Reaver v. Commissioner, T.C. Memo. 1971-69

A taxpayer who initially fails to elect the installment method of reporting income from a sale on their original tax return is not automatically barred from doing so; they may make a valid election on an amended return, provided they have not made an affirmative election of a different reporting method on the original return and meet the requirements for installment reporting.

Summary

John and Opal Reaver sold property and received cash and promissory notes. On their original tax return, they mistakenly reported the cash received as ordinary business income and did not report the sale as a capital transaction or elect the installment method. Upon audit, they filed an amended return electing the installment method. The Tax Court held that the Reavers could elect the installment method on an amended return because their initial misreporting did not constitute an affirmative election of an inconsistent method. The court emphasized that neither the statute nor regulations explicitly require the installment method election to be made on a timely filed original return, and the taxpayers had not misled the government to its disadvantage.

Facts

Petitioners John and Opal Reaver operated an airport business on a 35-acre tract of land. In 1958, due to John's health issues, they sold the property to Central Baptist Church for $182,600. The church paid $1,000 cash in 1958 and issued two promissory notes for the balance. The Reavers received a total of $2,600 in cash payments in 1958. On their original 1958 tax return, prepared by Opal, who had no formal bookkeeping training, they mistakenly included the $2,600 as gross receipts from their airport business and did not report the property sale as a capital transaction or elect the installment method. After an IRS audit, and upon advice from an accountant, the Reavers filed an amended return electing the installment method.

Procedural History

The Commissioner determined a deficiency in the Reavers' 1958 income tax, disallowing the installment method election and asserting additions to tax for negligence and failure to file estimated tax. The Reavers petitioned the Tax Court, contesting the deficiency and additions to tax. The Tax Court considered whether the installment method election was valid and whether the additions to tax were warranted.

Issue(s)

1. Whether the petitioners were entitled to elect the installment method of reporting gain from the sale of real property on an amended income tax return

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for 1958, after failing to do so on their original return.
2. Whether the petitioners were liable for an addition to tax for negligence under Section 6653(a) of the Internal Revenue Code of 1954.
3. Whether the petitioners were liable for an addition to tax for failure to file a declaration of estimated tax under Section 6654(a) of the Internal Revenue Code of 1954.

Holding

1. Yes, because neither the statute nor the regulations explicitly require the installment method election to be made on an original return, and the petitioners did not make an affirmative election of an inconsistent method on their original return.
2. No, because the petitioners' underpayment, if any, was not due to negligence or intentional disregard of rules and regulations.
3. Yes, because the addition to tax under Section 6654(a) is mandatory unless an exception applies, and the petitioners presented no evidence of an applicable exception.

Court's Reasoning

The Tax Court reasoned that Section 453(b) of the 1954 Code and related regulations do not explicitly mandate that the installment method election must be made on an original, timely filed return. The court distinguished prior cases and Revenue Ruling 93, which suggested a stricter rule, noting that in those cases, taxpayers either failed to report the transaction at all or affirmatively elected an inconsistent method. The court emphasized that the purpose of the installment method was to alleviate the burden of valuing deferred payment obligations and to allow taxpayers to report income as they actually received payments. The court stated, "Neither the statute nor the regulations specifically require that the taxpayer must elect to report a casual sale of real estate on the installment method in a timely filed return." The court found that the Reavers' mistake was honest and rectified promptly, and they had not adopted an inconsistent position or misled the government. Quoting *John F. Bayley, 35 T.C. 288 (1960)*, the court stated, "An election normally implies a choice between two or more alternatives" and concluded that the Reavers' initial reporting was not a conscious election against the installment method. Regarding negligence, the court found no evidence of intentional disregard of rules, noting the revenue agent could reconstruct income from the petitioners' records. On the estimated tax penalty, the court followed precedent that the penalty is mandatory absent evidence of an exception.

Practical Implications

Reaver v. Commissioner provides important practical guidance for tax practitioners and taxpayers regarding the installment method election. It clarifies that taxpayers are not necessarily locked into their initial reporting position and may correct errors

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by electing the installment method on an amended return, especially when the original misreporting was inadvertent and not an affirmative election of an inconsistent method. This case underscores the importance of examining the specific facts and circumstances to determine if a taxpayer has truly made an election against the installment method. It also highlights the Tax Court's willingness to consider the purpose of the installment method – to match tax liability with actual cash receipts – and to avoid overly rigid interpretations of procedural requirements when no prejudice to the government exists. Later cases and IRS guidance have generally followed this more lenient approach, focusing on whether the taxpayer's actions constituted a clear and informed election of an alternative method, rather than a mere oversight or mistake.

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