Greene v. Commissioner, 75 T. C. 32 (1980)

Upon reacquisition of real property in satisfaction of a purchase money mortgage, gain is calculated under IRC § 1038(b)(1) based on money and property received prior to reacquisition minus gain previously reported, without deducting original sales costs.

Summary

In Greene v. Commissioner, the taxpayers sold land in 1974 and reported the gain on an installment basis. They reacquired the land in 1976 when the buyers defaulted. The issue was whether they could deduct sales costs from the 1974 sale when calculating gain upon reacquisition. The Tax Court held that under IRC § 1038(b)(1), the taxpayers must recognize gain based on the difference between payments received before reacquisition and gain already reported, without subtracting original sales costs. The decision emphasizes the mandatory application of § 1038(b)(1) and its implications for tax reporting on reacquired property.

Facts

In 1974, G. Van Greene, Jr. and Minta J. Greene sold 226. 02 acres of land in Walton County, Georgia, to Bick, Nuzzulo, and Robinson for $350,176, receiving $70,035. 20 in cash and notes that year. They reported a gain of $48,891. 23 on an installment basis. The buyers defaulted on payments, and in 1976, the Greenes reacquired the property in satisfaction of the $280,140. 80 purchase money mortgage. The Greenes claimed a loss on the reacquisition, arguing that sales costs from the 1974 sale should reduce the gain calculation. The IRS determined a long-term capital gain of $10,559. 49 and assessed a minimum tax of $2,427. 17.

Procedural History

The IRS issued a statutory notice of deficiency to the Greenes for the 1976 tax year, asserting a long-term capital gain upon reacquisition of the property and a minimum tax liability. The Greenes petitioned the Tax Court for a redetermination of the deficiency. The Tax Court ruled in favor of the Commissioner, affirming the IRS's calculation of gain under IRC § 1038(b)(1) and the imposition of the minimum tax.

Issue(s)

1. Whether the taxpayers are entitled to deduct the sales commissions and other selling costs incurred at the time of the original sale in 1974 when calculating the amount of reportable long-term capital gain upon reacquisition of real property in 1976 under IRC § 1038(b)(1).

2. Whether the taxpayers are liable for a minimum tax pursuant to IRC §§ 56(a) and 57(a)(9) based on the long-term capital gain recognized upon reacquisition of the property.

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Holding

1. No, because IRC § 1038(b)(1) mandates that gain upon reacquisition be calculated as the difference between money and property received prior to reacquisition and the gain previously reported, without allowing for deductions of original sales costs.

2. Yes, because the long-term capital gain recognized under IRC § 1038(b)(1) is subject to the minimum tax imposed by IRC §§ 56(a) and 57(a)(9).

Court's Reasoning

The Tax Court applied IRC § 1038(b)(1), which specifies that gain upon reacquisition of real property is the excess of money and property received before reacquisition over the gain previously reported. The court emphasized that this provision does not allow for the deduction of sales commissions and other costs from the original sale, as argued by the taxpayers. The court noted that the language of § 1038(b)(1) is mandatory and mechanical, requiring strict application without room for taxpayer discretion. The court also referenced the legislative history of § 1038, which aimed to provide a uniform method of reporting gain upon repossession and to prevent the taxpayer from being taxed on unrealized gains. The court rejected the taxpayers' contention that they should only be taxed on the cash received in 1974, stating that the sales commissions paid by the buyers were effectively received by the taxpayers. The court further explained that any perceived hardship from this rule is mitigated by the increased basis in the reacquired property under IRC § 1038(c). Regarding the minimum tax, the court found that the recognized long-term capital gain was a tax preference item under IRC § 57(a)(9), thus subjecting the taxpayers to the minimum tax under IRC § 56(a).

Practical Implications

This decision clarifies that taxpayers cannot deduct original sales costs when calculating gain upon reacquisition of real property under IRC § 1038(b)(1). Attorneys advising clients on similar transactions must ensure that clients understand the tax implications of reacquiring property in satisfaction of a mortgage, particularly the mandatory calculation of gain without deductions for prior sales costs. This ruling may influence how sellers structure sales contracts to minimize tax liabilities upon potential reacquisition. Businesses and individuals dealing in real estate should consider the potential tax consequences of reacquiring property and plan accordingly, potentially seeking tax advice before entering into such transactions. Subsequent cases have generally followed this interpretation of § 1038, reinforcing its application in tax practice.

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