would exercise the option to reacquire the Spruce plant. At the very least, it was reasonably likely at the time of the transaction that the purchase option would be exercised.

Therefore, the Court agreed with the IRS's view that this was really a loan to the public utility secured by the plant, rather than the actual acquisition of the plant. Since exchanging the plants for secured loans is not a valid §1031 exchange, the taxpayer must recognize the entire gain on this transaction.

SECTION: 1221
PROPERTY DEEMED HELD FOR DEVELOPMENT AND WAS NOT A CAPITAL ASSET

Citation: Boree v. Commissioner, 118 AFTR 2d ¶ 2016-5207, CA11, No.14-15149, 9/12/16

An often contentious issue for taxpayers who have real estate is determining if a piece of property does or does not represent a capital asset when it is sold. The case of *Boree v. Commissioner*, 118 AFTR 2d ¶ 2016-5207, CA11, No.14-15149 posed just such an issue.

There is no question that Mr. Boree initially acquired the land in 2002 with the intent to develop the land and sell the property as over 100 lots. Such a plan will generally cause the lots to be treated as property held for sale in the ordinary course of business.

The law initially defines all assets held by a taxpayer as capital assets (IRC §1221(a)), but then proceeds to give a list of property excluded from that definition. Of interest in this case is IRC §1221(a)(1) which excludes:

> (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

The IRS and Mr. Boree agree that had his plan gone forward the property would have clearly been of the type described in that section and, therefore, not treated as a capital asset. Any gain or loss from the sale of the property would considered an ordinary, rather than capital, gain or loss.

But the situation changed. In 2004 the County began imposing a number of restrictions and conditions on land in the area that made the planned development no longer economically feasible. Rather, Mr. Boree concluded that a higher density development would be needed to justify the additional costs that the County now would impose, a type of development Mr. Boree did not himself wish to undertake.

Mr. Boree looked to "upzone" the property to make it appealing to other developers and obtained zoning changes that allowed a higher density development to be undertaken. However, the County also later imposed additional conditions that would have made development even more expensive, and outside of what Mr. Boree wished to undertake.

He discovered another developer was planning a large scale project on property adjacent to his property. He negotiated a sale of all remaining lots (he had sold only a few over the years before this point) to the other developer. In 2007 the sale closed with a selling price of just over $9,600,000. The gain of $8,578,636 was reported as a long-term capital gain on Mr. Boree's tax return.

The IRS cried foul at this point, arguing that the property retained its status as property was excluded from capital asset treatment. Mr. Boree argued that the County's actions had changed the nature of the property from that held for sale to customers to property held for investment since the actions rendered the initial plan no longer feasible.

The Tax Court found for the IRS, noting the principal purpose for holding the land was development and eventual sale to customers. The taxpayer appealed that decision, which lead to this decision of the Eleventh Circuit.

The Eleventh Circuit sustained the Tax Court's decision. First, it rejected Mr. Boree's contention that only his intention at the instant of the sale mattered, noting:

> [I]n *Suburban Realty Co.* , the Fifth Circuit rejected the notion that "the decisive question is the purpose for which (the property) 'primarily' was held *when sold.*" 615 F.2d at 182 (emphasis added). Rather, the court reasoned, "At the very moment of sale, the property is certainly being held 'for sale.' The appropriate question certainly must be the taxpayer's primary holding purpose at some point before he decided to make the sale in dispute." Id. The court thus analyzed the taxpaying entity's purpose in holding the property over multiple years prior to its sale, finding that although the company originally

> acquired the property as an investment, it engaged in such frequent sales through a ten-year period that its primary purpose changed to “for sale” at some point during that time. *Id*. at 183-85. While the Borees would have us focus instead on this Court's statement in the subsequent case of *Sanders v. United States* that “it was the taxpayer's intent at the time of the sales that is relevant for an inquiry as to whether capital gains treatment is justified,” 740 F.2d at 889, *Sanders* is not at all inconsistent with Suburban Realty Co. The *Sanders* court also analyzed the taxpayer's activities over multiple years in sustaining the Tax Court's decision that the taxpayer's income was ordinary income, finding that although the taxpayer's original purpose was not to establish a real estate business, by the time he earned the profits at issue in the years 1974 and 1975, he had been engaging in the business of subdividing land, making improvements, and selling lots for several years. *Id* . Thus the “sales” the *Sanders* court referred to in the above-quoted statement were the taxpayer's “continuous and frequent sales of the lots over the period from 1972 to 1976.”Id . Far from diverging from *Suburban Realty Co.'s* direction to look at the circumstances leading up to the sale, the *Sanders* court actually did the same thing, in fact citing *Suburban Realty Co* . as its source. See *id.*

