Dessauer v. Commissioner, 54 T. C. 327 (1970)

Gain or loss on the disposition of installment obligations is calculated as the difference between the amount of cash received and the basis of the obligation as determined by the Commissioner under section 453(d)(2) of the Internal Revenue Code.

Summary

In Dessauer v. Commissioner, the Tax Court addressed the calculation of gain or loss from the disposition of installment obligations by two subchapter S corporations. The corporations sold mobile homes on installment contracts and transferred these contracts to a finance company in exchange for cash. The court held that the gain or loss should be calculated using the cash received from the finance company minus the basis of the obligations, as determined by the Commissioner under section 453(d)(2). This decision clarified that the installment method ceases when the vendor receives all proceeds as if the sale were for cash, and the transaction's arm's length nature supports using the cash received as the fair market value of the obligations.

Facts

Ralph and Rebecca Dessauer owned subchapter S corporations, Huddleston Bros. Sales, Inc. , and Washington Trailer Sales, Inc. , which sold mobile homes on installment contracts. These corporations borrowed money from an unrelated finance company by executing notes equal to the outstanding balance of the installment contracts and transferred the contracts to the finance company via a pledge agreement. The transactions with the finance company were considered a disposition of the installment obligations. The corporations initially did not report any gain or loss from these transactions, but the Commissioner determined that a disposition had occurred and calculated the gain or loss based on the difference between the cash received and the basis of the obligations.

Procedural History

The Commissioner determined deficiencies in the Dessauers' Federal income tax for 1964 and 1965 and proposed additional deficiencies. The Tax Court reviewed the case, focusing solely on the amount of gain or loss resulting from the disposition of the installment obligations under section 453(d) of the Internal Revenue Code.

Issue(s)

1. Whether the basis of the installment obligations should be determined by the Commissioner under section 453(d)(2) of the Internal Revenue Code?
2. Whether the gain or loss on the disposition of the installment obligations should be calculated as the difference between the amount of cash received and the basis of the obligations?

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Holding

1. Yes, because the Commissioner's calculations under section 453(d)(2) were correct and supported by the evidence presented.
2. Yes, because the transactions with the finance company were at arm's length, and the cash received represents the fair market value of the obligations disposed of.

Court's Reasoning

The Tax Court applied section 453(d) of the Internal Revenue Code to determine the basis of the installment obligations, accepting the Commissioner's calculations under section 453(d)(2). The court emphasized that the term "disposition" in section 453(d)(1) is broad, intended to terminate the use of the installment method when the vendor receives all proceeds as if the sale were for cash. Given the arm's length nature of the transactions with the finance company, the court held that the cash received by the corporations was the fair market value of the obligations under both sections 453(d)(1)(A) and (B). The court cited Hegra Note Corporation v. Commissioner and United States v. Davis to support its reasoning that the values of properties exchanged in an arm's length transaction are presumed equal.

Practical Implications

This decision impacts how taxpayers report gain or loss from the disposition of installment obligations. It clarifies that the installment method must cease when the vendor receives all proceeds as if the sale were for cash, and the gain or loss is calculated based on the cash received minus the basis of the obligations. For legal practitioners, this case provides guidance on calculating the basis under section 453(d)(2) and emphasizes the importance of arm's length transactions in determining the fair market value. Businesses involved in similar transactions should ensure accurate reporting of such dispositions and consider the implications of this ruling on their tax liabilities. Subsequent cases may reference Dessauer to establish the proper method for calculating gain or loss in similar situations.

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