Nina J. Ennis v. Commissioner, 17 T.C. 469 (1951)

A cash basis taxpayer realizes income from the sale of property only to the extent that the amount realized (cash or its equivalent) exceeds their basis in the property; a mere contractual obligation to pay in the future, not embodied in a negotiable instrument, is not the equivalent of cash.

Summary

Nina Ennis, a cash basis taxpayer, sold her interest in real property, receiving a cash down payment and a contractual obligation for future payments. The Commissioner argued that the entire profit from the sale was taxable in the year of the sale. The Tax Court held that because Ennis was a cash basis taxpayer, she only recognized income to the extent of cash or its equivalent received. Since the contractual obligation was not a negotiable instrument readily convertible to cash, it was not considered an “amount realized” in the year of the sale, and therefore, not taxable until received.

Facts

Ennis, reporting income on the cash receipts method, sold her half-interest in the Deer Head Inn. The vendee took possession in 1945, assuming the benefits and burdens of ownership. The purchase price was fixed, and the vendee was obligated to pay it under the contract terms. Ennis received a cash down payment, which was less than her basis in the property, and a contractual obligation from the buyer to pay the remaining balance in deferred payments extending beyond 1945. The contractual obligation was not evidenced by a note or mortgage.

Procedural History

The Commissioner increased Ennis’s income for 1945, arguing that she should include the full profit from the sale of the Inn. Ennis petitioned the Tax Court, arguing that as a cash basis taxpayer, she only recognized income to the extent of cash or its equivalent received in 1945.

Issue(s)

Whether a contractual obligation to pay in the future, received by a cash basis taxpayer in a sale of property, constitutes an “amount realized” under Section 111(b) of the Internal Revenue Code, even if such obligation is not embodied in a note or other negotiable instrument.

Holding

No, because for a cash basis taxpayer, only cash or its equivalent constitutes income when realized from the sale of property. A mere contractual promise to pay in the future, without a negotiable instrument, is not the equivalent of cash.

Court's Reasoning

The court relied on Section 111(a) of the Internal Revenue Code, which states that gain from the sale of property is the excess of the amount realized over the adjusted basis. Section 111(b) defines "amount realized" as "any money received plus the fair market value of the property (other than money) received." The court emphasized that for a cash basis taxpayer, only cash or its equivalent constitutes income. The court cited *John B. Atkins, 9 B. T. A. 140*, stating "* * * in the case of one reporting income on the receipts and disbursements basis only cash or its equivalent constitutes income." The court reasoned that for an obligation to be considered the equivalent of cash, it must be "freely and easily negotiable so that it readily passes from hand to hand in commerce." Because the promise to pay was merely contractual and not embodied in a note or other evidence of indebtedness with negotiability, it was not the equivalent of cash. The court acknowledged that the contract had elements of a mortgage but found that this did not lend the contract the necessary element of negotiability. Therefore, the only "amount realized" in 1945 was the cash received, which was not in excess of Ennis's basis.

Practical Implications

This case clarifies the definition of "amount realized" for cash basis taxpayers in property sales. It establishes that a mere contractual promise to pay in the future is not taxable income until actually received if not evidenced by a negotiable instrument such as a note. Attorneys advising clients on structuring sales of property should consider the taxpayer's accounting method and ensure that, if the taxpayer is on a cash basis, deferred payments are structured in a way that avoids immediate tax consequences (e.g., by not using negotiable notes or mortgages). This ruling impacts tax planning for individuals and businesses using the cash method of accounting by providing clarity on when income is recognized in property sales. Later cases have distinguished this ruling based on the specific facts, such as the presence of readily marketable notes or mortgages, but the core principle remains that cash basis taxpayers are taxed on what they actually receive or can readily convert to cash.

