Bolton v. Commissioner, 92 T. C. 303 (1989)

A taxpayer must make a timely election on or before the due date of the return for the year of sale to opt out of the installment method of reporting income from a sale.

Summary

In Bolton v. Commissioner, the Tax Court ruled that Everett and Zona Bolton could not elect out of the installment method for the sale of their property in 1982 by reporting the entire gain on their 1983 tax return. The court emphasized that under Section 453(d) of the Internal Revenue Code, added by the Installment Sales Provision Act of 1980, an election to opt out must be made on or before the due date of the return for the year of the sale. The Boltons failed to make a timely election, thus they were required to report the sale under the installment method. This decision underscores the importance of timely elections in tax reporting and impacts how taxpayers must plan for installment sales.

Facts

In 1982, Everett and Zona Bolton sold real property in Sallisaw, Oklahoma, for $160,000. They received $25,000 in cash and a $135,000 promissory note at the time of sale. The Boltons reported $500 in interest income on their 1982 tax return but did not report any gain from the sale. In 1983, they reported the entire $160,000 as a completed transaction on their tax return, claiming a long-term capital gain of $51,260. 56. The Commissioner of Internal Revenue challenged this, asserting that the Boltons had made a binding election out of the installment method and were subject to an alternative minimum tax in 1983.

Procedural History

The Boltons filed a petition with the United States Tax Court contesting the Commissioner’s determination of a deficiency in their 1983 Federal income tax. The issue before the court was whether the Boltons’ election on their 1983 return to treat the sale as a completed transaction could override the requirement of Section 453(d) for a timely election out of the installment method. The court ruled in favor of the Boltons on the issue of the installment method but noted potential tax implications for the 1982 tax year.

Issue(s)

1. Whether the Boltons’ election on their 1983 tax return to treat the sale of their property as a completed transaction can override the requirement of Section 453(d) that an election out of the installment method must be made on or before the due date of the return for the year of the sale.

Holding

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1. No, because the Boltons did not make a timely election on or before the due date of their 1982 tax return as required by Section 453(d). Therefore, they are bound by the installment method for reporting the sale.

Court’s Reasoning

The court applied Section 453 of the Internal Revenue Code, which mandates the use of the installment method for sales where payments are received after the year of sale unless the taxpayer elects out. The court specifically cited Section 453(d), which requires that any election to opt out must be made on or before the due date of the return for the year of the sale. The Boltons did not make such an election on their 1982 return, and their attempt to report the sale as completed on their 1983 return was deemed untimely. The court noted the legislative intent behind the timely election rule, as explained in the Senate Finance Committee Report, which aimed to streamline tax reporting and prevent taxpayers from changing their method of reporting after the due date. The court also referenced temporary regulations and prior case law to support its interpretation of the binding nature of the election rule.

Practical Implications

This decision reinforces the importance of timely elections in tax planning for installment sales. Taxpayers must carefully consider and make any elections to opt out of the installment method on or before the due date of the return for the year of the sale. The ruling impacts legal practice by requiring attorneys to advise clients on the necessity of timely filing and the consequences of missing these deadlines. Businesses engaging in installment sales must now account for this requirement in their tax strategies. Subsequent cases have followed this precedent, emphasizing the strict application of the timely election rule. The decision also highlights the need for taxpayers to recognize income in the year it is due under the installment method, which may affect cash flow and tax liabilities in subsequent years.

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