12 T.C. 1178 (1949)

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A vendor who elects to report gains from property sales on the installment basis must recognize a gain or loss when repossessing the property after the purchaser's default, calculated as the difference between the fair market value of the repossessed property and the adjusted basis of the purchaser's installment obligations, even if the purchaser is released from further liability upon default.

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Summary

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Lucille and Charles Morrison, operating the Morrison Land Co., sold lots on an installment plan, reporting income on the installment basis. When purchasers defaulted, the Morrisons repossessed the lots. The Commissioner of Internal Revenue determined a gain on these repossessions, treating the transaction as an exchange of the purchaser's installment obligations for the repossessed lot. The Tax Court upheld the Commissioner's determination, reasoning that Internal Revenue Code section 44(d) and Regulation 111 section 29.44-3 mandate this treatment, regardless of whether the purchaser remains liable for the unpaid balance after default, once the seller elects the installment method.

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Facts

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The Morrisons sold land lots under contracts requiring a down payment and subsequent monthly payments. The contracts stipulated that upon a 30-day default, all prior payments would be forfeited as rent, the contract would become void, and the purchaser would be relieved of further liability. Upon default, the Morrisons sent notices of cancellation. In some instances, the Morrisons transferred the defaulting payor's credit to other lots instead of forfeiting the payments.

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Procedural History

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The Commissioner determined deficiencies in the Morrisons' income taxes, adding gains from the repossessed lots to their community income. The Morrisons petitioned the Tax Court, arguing that no taxable gain should be recognized because the purchasers were released from further liability upon default, thus extinguishing any installment obligations. The Tax Court upheld the Commissioner's determination.

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Issue(s)

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Whether a vendor reporting income on the installment basis realizes a taxable gain upon repossessing property after the purchaser's default, where the default releases the purchaser from further liability for the unpaid balance.

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Holding

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Yes, because section 44(d) of the Internal Revenue Code and section 29.44-3 of Regulations 111 treat the repossession as a satisfaction of the installment obligations, resulting in a taxable gain or loss measured by the difference between the fair market value of the reacquired property and the adjusted basis of the purchaser's obligations.

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Court's Reasoning

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The court relied on the established principle that section 44(d) applies to repossessions after default, citing *Boca Ratone Co. v. Commissioner*, which held that repossession

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