UNITED STATES TAX COURT
WASHINGTON, DC 20217

GREENTEAM MATERIALS RECOVERY FACILITY PN; GREENWASTE RECOVERY, INC., TAX MATTERS PARTNER, ET AL.,	)	
Petitioner,	)	
v.	)	Docket No. 21946-09, 22233-09.
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent	)	

O R D E R

These cases were assigned to this division of the Court, together with a companion case, No. 423-11. In each of these cases, the petitioner has moved for summary judgment. The petitioner in both of these two consolidated cases is the same S Corporation, Greenwaste Recovery, Inc., which is the tax matters partner for both Greenteam Materials Recovery Facility (Greenteam Facility) and Greenteam of San Jose.[1] The Court will assume that the parties know the background facts and general rules regarding summary-judgment law.

[1]Greenteam Facility and Greenteam of San Jose are both TEFRA partnerships under the Code. (TEFRA is the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, one part of which governs the tax treatment and audit procedures for most partnerships. *See* TEFRA secs. 401-406, 96 Stat. at 648. TEFRA requires the uniform treatment of all "partnership items"--a term defined by section 6231(a)(3) and (4)--and its general goal is to treat all partners alike when the IRS adjusts partnership items.) Each TEFRA partnership is supposed to designate one of its partners as TMP to handle TEFRA issues and litigation for the partnership. Here the IRS mailed the notices of final partnership administrative adjustments to the TMP. (An FPAA, as a notice of final partnership administrative adjustments is abbreviated, is the TEFRA equivalent of a notice of deficiency, in that it triggers the start of the time for filing a case in Tax Court.)

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Greenwaste Recovery is a partner in both Greenteam Facility and Greenteam of San Jose. Greenteam Facility is a partnership that provided services to Greenteam of San Jose. Greenteam of San Jose had an exclusive contract with the City of San Jose, California to dispose or recycle waste from certain districts within the City. The contract was for a fixed term of five years, with the possibility of two three-year renewal periods after the initial term expired.

Substantially all the assets of both Greenteam Facility and Greenteam of San Jose were sold to an unrelated third-party, Waste Connections, Inc., in 2003. The cases involve disputes between the partnerships and the Commissioner in the amounts reported and how to characterize them in computing tax on the sales.

No. 21946-09 - Greenteam Materials Recovery Facility PN

Greenteam Facility apparently reported (we don't have the return in the record) that it had sold its assets to Waste Connections for a total of $6,278,320. In his FPAA, the Commissioner recharacterized this amount -- that Greenteam Facility had reported as capital gain -- as ordinary income instead.

In its petition, Greenteam Facility admitted that it had made a mistake in the number it put on its return, and that the sale was for $6,460,000. It claimed that that sum should be allocated differently:

> $374,000 to depreciable assets, with a net gain after basis is accounted for, of $231,964;
>
> $6,065,090 to goodwill taxable as capital gain; and
>
> $20,910 to a covenant not to compete, taxable as ordinary income.

No. 22233-09 - Greenteam of San Jose PN

Greenteam of San Jose apparently reported (we don't have its return in the record either) that it had sold its assets to Waste Connections for a total of $20,221,928. In his FPAA for the 2003 tax year, the Commissioner recharacterized this amount -- that Greenteam of San Jose had also reported to be capital gain -- as ordinary income instead. (The Commissioner also issued FPAAs

to Greenteam of San Jose for its 2004 and 2005 tax years. These are not mentioned in the summary-judgment motion.)

In its petition, Greenteam Facility admitted that it had made a mistake in the number it put on its return, and that the sale was for $31,540,000. It claimed that that sum should be allocated differently:

> $8,813,450 to depreciable assets, with a net gain after basis is accounted for, of $647,171;
>
> $22,624,460 to goodwill taxable as capital gain; and
>
> $102,090 to a covenant not to compete, taxable as ordinary income.

The Motion

In its motion for summary judgment, Greenwaste Recovery argues that there is no dispute that (a) the covenants not to compete had no value (instead of the more than $120,000 that it asserted in its petitions) and (b) "there is no guaranteed income stream resulting from the exclusive municipal contract acquired by Waste Connections, Inc." Like the Commissioner, we construe this second ground to be an objection to the Commissioner's recharacterization of what petitioner reported to be capital gain as ordinary income instead.

We analyze them in turn.

