1 T.C. 198 (1942)

A taxpayer cannot use the installment method of reporting income from a sale if the initial payments received in the year of sale exceed 30% of the selling price, including amounts constructively received through interconnected transactions.

Summary

James Hammond sold stock for $965,000, receiving $74,000 cash from the buyer. He also received $280,000 from a creditor, Roy W. Howard Co., and cancellation of a $150,000 debt to Howard Co., giving Howard Co. notes for $430,000 payable only from the buyer's payments. The Tax Court held that Hammond could not report the sale on the installment basis because the initial payments constructively received ($74,000 + $430,000) exceeded 30% of the selling price. The court looked beyond the form of the transaction to its substance, finding that Hammond effectively received $504,000 in the year of sale.

Facts

Hammond sold his stock in the Tennessee Co. for $965,000. He received a $74,000 cash payment in 1936. Hammond owed $150,000 to the Roy W. Howard Co. Press-Scimitar, the buyer, agreed to a complex arrangement: Howard Co. lent Hammond $280,000 to pay a debt to Commercial Appeal, Inc. Howard Co. also canceled Hammond's $150,000 debt. Hammond gave Howard Co. new notes for $430,000, payable only from payments Press-Scimitar would make for the stock. Hammond granted an irrevocable power of attorney to H.E. Neave (treasurer of Scripps-Howard) to receive payments from Press-Scimitar and pay the notes to Howard Co.

Procedural History

The Commissioner of Internal Revenue determined income tax deficiencies against Hammond for 1935 and 1936. The parties stipulated to a deficiency for 1935. The Tax Court addressed the deficiency for 1936, specifically whether Hammond could use the installment method to report gain from the stock sale.

Issue(s)

Whether Hammond could report the gain from the sale of his stock on the installment basis, given that he received $74,000 directly and entered into an arrangement where $430,000 of the purchase price was used to satisfy his debts to a third party.

Holding

No, because the initial payments constructively received by Hammond in 1936, including the $430,000 used to satisfy his debts, exceeded 30% of the selling price, disqualifying him from using the installment method under Section 44(b) of the

© 2025 SCOTUSreports.com. All rights reserved.

Revenue Act of 1936.

Court’s Reasoning

The court reasoned that the complex arrangement was designed to circumvent the 30% limit on initial payments for installment sales. Even though Press-Scimitar didn’t directly assume Hammond’s debt, the effect was the same: Hammond’s debt was canceled, and he received the benefit of $430,000. The court emphasized that the notes Hammond gave to Howard Co. were contingent on Press-Scimitar making payments, and Hammond was effectively relieved of personal liability. The court stated, “A given result at the end of a straight path is not made a different result because reached by following a devious path,” quoting *Minnesota Tea Co. v. Helvering, 302 U.S. 609*. The court also noted that Neave, acting as Press-Scimitar’s nominee, effectively controlled the payments, further demonstrating the lack of genuine liability on Hammond’s part. The court also cited authorities holding that amounts received by an agent, payments made to a vendor’s creditor, and cancellation of indebtedness by the vendee are all included in initial payments.

Practical Implications

This case illustrates the importance of looking beyond the form of a transaction to its substance when determining tax consequences. Taxpayers cannot use complex, interconnected transactions to circumvent the limitations on installment sales. The IRS and courts will scrutinize such arrangements to determine whether the taxpayer has constructively received payments exceeding the statutory limit. This case reinforces the principle that a taxpayer is considered to have received income when it is applied for their benefit, even if they do not directly possess it. Later cases cite *Hammond* for the principle that the substance of a transaction, not its form, controls for tax purposes, and that constructive receipt can disqualify a taxpayer from using the installment method. It also highlights that interconnected steps in a series of transactions cannot be viewed in isolation.

© 2025 SCOTUSreports.com. All rights reserved.