The Court also distinguished this case from the result that the taxpayer cited in the case of *Ridgewood Land v. Commissioner*, noting:

> For instance, they rely on *Ridgewood Land Co. v. Commissioner*, in which the taxpayer acquired property intending to develop and sell it in the ordinary course of business. 477 F.2d 135, 136 [31 AFTR 2d 73-970] (5th Cir. 1973) (per curiam). The State of Mississippi then authorized condemnation proceedings against the property for use in the construction of a highway. *Id* . Under threat of condemnation, the taxpayer sold the property to an adjacent landowner who was negotiating to sell the land to the state for inclusion in the highway project. *Id*. In a decision the court emphasized was based on the “the particular facts of the case,” the court found that the taxpayer's purpose in holding the property had changed from ordinary course of business to investment because any development of the land would have been futile due to the impending condemnation. *Id* . That case is distinguishable, however, because an exercise of the government's eminent domain power, unlike an ordinance mandating the paving of roads, deprives a landowner of all potential uses of his property except selling the property to the government. It was appropriate for the court to conclude in *Ridgewood Land Co.* that because the property was condemned, the taxpayer lost the opportunity to develop it, and therefore had no other purpose for holding the property aside from investment. The Baker County paving requirements, however, merely placed additional costs on developers interested in pursuing certain types of development. The restrictions did not foreclose all development of property in Baker County. Potential developers just had to be financially able to pave internal and connecting roads. As such, “adverse government action” cases like *Ridgewood Land Co* . are of no help to the Borees.

And, as the Court noted, the taxpayers continued to take steps to ready the property for development following the adverse decision of the County:

> More importantly, even if we were to focus only on the Borees' intentions for the property after the land use restrictions were imposed in 2004 and 2005, their actions in the years 2004 through the sale in 2007 betray their true intent to continue to develop the property. When compliance with the moratoria threatened to render the original West Glen Estates development plan unprofitable, Mr. Boree did not passively hold the property in hopes that he could sell it to a buyer at an attractive price, but instead first sought to obtain exceptions to the paving requirements so that his subdivision could proceed. When that was unsuccessful, he hired a land-use attorney and applied to rezone the property for a more densely zoned residential and commercial development that would fund his costs of complying with the new county paving requirements. Indeed, Mr. Boree was successful in persuading the county board to create a new land use designation of “rural commercial,” never before used in the county, for part of the Planned Unit Development. The Borees assert that the fact that their preliminary maps of the Planned Unit

Development had no roads leading to it reveals that it was a mere hypothetical and that they were only trying to "up-zone" the property to make it more attractive to a buyer in hopes of selling it in bulk, but they offer no explanation for the fact that they continued to pursue the Planned Unit Development strategy even after they entered into the sales agreement with Adrian in April 2006. Indeed, at the June 2006 meeting of the Baker County Board of Commissioners, Mr. Boree's attorney confirmed that the Planned Unit Development had been undertaken to justify the paving costs imposed by the county restrictions and that Glen Forest, "the development entity that originally owned all this land and sold off some of it," was the same developer who owned the remaining acreage. Such evidence of strategic and thorough involvement in pursuit of developing the property indicates that the Borees were holding the property for sale in the ordinary course of business right up until they sold it to Adrian, and not merely as an investment property. Not only that, but the Borees continued to sell, or attempt to sell, some lots to individuals after the land use restrictions were first imposed in 2004, and they deducted (instead of capitalized) expenses related to the property in 2006 and 2007. Thus, the Tax Court's factual finding that the Borees "continued to pursue development activities after the board adopted the moratoriums and requirements' was not clearly erroneous.

The panel concluded that this property continued to be property other than a capital asset and the resulting gain was ordinary income.