***Gibson v. Commissioner, 89 T. C. 1177 (1987)***

A taxpayer is bound by their election of a method of reporting income, even if made in the wrong year, and cannot later elect the installment method.

**Summary**

The Gibsons and their corporation, ABC, Inc. , sold property and a business in 1979 but failed to report the sale on their 1979 returns. They reported the sale in 1980 using the closed-transaction method. After an audit, they attempted to elect the installment method on amended 1979 returns. The Tax Court held that their initial election of the closed-transaction method, though in the wrong year, was binding and precluded them from electing the installment method under the "binding election" rule. The court also determined the proper allocation of the sales proceeds between the Gibsons and ABC, Inc.

**Facts**

In 1979, the Gibsons and their wholly owned corporation, ABC, Inc. , sold real property and a day-care center and nursery school business for $175,000, receiving $10,000 that year. They did not report the sale or the $10,000 on their 1979 tax returns. On their 1980 returns, they reported the sale as a closed transaction, claiming a sales price of $165,000. After an audit, they filed amended 1979 returns, reporting the full $175,000 and attempting to elect the installment method. The Commissioner disallowed the installment method, asserting the Gibsons had made a binding election of the closed-transaction method in 1980.

**Procedural History**

The Commissioner issued notices of deficiency for 1979 and 1980, disallowing the installment method election on the amended 1979 returns. The Gibsons and ABC, Inc. , petitioned the U. S. Tax Court, challenging the disallowance of the installment method and the allocation of the sales proceeds. The Tax Court upheld the Commissioner's position on both issues.

**Issue(s)**

1. Whether the "binding election" rule precludes the taxpayers from electing the installment method on their amended 1979 returns after reporting the sale on the closed-transaction method on their 1980 returns?
2. Whether the allocation of the $81,500 of the sales price between the Gibsons and ABC, Inc. , is proper?

**Holding**

1. Yes, because the taxpayers' election of the closed-transaction method on their 1980 returns, even though in the wrong year, was binding and precluded them from

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electing the installment method on their amended 1979 returns.
2. Yes, because the $81,500 allocated to the real property and improvements was properly allocated to the Gibsons as owners of the real estate, absent evidence of an agreement entitling ABC, Inc. , to the proceeds from the improvements.

**Court’s Reasoning**

The court applied the “binding election” rule established in *Pacific National Co. v. Welch*, holding that an election of a permissible method of reporting income is binding on the taxpayer, even if made in the wrong year. The court distinguished cases where taxpayers had not made a choice between reporting methods because they mischaracterized the transaction or where no payment was received in the year of sale. The court found that the Gibsons had an opportunity to choose a reporting method and selected the closed-transaction method, which was proper but applied to the wrong year. The court rejected the argument that the method was impermissible because it was reported in the wrong year, citing cases where errors in the year of election did not render the method impermissible. The court also determined that the Gibsons were entitled to the proceeds from the improvements because there was no evidence of an agreement entitling ABC, Inc. , to those proceeds.

**Practical Implications**

This decision reinforces the importance of timely and accurate tax reporting. Taxpayers must carefully consider their method of reporting income at the time of sale, as later attempts to change that method may be precluded by the “binding election” rule. The case also highlights the need for clear agreements between related parties regarding the allocation of sales proceeds, particularly when improvements to leased property are involved. Practitioners should advise clients to report sales transactions in the correct year and to elect the desired method of reporting income at that time. This case may also influence how subsequent cases involving the allocation of sales proceeds between related parties are analyzed, emphasizing the importance of evidence of entitlement to those proceeds.

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