Hunt v. Commissioner, 88 T. C. 1135 (1987)

In an installment sale, the excess of mortgage liability over the seller's basis is not treated as a payment received in the year of sale if the buyer does not assume or take the property subject to the mortgage.

Summary

In Hunt v. Commissioner, the Tax Court held that in an installment sale involving a wraparound mortgage, the excess of the mortgage liability over the seller's basis is not considered a payment received in the year of sale under Section 453 of the Internal Revenue Code, unless the buyer assumes the mortgage or takes the property subject to it. The court applied the Stonecrest line of cases, emphasizing that the buyer, Southland Capital Corp. , did not assume the underlying debt nor was the property taken subject to it. The decision clarified that the installment sale method could be used without immediate tax on the mortgage excess, as long as the seller was expected to continue paying the underlying debts from the sale proceeds. This ruling has significant implications for structuring real estate transactions to defer tax liability.

Facts

Petitioners D. A. Hunt, Dewey A. Hunt, Jr. , and William J. Hunt sold an apartment complex, King Edward Village (KEV), to Southland Capital Corp. on March 26, 1973, for $2,701,000. The payment structure included a $5,000 initial payment, a $2,541,000 all-inclusive mortgage, and a $155,000 purchase money note. The sale was subject to existing underlying mortgages totaling $1,963,222. 69, which exceeded the sellers' combined basis in KEV by approximately $400,000. The Hunts were expected to continue paying these underlying debts. Southland did not assume the underlying debts, nor did it take the property subject to them.

Procedural History

The IRS determined deficiencies in the Hunts' federal income tax for 1973, asserting that the excess of the underlying mortgage over the Hunts' basis should be treated as a payment received in that year. The Hunts contested this determination, and the cases were consolidated for trial before the Tax Court. The court reviewed the applicability of Section 453 and its regulations to the transaction.

Issue(s)

1. Whether the amount by which each petitioner-husband's share of the outstanding indebtedness on the apartment complex exceeds his adjusted basis therein constitutes payment received in the year of sale under Section 453.
2. Whether the amount of this indebtedness is included in the total contract price only to the extent of this excess under Section 453.

© 2025 SCOTUSreports.com. All rights reserved.

Holding

1. No, because Southland did not assume the underlying debt nor take the property subject to it, the excess of mortgage liability over basis is not treated as a payment received by petitioners in 1973.
2. No, because the mortgages are not excluded from the total contract price for determining the proportion of gain under Section 453(a)(1).

Court’s Reasoning

The court applied the Stonecrest line of cases, which distinguishes between a buyer assuming a mortgage and taking property subject to it. The court found that Southland did not assume the underlying debt, and the property was not taken subject to it, as the Hunts were expected to continue paying the underlying mortgages out of the sale proceeds. The court rejected the IRS’s argument that the transaction’s wraparound mortgage structure should lead to a different result, emphasizing that the legal obligations of the parties did not change with the conveyance of title. The court also noted that the IRS’s interpretation would lead to a harsh and perverse result, contrary to the purpose of the statute and regulation. The court’s decision was influenced by the policy considerations of preventing tax abuse while allowing legitimate deferral of gain under Section 453.

Practical Implications

This decision clarifies that in structuring installment sales with wraparound mortgages, the excess of mortgage liability over the seller’s basis is not treated as a payment received in the year of sale if the buyer does not assume the mortgage or take the property subject to it. This ruling allows sellers to defer tax on the gain from such sales, provided they continue to pay the underlying debts. Legal practitioners should ensure that the transaction documents clearly reflect the parties’ intentions regarding the underlying debt to avoid unintended tax consequences. The decision also highlights the importance of the Stonecrest line of cases in interpreting the installment sale regulations, which may influence how similar cases are analyzed in the future. Subsequent cases and changes in tax law, such as the Installment Sales Revision Act of 1980, should be considered when applying this ruling.

© 2025 SCOTUSreports.com. All rights reserved.