28 T.C. 773 (1957)

A taxpayer may not include a contingent liability in the cost basis of property for tax purposes until the liability becomes fixed and certain.

Summary

In Redford v. Commissioner, the U.S. Tax Court addressed whether a taxpayer could include a contingent liability in the cost basis of property for determining taxable gain. The taxpayer purchased land, paying a portion with a note and another portion with a non-interest-bearing, non-negotiable second note that stipulated the seller would receive the lesser of $25,000 or one-half of the profits from resale. The Court held that the taxpayer could not include the $25,000, or any lesser amount representing the potential profit-sharing liability, in his cost basis for the land until the amount was fixed and certain, as the liability was contingent upon future profits and had not yet been paid.

Facts

In 1946, Lloyd Redford purchased a tract of land, intending to subdivide and resell it. He paid for the land with two notes: a negotiable note for $61,000 and a non-negotiable note for $25,000. The second note stipulated that Redford would pay the seller the lesser of $25,000 or one-half of the profits realized from reselling the land after recovering his initial investment and development costs. Redford subdivided and sold approximately 90% of the property between 1946 and 1949, recovering his initial investment and development costs. He made no payments on the $25,000 note before the hearing. Redford sought to include the $25,000 in his cost basis for calculating gain from the sales. The Commissioner of Internal Revenue disallowed this inclusion.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Redford’s income tax for 1946, 1947, and 1949. The Commissioner determined that Redford’s cost basis in the lots sold should exclude the $25,000. The U.S. Tax Court reviewed the Commissioner’s decision.

Issue(s)

1. Whether Redford could include the $25,000 (or any lesser sum) from the second note in his cost basis for the land sold in 1946, 1947, and 1949.

Holding

1. No, because the obligation to pay the $25,000 was contingent, and therefore, the amount could not be included in the cost basis until the liability was fixed and certain.

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Court’s Reasoning

The court relied on Section 113 of the Internal Revenue Code, which states that the basis of property for determining gain or loss is the “cost of such property.” The court reasoned that the $25,000 payment was contingent on future profits and had not been paid, making it uncertain. The court emphasized that the petitioner was trying to increase the cost basis with an amount he had not paid. Moreover, the note could have become null and void if the seller breached the agreement, illustrating the contingent nature of the obligation. The court cited Heiner v. Mellon, which held that a taxpayer can only use amounts paid when calculating cost. The court rejected the taxpayer’s argument because it would give him a

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