Millar v. Commissioner, 67 T. C. 656 (1977); 1977 U. S. Tax Ct. LEXIS 170

When nonrecourse debt secured by stock is discharged upon foreclosure, the amount of debt extinguished constitutes gain realized, regardless of the stock's fair market value.

Summary

In Millar v. Commissioner, the Tax Court determined that amounts contributed to a subchapter S corporation, secured by nonrecourse notes and the shareholders' stock, were loans, not gifts. The court further held that when shareholders surrendered their stock to discharge these notes, they realized a gain equal to the debt extinguished, irrespective of the stock's market value. This ruling reaffirmed the application of the Crane doctrine, emphasizing that the full amount of nonrecourse debt must be included in the realized gain on foreclosure, even if the property's value is less.

Facts

R. H. Jamison, Jr. advanced $500,000 to shareholders of Grant County Coal Corp. , a subchapter S corporation, via checks which the shareholders endorsed over as capital contributions. These advances were secured by nonrecourse notes and the shareholders' stock. When the corporation faced bankruptcy, Jamison foreclosed on the stock, which was surrendered in discharge of the notes. The shareholders sought to deduct losses based on their increased stock basis from these contributions and contested the tax treatment of the foreclosure.

Procedural History

The Tax Court initially allowed the shareholders to include the advances in their stock basis for loss deductions. On appeal, the Third Circuit remanded the case for the Tax Court to determine whether the advances were loans or gifts and to address the gain realized upon foreclosure. The Tax Court reaffirmed its initial decision, classifying the advances as loans and holding that the full amount of the nonrecourse debt was gain realized upon foreclosure.

Issue(s)

1. Whether the advances from R. H. Jamison, Jr. to the shareholders constituted loans or gifts.
2. Whether the discharge of nonrecourse debt upon foreclosure of the stock should be included in the amount realized, even if the stock's fair market value was less than the debt amount.

Holding

1. No, because the advances were structured as loans with nonrecourse notes and

© 2025 SCOTUSreports.com. All rights reserved.

secured by stock, indicating an intent for repayment rather than a gift.
2. Yes, because the discharge of nonrecourse debt constitutes an amount realized equal to the debt extinguished, regardless of the stock's market value, as per the Crane doctrine.

Court's Reasoning

The court analyzed the transaction's structure, noting the use of nonrecourse notes and stock as collateral, which evidenced an intent for repayment, not a gift. The court applied the Crane doctrine, established in Crane v. Commissioner, which states that the full amount of nonrecourse debt must be included in the amount realized upon property disposition. The court emphasized that the shareholders received a tax benefit from the increased basis due to the loans, and thus must account for these deductions when the stock is foreclosed upon. The court rejected the purchase-money exception to the cancellation-of-indebtness doctrine, as the foreclosure followed the original loan terms without renegotiation. Judge Sterrett's concurring opinion further supported the application of Crane, noting the economic substance of the tax benefit received by the shareholders.

Practical Implications

This decision reaffirms the Crane doctrine's application to nonrecourse debt, impacting how tax practitioners should structure and analyze transactions involving such debt. It underscores the need to consider the full amount of nonrecourse debt as realized gain upon foreclosure, even if the underlying property's value is less. This ruling may deter taxpayers from using nonrecourse debt to inflate basis for tax loss deductions without recognizing corresponding gain upon disposition. Subsequent cases have cited Millar for its clear application of Crane, influencing tax planning strategies involving nonrecourse financing and subchapter S corporations.

© 2025 SCOTUSreports.com. All rights reserved.