Rogers v. Commissioner, 143 F.2d 695 (5th Cir. 1944)

A taxpayer constructively receives income when a third party pays the taxpayer's debt with promissory notes, and those notes have ascertainable fair market value, even if the taxpayer's original obligation is not discharged.

Summary

Rogers sold oil and gas leases to Davis & Co., who agreed to pay Rogers' debts to Transwestern Oil Co. and Kellogg. Davis paid Transwestern $60,000 and Kellogg $100,000 in cash. Davis also gave Kellogg promissory notes for the remaining $100,000 owed to Kellogg. Davis paid $33,332 of the notes in 1939. The remaining $66,668 of notes were not due or paid in 1939, which is the subject of dispute. The court held that Rogers constructively received income in 1939 equal to the fair market value of the notes, even though Rogers's debt to Kellogg was not fully discharged until the notes were paid.

Facts

In 1939, Rogers sold oil and gas leases to Davis & Co.
As consideration, Davis & Co. promised to pay Rogers's $60,000 debt to Transwestern Oil Co. and $200,000 debt to Kellogg.
Davis paid Transwestern $60,000 cash and Kellogg $100,000 cash.
Davis gave Kellogg promissory notes for the remaining $100,000 owed by Rogers.
$33,332 of the notes were paid by Davis in 1939.
The remaining $66,668 in notes were not due or paid in 1939.
The notes were collateral to Rogers's obligation to Kellogg.
The $66,668 in notes were paid according to their terms in the following year.

Procedural History

The Commissioner determined that the $66,668 in unpaid notes constituted income to Rogers in 1939.
Rogers appealed the Commissioner's determination.
The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether Rogers constructively received income in 1939 for the remaining $66,668 in promissory notes given to Kellogg by Davis & Co., even though Rogers' obligation to Kellogg was not discharged in 1939.
Whether the promissory notes had a fair market value in 1939 that could be included as income.

Holding

Yes, because the legal fiction of constructive receipt treats the receipt by Kellogg as

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the receipt by Rogers, and the receipt by Rogers directly of the Davis notes in consideration for the sale of the oil and gas leases would be income even though Rogers' obligation to Kellogg continued.
Yes, because the evidence does not establish that the notes were worth less than their face value. The Commissioner's determination that they were worth $66,668 is sustained.

Court's Reasoning

The court reasoned that the receipt of property in consideration for a sale is regarded as the receipt of cash to the extent of the property's value, citing Section 111(b) of the Revenue Act of 1938 and several cases.
The court found that if Davis's notes had come to Rogers directly instead of going to Kellogg on account of Rogers's debt, Rogers would have been taxable on the gain when the notes were received.
The court addressed Rogers's argument that the notes may not be regarded as constructively received because Rogers's obligation to Kellogg persisted. The court stated that the realization of income is not merely found in Davis's promise to pay Rogers's debt to Kellogg but in the constructive receipt by Rogers of property consisting of the Davis notes.
The court acknowledged that the notes were "collateral" to Rogers's obligation but stated that the legal fiction of constructive receipt treats the receipt by Kellogg as the receipt by Rogers.
The court rejected Rogers's argument that the notes were without market value in 1939. The court noted that the notes were given under the agreement, and the remaining $33,332 of the $100,000 notes were paid when due in 1939. The $66,668 of notes were paid according to their terms within the following year. The court found that the notes had full value subject to the possibility of a rescission of the contract upon the happening of a condition subsequent.

Practical Implications

This case clarifies the application of the constructive receipt doctrine, emphasizing that income is realized when a taxpayer benefits from the payment of their debt by a third party, regardless of whether the original obligation is immediately discharged.
The ruling highlights the importance of determining the fair market value of promissory notes at the time of receipt. Taxpayers must be prepared to demonstrate that notes received as payment for goods or services have a value less than their face value, or they will be taxed on the face value.
Practitioners should advise clients that if a third party pays a taxpayer's debt with notes, the taxpayer can be taxed on the value of the notes in the year they are received, even if the original obligation is not fully discharged until a later year.

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