Hammerstrom v. Commissioner, 60 T. C. 167 (1973)

A mere change in the form of ownership from community property to tenancy in common, or an election to purchase property under a property settlement agreement, does not trigger investment credit recapture unless a binding sale agreement is executed.

Summary

In Hammerstrom v. Commissioner, the U. S. Tax Court held that the conversion of business assets from community property to tenancy in common, as part of a divorce settlement, did not constitute a disposition triggering investment credit recapture. Additionally, an election to purchase the assets made by the former husband did not result in a sale until a formal agreement was reached years later. The court reasoned that for investment credit recapture to apply, there must be a binding agreement to transfer title for a determinable consideration, which was not present until 1972. This decision clarifies that mere changes in property ownership forms or elections to purchase without a finalized agreement do not trigger investment credit recapture.

Facts

Jewel Hammerstrom and her former husband, Clifford Bockman, owned a logging and contracting business as community property. Upon their divorce on October 13, 1967, they agreed to convert their business assets to tenancy in common. The property settlement agreement allowed Bockman to elect to purchase Hammerstrom's interest for $25,000 over ten years. Bockman elected to purchase on October 18, 1967, but no formal agreement was reached until December 15, 1972. During the intervening period, Hammerstrom retained her ownership interest, and Bockman continued to operate the business.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Hammerstroms' 1967 Federal income tax, asserting that Hammerstrom disposed of business assets in 1967, triggering investment credit recapture. Hammerstrom petitioned the U. S. Tax Court, which ruled in her favor, holding that no disposition occurred in 1967.

Issue(s)

1. Whether the conversion of the business assets from community property to tenancy in common constituted a disposition for purposes of investment credit recapture under section 47 of the Internal Revenue Code?
2. Whether the former husband's election to purchase Hammerstrom's interest in the business assets on October 18, 1967, constituted a sale or other disposition triggering investment credit recapture in 1967?

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Holding

1. No, because the change in ownership form was not a disposition under section 47(a)(1) and did not cause the property to cease being section 38 property under section 47(b).
2. No, because the election to purchase did not result in a binding agreement for the transfer of title until 1972, and thus no sale or disposition occurred in 1967.

Court’s Reasoning

The court found that the conversion from community property to tenancy in common did not constitute a disposition under section 47(a)(1) because it did not result in a sale, exchange, transfer, distribution, involuntary conversion, or gift. Even if it were considered a disposition, it would not trigger recapture under section 47(b) because it was a mere change in the form of ownership, and Hammerstrom retained a substantial interest in the business. Regarding the election to purchase, the court held that a sale requires a binding agreement to transfer title for a determinable consideration, which did not exist until the 1972 agreement was executed. The court cited Dezendorf v. Commissioner, emphasizing that an agreement to agree is not a sale. The court also noted that Bockman’s possession and control of the assets did not change upon election, as he already held them as manager of the community property and later under the settlement agreement.

Practical Implications

This decision clarifies that for investment credit recapture to apply, there must be a clear and binding transfer of property. Practitioners should advise clients that mere changes in ownership form or elections to purchase without a finalized agreement do not trigger recapture. This ruling is particularly relevant in divorce settlements involving business assets, where parties may agree to future purchase options without immediately triggering tax consequences. Future cases involving similar scenarios should be analyzed to determine if a binding agreement for the transfer of title has been reached. This decision may influence how parties structure property settlement agreements to avoid unintended tax consequences and how businesses plan for potential changes in ownership.

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