Arkin v. Commissioner, 76 T. C. 1048 (1981)

Abandonment of an interest in a land trust can be treated as a sale or exchange, resulting in a capital loss if the interest relinquished is a capital asset.

Summary

In Arkin v. Commissioner, the court determined that Lester Arkin's abandonment of his interest in a Florida land trust resulted in a capital, not an ordinary, loss. Arkin had purchased a 5% interest in the trust, which held undeveloped real property subject to a nonrecourse mortgage. When the real estate market declined, Arkin abandoned his interest. The court ruled that this abandonment was akin to a sale or exchange under IRC section 165(f), as Arkin was relieved of financial obligations and potential liabilities associated with the property. Additionally, the court upheld Arkin's deductions for contributions to a Keogh Plan made by his law partnership, clarifying that the $7,500 annual limit under IRC section 404(e) applies to the partnership's fiscal year, not the individual's taxable year.

Facts

In December 1973, Lester Arkin purchased a 5% interest in a Florida land trust for $32,197. The trust held undeveloped real property in Palm Beach County, Florida, subject to a $2,560,000 nonrecourse mortgage. The land trust agreement granted the beneficiaries full control over the property's management and disposition, with obligations to contribute proportionately to mortgage payments, taxes, and trustee fees. By mid-1974, due to a recession, the real estate market declined significantly. After consulting with a real estate expert, Arkin determined his interest was worth less than his share of the mortgage. On December 23, 1974, Arkin notified the trustee and other beneficiaries of his intent to abandon his interest, just before a mortgage payment was due. In 1974 and 1975, Arkin was also a partner in a law firm that contributed to a Keogh Plan on his behalf.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Arkin's federal income tax for 1974 and 1975. Arkin petitioned the U. S. Tax Court to challenge these deficiencies. The court addressed two main issues: the character of Arkin's loss from abandoning his land trust interest and the deductibility of his Keogh Plan contributions.

Issue(s)

1. Whether Arkin's abandonment of his interest in the Florida land trust in 1974 resulted in an ordinary loss or a capital loss.
2. Whether Arkin is entitled to deduct contributions to a Keogh Plan exceeding $7,500 for the calendar year 1975.

Holding

1. No, because Arkin’s abandonment of his interest in the land trust constituted a sale or exchange under IRC section 165(f), resulting in a capital loss.
2. Yes, because the $7,500 limitation under IRC section 404(e) applies to the partnership’s fiscal year, and the contributions were made in two separate fiscal years of the partnership.

Court’s Reasoning

The court reasoned that Arkin’s interest in the land trust was a capital asset under Florida law, which classifies such interests as personal property. The court found that Arkin’s abandonment of this interest was equivalent to a sale or exchange, as defined by IRC section 165(f), because it relieved him of obligations to pay a portion of the mortgage, taxes, and trustee fees, as well as potential liabilities from property-related litigation. The court cited Freeland v. Commissioner to support its broad interpretation of “sale or exchange. ” Regarding the Keogh Plan contributions, the court applied the regulations under IRC section 404(e), which clarify that the $7,500 limit applies to the partnership’s taxable year. Since the contributions were made in two separate fiscal years, the limit was not exceeded. The court rejected the Commissioner’s new argument about Arkin’s earned income as untimely.

Practical Implications

This decision impacts how similar cases should be analyzed, particularly those involving land trusts and the character of losses from abandonment. Practitioners should note that abandoning an interest in a land trust can result in a capital loss if it is considered a sale or exchange under IRC section 165(f). This ruling also clarifies that the $7,500 limit on Keogh Plan contributions applies to the partnership’s fiscal year, which can affect tax planning for partners in similar situations. Subsequent cases have followed this interpretation, reinforcing the principle that relief from obligations can constitute a sale or exchange for tax purposes.