Tecumseh Corrugated Box Co. v. Commissioner, 94 T. C. 360 (1990)

The installment method is unavailable if property sold on installment is resold by a related party before full payment, unless the sale is involuntary or not for tax avoidance.

Summary

Tecumseh Corrugated Box Co. sold real property to related trusts under an installment contract, and the trusts subsequently sold the property to the U. S. Government. The Tax Court held that the installment method could not be used for the initial sale because the subsequent sale by the related party triggered immediate tax recognition under Section 453(e). Neither the involuntary conversion exception nor the tax avoidance exception applied, as the sale to the government was voluntary and tax avoidance was a principal purpose of the transactions.

Facts

Tecumseh Corrugated Box Co. (Tecumseh) owned real property within the Cuyahoga Valley National Recreation Area. In February 1984, Tecumseh sold four unimproved parcels to the U. S. Government. In May 1984, Tecumseh sold its remaining improved parcel to related trusts under an installment contract, which was then assigned to a related partnership. The partnership sold the property to the Government in December 1984 for $4. 5 million, payable in 1985. Tecumseh attempted to defer recognizing the gain from its sale to the trusts using the installment method.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Tecumseh’s tax returns for the fiscal years ending October 31, 1984, and 1985, asserting that the installment method was not applicable. Tecumseh petitioned the U. S. Tax Court for review. The Tax Court held that Section 453(e) applied, requiring immediate recognition of the gain from the initial sale to the trusts.

Issue(s)

1. Whether the December 1984 sale to the Government by the related party constitutes a second disposition under Section 453(e)(1)?
2. Whether the exception provided by Section 453(e)(6) for involuntary conversions applies to the December 1984 sale?
3. Whether the exception provided by Section 453(e)(7) for transactions not primarily for tax avoidance applies to the December 1984 sale?

Holding

1. Yes, because the December 1984 sale by the related party occurred before

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Tecumseh received full payment under the installment contract.
2. No, because the December 1984 sale was voluntary and not under threat or imminence of condemnation.
3. No, because Tecumseh failed to prove that neither the initial sale nor the subsequent disposition was part of a tax avoidance plan.

Court’s Reasoning

The Court applied Section 453(e), which disallows installment reporting when a related party disposes of property before the original seller receives all payments. The Court rejected Tecumseh’s argument for the involuntary conversion exception under Section 453(e)(6), finding no evidence of threat or imminence of condemnation by the Government. The Court also rejected the tax avoidance exception under Section 453(e)(7), concluding that tax avoidance was a principal purpose of the transactions. The Court noted that the transactions were structured to defer tax recognition and that Tecumseh’s labor problems, cited as a business purpose, could not be resolved by the sale to the trusts. The Court emphasized the objective facts, including the timing of the sales and the related party relationships, in inferring tax avoidance motives.

Practical Implications

This decision underscores the importance of understanding the tax implications of related party transactions, particularly when using the installment method. Practitioners should be cautious when structuring sales to related parties, as subsequent dispositions may trigger immediate tax recognition. The ruling clarifies that the involuntary conversion exception requires a clear threat or imminence of condemnation, and the tax avoidance exception demands clear evidence that tax avoidance was not a principal purpose. This case has influenced subsequent cases involving related party transactions and the application of Section 453(e), reinforcing the need for careful planning and documentation of business purposes to avoid tax avoidance allegations.

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