***Kirschenmann v. Commissioner, 57 T. C. 524 (1972)***

The excess of an assumed mortgage over the seller's basis in property sold must be included in the payments received in the year of sale for determining eligibility for installment sale treatment under IRC Section 453.

**Summary**

In Kirschenmann v. Commissioner, the Tax Court addressed whether a partnership could report the gain from a real estate sale under the installment method when the buyer assumed a mortgage exceeding the partnership's adjusted basis. The court held that the excess of the mortgage over the basis must be treated as a payment received in the year of sale, which disqualified the partnership from using the installment method as it exceeded the 30% limit of the selling price. Additionally, the court ruled that selling expenses could not be added to the basis for this calculation, affirming the IRS's position and denying the installment sale treatment to the partnership.

**Facts**

In 1965, A-K Associates, a family partnership, sold a farm for $432,000. The farm had an adjusted basis of $98,509. 36 after depreciation, and selling expenses totaled $23,378. 42. The buyer assumed an existing $160,000 mortgage, paid $80,011. 54 in cash, and issued a note for the balance. A-K attempted to report the gain under the installment method, treating the mortgage assumption as not affecting their eligibility. The IRS challenged this, arguing that the excess of the mortgage over the basis should be treated as a payment received in the year of sale, thus exceeding the 30% limit of the selling price and disqualifying A-K from installment reporting.

**Procedural History**

The case originated with the IRS's determination of deficiencies in the partners' federal income taxes, leading to a dispute over the applicability of the installment method under IRC Section 453. The Tax Court, after consolidation of related petitions, heard the case and issued its opinion on January 26, 1972, ruling in favor of the Commissioner.

**Issue(s)**

1. Whether the amount by which an assumed mortgage exceeds the seller's basis must be included in the payments received in the year of sale for determining eligibility for the installment sale provisions of IRC Section 453.
2. Whether selling costs must be offset against gross profit or may be added to the seller's basis for determining eligibility for the installment sale provisions of IRC Section 453.

**Holding**

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1. Yes, because Section 1. 453-4(c) of the Income Tax Regulations mandates that the excess of an assumed mortgage over the seller's basis be included as a payment received in the year of sale for determining installment sale eligibility.
2. No, because selling expenses are not properly chargeable to capital account and thus cannot be added to the seller's basis; they must be offset against gross profit.

**Court's Reasoning**

The Tax Court upheld the validity of the regulations, noting that Congress had given the IRS wide discretion in implementing IRC Section 453. The court found that treating the excess of the mortgage over the basis as a payment in the year of sale was a reasonable measure to prevent evasion of the 30% limit on year-of-sale payments. The court also rejected the argument that selling expenses could be added to the basis, stating that these are not capital expenditures but rather should be offset against gross profit, consistent with prior rulings and regulations. The court's decision was influenced by the need to maintain the integrity of the installment sale provisions and to prevent manipulation through mortgage assumptions.

**Practical Implications**

This decision has significant implications for tax practitioners and taxpayers involved in real estate transactions. When a buyer assumes a mortgage in excess of the seller's basis, this excess must be treated as a payment received in the year of sale, potentially disqualifying the transaction from installment sale treatment if it exceeds the 30% threshold. Taxpayers and their advisors must carefully consider the structuring of sales involving mortgage assumptions to ensure compliance with the installment sale rules. This ruling also reaffirms that selling expenses cannot be added to the basis for these calculations, impacting how such costs are treated in determining taxable gain. Subsequent cases have continued to apply this ruling, shaping the practice of tax law in real estate transactions.

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