

Pursuant to Tax Court Rule 50(f), orders shall not be treated as precedent, except as otherwise provided.

UNITED STATES TAX COURT
WASHINGTON, DC 20217

DONALD BAILEY & SANDRA M. BAILEY,)	
ET AL.,)	
)	
Petitioner(s),)	CT
)	
v.)	Docket No. 5477-14.
)	
COMMISSIONER OF INTERNAL REVENUE,)	
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Respondent)	
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ORDER

This case is related to one that was on the Court’s September 22, 2014 trial calendar for Phoenix, Arizona, and another that was consolidated with that one. Those two related cases have settled. The Baileys’ case remains unsettled, and they have filed two motions for partial summary judgment.

We will assume the parties know the background facts and the general rules that apply to summary-judgment motions.

First Motion for Partial Summary Judgment

This case arises from a software program developed by Uwe Zink and Gary Skuro. Zink and Skuro had formed Interradiology LLC. The LLC owned this software and all agree that it had a basis of zero to the LLC. Then Zink and Skuro formed an S corporation, Interradiology, Inc. They exchanged all the LLC’s property for stock in this corporation. Mr. Bailey bought a 10% share of the corporation’s total stock. Neither the LLC nor the individual LLC members got anything but corporate stock in exchange for the transfer of all the LLC’s property to the corporation.

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The Baileys, as shareholders of the S corporation, argue that it got a stepped-up basis in the software. The Baileys have filed two motions for partial summary judgment and ask for oral arguments on their first motion.

Both parties have fully briefed their arguments, so oral arguments aren't necessary to decide the Baileys' partial summary-judgment motions.

Summary judgment is appropriate where "there is no genuine dispute as to any material fact and * * * a decision may be rendered as a matter of law." Tax Court Rule 121(b). [#co_footnote_B00332003712468](#) "[A]n adverse party may not rest upon the mere allegations or denials of such party's pleading, but such party's response * * * must set forth specific facts showing that there is a genuine dispute for trial." Tax Court Rule 121(d).

In this motion, the Baileys argue there's no factual dispute about the basis of software transferred in the section 351 transaction. The parties do agree that the transaction wasn't subject to tax under section 351 and that the basis of the software was zero before that transaction. But that's where the agreement stops. After the transaction, the corporation increased its basis in the software from zero to around \$9.7 million and began to depreciate it. This enabled the company to offset its cash income and therefore the amount of passthrough income taxable to its shareholders, including the Baileys. The Commissioner says the basis of the software should have stayed at zero. This disagreement is important -- it's the difference between the Baileys' having taxable income or not.

The Code tells us that when there is no boot in a section 351 transfer, the basis of the stock the shareholders get must be the same as the property exchanged. I.R.C. § 358(a). The corporation gets a carryover basis in the property it receives too. I.R.C. § 362. So the corporation's basis in the software should have been the same as it was before the transaction -- zero. The Baileys point to Revenue Ruling 85-164, but this ruling doesn't help them. This ruling tells taxpayers how to allocate basis among different stocks and securities received in exchange for property contributed to a corporation, not how to increase the basis of that property to its fair market value. That means the Baileys haven't shown they are entitled to judgment as a matter of law here.

We must also deny the Baileys' requests for court costs, expert witness fees, and other fees. A "prevailing party" may be awarded reasonable administrative and litigation costs under section 7430, but the Baileys aren't a prevailing party, at least not at this stage.

Second Motion for Partial Summary Judgment

In their second motion for partial summary judgment the Baileys argue that the Commissioner's adjustments in the notice of deficiency are false statements and that new Forms 1040, attached as exhibits to their motion, show their correct liability.

This doesn't get them summary judgment either. Part of the Baileys' argument in this motion hinges on the appropriate basis of the software, and we've already held that the Baileys lose on that issue. And just because the Baileys attached new 1040s as exhibits to their motion doesn't disprove the notice of deficiency or mean there aren't genuine issues of fact. Tax returns are just a taxpayer's assertion, and here, may be their admission, but they are not proof of what their correct deficiency is. I.R.C. § 7491(a)(2); Tax Court Rule 142(a).

It is therefore

ORDERED that the petitioners' motion for partial summary judgment is denied. It is also

ORDERED that petitioners' motion to request oral argument is denied. It is also

ORDERED that petitioners' second motion for partial summary judgment is denied. It is also

ORDERED that the parties file a joint status report on or before October 22, 2018 that includes their positions on whether they will be able to settle this case or need a trial date.

(Signed) Mark V. Holmes
Judge

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Dated: Washington, D.C.
September 11, 2018