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Tax Court: Forfeited deposit on canceled sale of hotel not capital asset

The U.S. Tax Court today issued an opinion in a case of "first impression" concluding that a limited liability company was not entitled to capital gain treatment under section 1234A for its right to retain forfeited deposits of $9.7 million from a canceled sale of real property used in its trade or business in 2008.

The case is: *CRI-Leslie, LLC v. Commissioner,* 147 T.C. No. 8 (September 7, 2016). Read the Tax Court's **opinion** [PDF 89 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 did not close.

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.

Tax Court's opinion

The parties agreed and stipulated that the property was real property used in the LLC's hotel business under section 1221(a)(2) and that the property was classified under section 1231(b)(1) as "property used in a trade or business." The sole issue before the Tax Court was whether "capital asset" as used in section 1234A extends to property described in section 1231.

The Tax Court agreed with the IRS that because the hotel was section 1231 property, it was by definition not a capital asset (as defined by section 1221) and thus could not fall under section 1234A. The IRS also asserted that because Congress wrote section 1234A to apply only to gain or loss from a termination of rights or obligations relating to property that is (or on acquisition would be) a capital asset, the statute is to be read narrowly to exclude property described in section 1231. The Tax Court stated:

> *Since section 1234A expressly refers to property that is "a capital asset in the hands of the taxpayer" and no other type of property, and since property described in section 1231 is excluded explicitly from the definition of "capital asset" in section 1221, we must conclude that the plain meaning of "capital asset" as used in section 1234A does not extend to section 1231 property. We therefore are not convinced by petitioner's argument that the statute is inherently ambiguous.*