Voight v. Commissioner, 68 T. C. 99 (1977)

A mortgage is considered assumed within the meaning of section 1. 453-4(c), Income Tax Regs. , if the buyer is obligated directly to the mortgagee for the mortgage indebtedness, even without a formal promise to assume.

Summary

In Voight v. Commissioner, the Voights sold a Holiday Inn property under an installment contract where the buyer, Madison Motor Inn, Inc. , made payments directly to the mortgagee, First Federal Savings & Loan Association, and guaranteed the mortgage payments. Despite no formal assumption, the court held that the mortgage was assumed because the buyer was directly liable to the mortgagee and intended to pay the mortgage directly. Consequently, the excess of the mortgage over the Voights' basis was considered a payment in the year of sale, disqualifying them from using the installment method under section 453 because it exceeded 30% of the selling price. This ruling clarified that the substance of the transaction, not just its form, determines whether a mortgage is assumed for tax purposes.

Facts

In 1968, Floyd J. Voight and Marion C. Voight sold a Holiday Inn property in Madison, Wisconsin, to Madison Motor Inn, Inc. , under an installment contract for $1,250,000. The property was subject to three mortgages totaling $1,136,698. 72 held by First Federal Savings & Loan Association. The Voights' adjusted basis in the property was $625,696. 22. The contract allowed the buyer to make mortgage payments directly to First Federal, and a separate agreement between the buyer, the Voights, and First Federal required the buyer to guarantee payment of the mortgage debt. The buyer made all mortgage payments directly to First Federal, and the Voights received cash payments of $35,814. 95 in 1968.

Procedural History

The Voights reported the sale on the installment method, but the Commissioner determined they received payments exceeding 30% of the selling price in the year of sale, disqualifying them from using the installment method. The Tax Court consolidated the cases and ruled that the buyer assumed the mortgages, requiring the Voights to recognize the full gain in the year of sale.

Issue(s)

1. Whether the buyer's obligation to pay the mortgage directly to the mortgagee constitutes an assumption of the mortgage within the meaning of section 1. 453-4(c), Income Tax Regs.

Holding

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1. Yes, because the buyer's direct obligation to the mortgagee and the intent to make direct payments to the mortgagee constituted an assumption of the mortgage under the regulation.

Court's Reasoning

The court analyzed the transaction's substance over its form. It found that despite the absence of a formal promise to assume the mortgage, the buyer's obligation to the mortgagee and the direct payment of mortgage installments by the buyer to First Federal constituted an assumption. The court cited *Stonecrest Corp. v. Commissioner* but distinguished the case due to the buyer's direct liability to the mortgagee and the intention for direct payments. The court emphasized that the regulation's purpose is to prevent spreading the tax over time when the excess of the mortgage over the basis would not actually come into the seller's hands, as supported by *Burnet v. S&L Building Corp.*

Practical Implications

This decision impacts how installment sales of mortgaged property are structured and reported for tax purposes. Sellers and buyers must carefully consider the implications of direct mortgage payments and guarantees when planning installment sales. The ruling emphasizes that the substance of the transaction, including the buyer's obligations to the mortgagee, is critical in determining whether a mortgage is assumed. Practitioners should advise clients to structure transactions to reflect their intended tax treatment accurately. Subsequent cases, such as *Waldrep v. Commissioner*, have applied this principle to similar transactions. Businesses selling property with existing mortgages must ensure compliance with tax regulations to avoid unexpected tax liabilities.

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