

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

**ROGER D. SACK, PERSONAL
REPRESENTATIVE OF DEAN
SACK, DECEASED,**

Petitioner,

v.

**STATE OF NEBRASKA, NEBRASKA
DEPARTMENT OF REVENUE and
NEBRASKA STATE TAX
COMMISSIONER**

Respondents.

Docket: 554 Page: 226

ORDER

Statement of the Case

This case seeks review of the decision of the State Tax Commissioner denying Dean Sack's claim for a refund of Nebraska income tax. Dean Sack ("Sack") acquired stock in York State Company by virtue of his employment with York State Bank. Sack maintained continuous employment with the Bank from 1943 to 1995. In April of 1994, Sack transferred ownership of his stock to the Sack Family Partnership. The partnership was created to hold the stock owned by Sack and other family members and to negotiate a sale of the stock. In 1995, the stock was sold.

On his 1995 income tax return, Sack made a special capital gains election pursuant to NEB. REV. STAT. § 77-2715.09 (1994 Cum. Supp.), which allows for a one-time election to exclude a capital gain on the sale of stock received by the taxpayer by virtue of his employment with the issuing corporation. The Nebraska Department of Revenue ("Department") disallowed the exclusion. Sack then filed an amended 1995 tax return, contesting the disallowance of the special capital gains election and claiming a refund. In January of 1997, the State Tax

Commissioner denied Sack's refund claim. The Department claimed that because he transferred his stock to the partnership, Sack was not the owner of the stock at the time it was sold. Thus, Sack did not qualify for the special capital gains election. Dean Sack died on August 17, 1997 and his personal representative, Roger D. Sack, ("Petitioner") was substituted as a party in this action.

Standard of Review

Pursuant to NEB. REV. STAT. § 77-2798 (1996), a taxpayer may bring an action in the district court where the taxpayer resides or in the district court of Lancaster County for recovery of income tax he has paid, based upon the grounds set forth in his claim for refund.

Analysis

The sole issue in this case is whether Sack's transfer of the stock to the partnership makes him ineligible for the special capital gains election under NEB. REV. STAT. § 77-2715.09. This statute allows persons who have received stock through their employment to exclude a capital gain on the sale of such stock. NEB. REV. STAT. § 77-2715.09. (1)(a) provides:

Every resident individual may elect under this section to subtract from federal adjusted gross income or, for trusts qualifying under subdivision (2)(c) of this section, from taxable income the capital gain from the sale or exchange of capital stock of a corporation acquired by the individual (i) on account of employment by such corporation or (ii) while employed by such corporation.

The purpose of the special capital gains exclusion is to encourage employees who receive stock by virtue of their employment with a Nebraska corporation to remain residents of Nebraska after selling such stock. Residents of Nebraska were moving out of the state to avoid the capital gains tax on the sale of stock they had received from their employers. As part of an economic revitalization program, the Legislature enacted the special capital gains exclusion to encourage

such employees to remain in Nebraska. An individual may make one special capital gains election during his or her lifetime. NEB. REV. STAT. § 77-2715.09 (2)(a).

To facilitate the purpose of this statute, several requirements must be met in order for a person to make a special capital gains election. First the person must be a resident of Nebraska. NEB. REV. STAT. § 77-2715.09. (1)(a). Second, the person must seek to exclude from his or her federal adjusted gross income a capital gain on the sale of capital stock. NEB. REV. STAT. § 77-2715.09. (1)(a) Third, the stock must have been obtained by the person during his employment or on account of his employment with the corporation issuing the stock. NEB. REV. STAT. § 77-2715.09. (1)(a)(i)-(ii). Sack clearly met the requirements of this statute. He was a resident of Nebraska who had received stock in a corporation on account of his employment with the corporation. The capital gain he was seeking to exclude from his adjusted gross income resulted from the sale of such stock. Sack was seeking to make a one-time election. The Department admits that Sack would have qualified for the special capital gains election had he not transferred the stock to the partnership before it was sold. (Letter to Dean Sack from State Tax Commissioner, dated January 15, 1997, page 2).

The Department contends that NEB. REV. STAT. § 77-2715.09 applies only when the individual taxpayer sells the stock himself or when sold by a spouse, issue, or trust for the benefit of a spouse or issue as provided in NEB. REV. STAT. § 77-2715.09 (2)(c)(1994 Cum. Supp.), and not when sold by another entity. The Department claims that because Sack transferred his stock to the partnership before selling it, he does not qualify for the special capital gains exclusion. The Department argues that in this case, the partnership was the seller, not Sack as an individual taxpayer. However, Petitioner argues that the partnership is simply a flow-through entity,

meaning that the tax consequences of the partnership business flow to each partner on his or her own individual tax return. Such an approach has been adopted by Nebraska. NEB. REV. STAT. § 77-2727 (1994 Cum. Supp.) provides:

(1) A partnership as such shall not be subject to the income tax imposed by the Nebraska Revenue Act of 1967. Persons or their authorized representatives carrying on business as partners shall be liable for the income tax imposed by the Nebraska Revenue Act of 1967 only in their separate or individual capacities.

(2) The partners of such partnership who are residents of this state or corporations shall include in their incomes their proportionate share of such partnership's income.

In this case, the tax consequences of the sale of the stock by the partnership flow to Sack's individual income tax return. Sack is individually liable for the tax imposed on partnership income. The partnership itself is not taxed. Sack sought to have the capital gain excluded from his individual income tax. The partnership itself would receive no benefit from the exclusion. Therefore, there is no reason to disallow Sack's special capital gains election. The tax consequences flow to him and him alone. The fact that he transferred the stock to the partnership before it was sold does not change this analysis.


Furthermore, NEB. REV. STAT. § 77-2715.09 (2)(c) is inapplicable in this case. This section allows a spouse, issue, or a trust for the benefit of a spouse or issue to take advantage of the special capital gains election if the stock was received by inter vivos gift from a taxpayer who could have exercised the special capital gains election. The Department contends that because a partnership is not included among those who may claim the exclusion, Sack cannot exclude the capital gain on the stock sold by the partnership. However, NEB. REV. STAT. § 77-2715.09 (2)(c) applies when the taxpayer is transferring the benefit of the special capital gains election to a third party, not when he is seeking the benefit on his own tax return. Sack was not trying to transfer

the benefit of the exclusion to anyone else. He was seeking to exclude the capital gain on his own tax return. Therefore, NEB. REV. STAT. § 77-2715.09 (2)(c) is inapplicable in this case.

The special capital gains election was designed to encourage people like Sack to remain in Nebraska after selling their stock. Sack did indeed remain a Nebraska resident after selling his stock. The fact that he transferred the stock to a partnership for the purposes of having it sold should not make him ineligible for the exclusion of capital gain. The partnership was not receiving a benefit from the capital gains exclusion because the tax consequences of the sale flow directly to Sack, the individual taxpayer. Sack was the person who would receive the benefits of the exclusion and he is the type of person this statute was intended to apply to. The circumstances under which Sack attempted to make the special capital gains election is consistent with the purposes for which the special capital gains elections was enacted. Sack is entitled to the capital gains election notwithstanding his transfer of the stock to the partnership. Therefore, Petitioner is entitled to the refund claimed, plus accrued interest.

Dated: November 6, 1998

BY THE COURT:



Donald E. Endacott
District Court Judge