Wilson v. Commissioner, 55 T. C. 731 (1971)

Water refund contracts can be treated as "evidences of indebtedness" for capital gains purposes if they resemble revenue bonds, despite not being registered if issued before 1955.

Summary

In Wilson v. Commissioner, the court determined that water refund contracts, which were used to finance water service expansions, qualified as "evidences of indebtedness" under IRC section 1232(a). The contracts, although not labeled as bonds, debentures, or similar, were treated as such due to their function in repaying advances from a specified revenue source. However, those issued before January 1, 1955, did not qualify for capital gains treatment because they were not in "registered form. " The decision highlights the importance of the nature of the obligation over its label and the necessity of registration for pre-1955 contracts.

Facts

Ernest and Marjorie Wilson purchased water refund contracts from developers, which were used to finance the expansion of water services in California. These contracts required water companies to refund developers' advances over time from a percentage of the gross revenue generated by the new water facilities. The Wilsons reported gains from these contracts as long-term capital gains. The IRS contested this, arguing that the contracts did not qualify as "evidences of indebtedness" under IRC section 1232(a), and thus, the gains should be treated as ordinary income.

Procedural History

The Wilsons filed a petition with the Tax Court after the IRS determined deficiencies in their income taxes for the years 1961, 1962, and 1963. The Tax Court heard the case and issued its decision in 1971, addressing whether the water refund contracts were "evidences of indebtedness" and whether those issued before January 1, 1955, were in "registered form. "

Issue(s)

1. Whether water refund contracts are "evidences of indebtedness" within the meaning of IRC section 1232(a)?
2. If so, whether water refund contracts issued before January 1, 1955, were in "registered form" as required by IRC section 1232(a)(1)?

Holding

1. Yes, because the water refund contracts resemble revenue bonds and were treated as liabilities by the water companies, qualifying them as "evidences of

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indebtedness” under IRC section 1232(a).
2. No, because the contracts issued before January 1, 1955, did not have registration noted on their face, thus failing to meet the “registered form” requirement of IRC section 1232(a)(1).

Court’s Reasoning

The court analyzed the nature of the water refund contracts, finding that they functioned similarly to revenue bonds, despite lacking a formal label. The court rejected the IRS’s argument that the contracts were mere contingent rights to share in future revenues, emphasizing that the contracts were treated as debts by both parties. The court applied the statutory language of IRC section 1232(a) broadly, considering the contracts as “other evidences of indebtedness. ” For the second issue, the court held that the contracts issued before January 1, 1955, did not meet the “registered form” requirement because they lacked registration notation on their face, as required by precedent. The court cited cases like Bryant v. Commissioner to support its view that obligations payable from a specific revenue source are still valid debts.

Practical Implications

The decision in Wilson v. Commissioner expands the scope of what can be considered an “evidence of indebtedness” under IRC section 1232(a), allowing similar contracts to potentially qualify for capital gains treatment. However, it also underscores the importance of registration for pre-1955 contracts. Legal practitioners should ensure that any contracts issued before this date are properly registered to qualify for capital gains treatment. The ruling impacts how developers and investors structure and report income from similar refund contracts. Subsequent cases have cited Wilson when determining the classification of other types of financial instruments as debts or equities.

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