T.C. Memo. 1949-264

A loss sustained from the forfeiture of a down payment on a land purchase contract is treated as a capital loss when the purchaser defaults, and the vendor has the option to enforce the contract or declare a forfeiture, and the purchaser does not negate the possibility of a subsequent agreement confirming the respondent's action.

Summary

Rogers claimed an ordinary loss deduction for the forfeiture of a down payment on a land purchase contract. The Tax Court ruled that the loss was a capital loss, limited to a $1,000 deduction. Rogers entered a binding contract to purchase land, made a down payment, and then failed to complete the purchase. He argued that the forfeiture was not a sale or exchange. The court held that because Rogers did not prove that a sale or exchange did not occur when the contract was terminated, and the vendor had the option of enforcing the contract, the loss was a capital loss. The court also addressed the deductibility of business bad debts, disallowing deductions for advances to a corporation deemed capital contributions rather than loans.

Facts

Rogers entered a contract to purchase land, paying a deposit and incurring $75 in expenses. He failed to complete the purchase on the agreed-upon date. He received a letter threatening a suit for specific performance from the seller. Rogers claimed a $2,075 loss on his 1945 tax return, representing the forfeited down payment and expenses.

Procedural History

The Commissioner of Internal Revenue determined that the loss was a capital loss, deductible only up to $1,000. Rogers appealed to the Tax Court, arguing that the loss was an ordinary loss. The Tax Court upheld the Commissioner's determination regarding the capital loss treatment.

Issue(s)

1. Whether the loss sustained from the forfeiture of the down payment and expenses on the land purchase contract constitutes a capital loss or an ordinary loss.
2. Whether advances made to a corporation by its president and substantial stockholder are deductible as business bad debts.

Holding

1. Yes, because the taxpayer did not prove that the transaction terminating the contract did not constitute a sale or exchange and the vendor had the option to

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enforce the contract.
2. No, because the advances made to the corporation in 1946 were considered capital contributions, not debts, given the corporation's deteriorating financial condition and the taxpayer's knowledge thereof.

Court's Reasoning

The court reasoned that when a buyer defaults on a land purchase contract, the seller has the option to either enforce the contract or declare a forfeiture. Absent proof that a sale or exchange did not occur upon the termination of the contract or the buyer's rights in the property were extinguished by the seller, the forfeiture is treated as a capital loss. Rogers failed to provide sufficient evidence to negate the possibility of a settlement or agreement that would constitute a sale or exchange. Regarding the advances to the corporation, the court found that while the 1945 advances could reasonably be considered debts, the 1946 advances were essentially capital contributions. The court stated, "It seems to us obvious that petitioner had no hope of recovering the amounts advanced in 1946… [H]e was not creating debts by advancing money to the corporation in 1946, but was in fact making a capital contribution to it." The court cited *Reading Co. v. Commissioner*, 132 F.2d 306 (3d Cir. 1942) where similar advances were characterized as "gifts or contributions of capital, but not debts."

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