The first ground is easy. The Commissioner now concedes that Greenteam Facility and Greenteam of San Jose correctly valued the covenants not to compete on their returns. He disputes Greenwaste's new position that these return positions were wrong. The question is one of fact and, as the Commissioner notes in his answering papers, an executive of Waste Connections testified at his deposition that the covenants "did not have as much value" as they might in situations where the contracts rights being sold did not have an exclusivity provision. This is *not* the same as testimony that they had *no* value. And that's quite enough to create a genuine dispute as to this material fact.

The second issue is substantially harder. When does a sale of rights under a contract create capital gain and when does it create only ordinary income? The

Code tells us that capital gain is derived from the sale or exchange of a capital asset. Section 1221 defines a capital asset as "property held by the taxpayer." (There are exceptions, but none apply here.) But caselaw has made clear that the list of statutory exceptions is not exhaustive, and there are scores, perhaps hundreds, of cases that try to draw clear lines in this especially fuzzy area -- none of which petitioner cites. Still, our own research in the area cannot improve on Judge Friendly's summary of the problem a half century ago:

> [I]t has long been settled that a taxpayer does not bring himself within the capital gains provision merely by fulfilling the simple syllogism that a contract normally constitutes 'property,' that he held a contract, and that his contract does not fall within a specified exclusion * * *. [I]t would be hard to think of a contract more 'naked' than a debenture, yet no one doubts that is a 'capital asset' if held by an investor. Efforts to frame a universal negative, e.g., that a transaction can never qualify if the taxpayer has merely collapsed anticipation of future income, are equally fruitless; a lessor's sale of his interest in a 999 year net lease and an investor's sale of a perpetual bond sufficiently illustrate why * * *
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> * * * * * * *
>
> One common characteristic of the group held to come within the capital gain provision is that the taxpayer had either what might be called an 'estate' in * * *, or an 'encumbrance' on * * *, or an option to acquire an interest in * * *, property which, if itself held, would be a capital asset. *In all these cases the taxpayer had something more than an opportunity, afforded by contract, to obtain periodic receipts of income, by dealing with another* * * *

Commissioner v. Ferrer, 304 F.2d 125, 129-30 (2d Cir. 1962) (emphasis added) (citations omitted), *rev'g* 35 T.C. 617 (1961).

We glean from Greenwaste's motion that Waste Connections was buying intangible assets that did not produce a guaranteed stream of income but instead required Waste Connections, as Greenteam Facility's and Greenteam of San Jose's

successor, to perform services before getting paid. But this is just the sort of disposition of a contractual right to "obtain periodic receipts of income by dealing with another" that precedent often places on the ordinary-income, and not the capital-gains, side of the line. Consider:

> *Flower v. Commissioner*, 61 T.C. 140, 149 (1973), holding that sale of the right to promote drugs produces ordinary income;
>
> *Maryland Coal & Coke Co. v. McGinnes*, 350 F.2d 293, 294 (3d Cir. 1965), holding that the sale of a right to sell a mine's output produces ordinary income; and
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> *Lozoff v. United States*, 266 F. Supp. 966, 970-71 (E.D. Wis. 1967), holding that sale of a right to act as a purchasing agent produces ordinary income.

The lines are not bright in this area. In a very similar case, *Foy v. Commissioner*, 84 T.C. 50, 69-70 (1985), we held that in determining whether the taxpayer's contract rights that were transferred constituted a capital asset, courts generally consider all aspects of the bundle of rights and responsibilities of the taxpayer that were transferred, specifically including the following six factors:

> (1) How the contract rights originated;
>
> (2) How the contract rights were acquired;
>
> (3) Whether the contract rights represented an equitable interest in property which itself constituted a capital asset;
>
> (4) Whether the transfer of contract rights merely substituted the source from which the taxpayer otherwise would have received ordinary income;
>
> (5) Whether significant investment risks were associated with the contract rights and, if so, whether they were included in the transfer; and

(6) Whether the contract rights primarily represented compensation for personal services.

In its summary-judgment motion, Greenwaste does not mention, much less show an absence of a genuine dispute about, these factors. It instead relies on the undisputed fact that payments under the contracts that Waste Connections bought did not guarantee a revenue stream. The uncertain amount of such payments, however, does not transform them into capital-gains income. *See, e.g., Hallcraft Homes, Inc. v. Commissioner,* 336 F.2d 701, 704-05 (9th Cir. 1964), *aff'g* 40 T.C. 199 (1963).

It is therefore

ORDERED that petitioner's summary-judgment motion is denied.

The Court will contact the parties to schedule a teleconference to discuss further scheduling in these cases.

(Signed) Mark V. Holmes
Judge

Dated: Washington, D.C.
August 6, 2013