Warren Jones Co. v. Commissioner, 60 T. C. 663 (1973)

A deferred-payment contract received in exchange for property is not considered ‘property’ for tax purposes if it cannot be sold for an amount near its face value, allowing the taxpayer to defer income reporting until cash payments are received.

Summary

Warren Jones Co. sold an apartment building for $153,000, receiving a $20,000 down payment and a deferred-payment contract for the balance. The IRS argued the contract was ‘property’ with a fair market value of $76,980, requiring immediate gain recognition. The Tax Court disagreed, holding that since the contract could not be sold for an amount near its face value, it was not ‘property’ under IRC § 1001(b), allowing the company to defer income recognition until receiving cash payments.

Facts

Warren Jones Co. , a cash basis taxpayer, sold the Wallingford Court Apartments for $153,000 in 1968. The buyers, Bernard and Jo Ann Storey, paid a $20,000 down payment and agreed to pay the remaining $133,000 plus 8% interest over 15 years. The company received $24,000 in 1968, with $20,457. 84 allocable to principal. Its basis in the property was $61,913. 34. On its tax return, the company did not report any gain but elected to use the installment method if required. The contract could be sold for approximately $76,980 ‘free and clear,’ with an additional $41,000 set aside in an escrow or savings account as security for the buyer.

Procedural History

The IRS determined a deficiency of $2,523. 94 for 1968, arguing the deferred-payment contract constituted ‘property’ under IRC § 1001(b). Warren Jones Co. petitioned the U. S. Tax Court, which held in favor of the company, allowing deferred reporting of income.

Issue(s)

1. Whether a deferred-payment contract received in exchange for property constitutes ‘property (other than money)’ under IRC § 1001(b) when it cannot be sold for an amount near its face value.

Holding

1. No, because the contract was not the equivalent of cash due to the significant discount at which it could be sold, and thus did not constitute ‘property’ under IRC § 1001(b).

Court’s Reasoning

The court applied the ‘cash equivalence’ test, noting that the contract could not be sold for an amount near its face value, only for $76,980 with an additional $41,000 set aside in escrow. The court cited *Cowden v. Commissioner* and *Harold W. Johnston* to support its view that a significant discount precludes treating a contract as the equivalent of cash. The court rejected the IRS’s argument, emphasizing that treating the contract as ‘property’ would force the company to report all gain in the year of sale without access to the deferred payments. The court also considered the policy implications of allowing deferral, noting it preserves the distinction between cash and accrual methods of accounting.

Practical Implications

This decision allows cash basis taxpayers to defer income recognition from sales involving deferred-payment contracts that cannot be sold at a price near their face value. It emphasizes the importance of the ‘cash equivalence’ test in determining when a contract constitutes ‘property’ under IRC § 1001(b). Practitioners should advise clients to consider the marketability and discount of such contracts when structuring sales and planning tax reporting. The ruling may encourage the use of deferred-payment arrangements in real estate transactions, allowing sellers to spread income over time. Subsequent cases like *Estate of Lloyd G. Bell* have distinguished this ruling based on the marketability of the contracts involved.

