



# TaxNewsFlash

## United States

No. 2018-068  
February 15, 2018

### **Eleventh Circuit: Deposit forfeited on canceled sale of hotel, not capital gain**

The U.S. Court of Appeals for the Eleventh Circuit today held that a taxpayer that contracts to sell property used in its trade or business was not entitled to treat, as capital gains, an advance deposit that the taxpayer rightfully retained when the would-be-buyer defaulted and canceled the sale. The Eleventh Circuit affirmed the Tax Court's opinion in this case of "first impression."

The case is: *CRI-Leslie, LLC v. Commissioner*, No. 16-17424 (11<sup>th</sup> Cir. February 15, 2018). Read the Eleventh Circuit's [decision](#) [PDF 82 KB]

#### **Background**

A limited liability company (LLC) acquired a hotel in Tampa, Florida. In 2006, the LLC agreed to sell the hotel to another entity for \$39 million. Because the sale of the property was not closed, the agreement terminated in 2008 with the LLC receiving \$9.7 million of deposits that were forfeited when the sale was canceled.

The LLC reported the \$9.7 million of deposits as net long-term capital gain on Schedule K of the partnership return for 2008. The IRS issued a notice of final partnership administrative adjustment (FPAA) to the LLC for the 2008, asserting that the forfeited deposit was ordinary income, and not capital gain.

The LLC filed a petition with the U.S. Tax Court which, in September 2016, held that because the hotel was section 1231 property, it was by definition not a capital asset (as defined by section 1221) and thus was not subject to capital gains treatment under section 1234A. Read [TaxNewsFlash-United States](#)

## Eleventh Circuit affirms the Tax Court

The Eleventh Circuit noted that if the sale of the hotel had been completed as planned, the \$9.7 million deposit (which would have gone toward the purchase price) would have been taxed at the lower capital gains rate under section 1231. However, the deal fell through, and the tax treatment of the \$9.7 million was not governed by section 1231, but was subject to section 1234A—the Code provision that applies to gains or losses from certain terminations if the property is classified as a “capital asset.”

The Eleventh Circuit explained that the hotel was not a “capital asset” (according to the definition under section 1221) and thus, capital gains treatment under section 1234A was not available.

In summary, the Eleventh Circuit found the case was “pretty straightforward:”

- Section 1234A provides for capital gains treatment of income resulting from canceled sales only when the underlying property constitutes a “capital asset.”
- Section 1221 defines a “capital asset” in a way that excluded the hotel in this case.
- Accordingly, the LLC was not entitled to treat the \$9.7 million deposit as capital gain.

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