Estate of Mose Silverman, Deceased, Rose Silverman, Executrix, and Rose Silverman, Petitioners v. Commissioner of Internal Revenue, Respondent, 98 T. C. 54 (1992)

Certificates of deposit received in exchange for stock can be treated as deferred payment obligations for installment sale purposes if they are not readily tradable or payable on demand.

Summary

In Estate of Silverman v. Commissioner, the Tax Court ruled that certificates of deposit, received in exchange for stock in a merger, could be treated as deferred payment obligations under the installment sale method. Mose and Rose Silverman exchanged their shares in Olympic Savings & Loan for Coast Federal's savings accounts and non-withdrawable certificates of deposit. After the Supreme Court's Paulsen decision, which held similar exchanges taxable, the Silvermans reported the transaction as an installment sale. The IRS contested this, arguing the certificates were cash equivalents. The court, however, found that the certificates were not readily tradable and upheld the Silvermans' right to report the gain on an installment basis, aligning with the policy of deferring tax until actual payment is received.

Facts

In 1982, Mose and Rose Silverman owned 29,162 shares in Olympic Savings & Loan Association. They exchanged these shares for Coast Federal Savings & Loan Association's savings accounts and certificates of deposit as part of a merger. The exchange offered 30% in withdrawable savings accounts and 70% in non-withdrawable term accounts, payable after six years. Following the Supreme Court's decision in Paulsen v. Commissioner in 1985, which ruled similar exchanges as taxable, the Silvermans filed an amended 1982 tax return treating the exchange as an installment sale, reporting gain on the savings accounts received but deferring gain on the term accounts. The IRS issued a notice of deficiency, asserting the entire gain should be reported in 1982.

Procedural History

The Silvermans timely filed their 1982 tax return, not reporting the gain from the exchange, believing it to be a tax-free reorganization. After the Paulsen decision, they filed an amended return in 1987, reporting the exchange as an installment sale. The IRS issued a statutory notice of deficiency in 1988, leading the Silvermans to petition the U. S. Tax Court, which ultimately ruled in their favor in 1992.

Issue(s)

1. Whether the certificates of deposit received by the Silvermans in exchange for their Olympic stock constituted "evidences of indebtedness" of Coast Federal under

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section 453(f)(3) of the Internal Revenue Code?

2. Whether the Silvermans were entitled to report the gain on the disposition of their Olympic stock under the installment method pursuant to section 453?

Holding

1. Yes, because the certificates of deposit were deemed "evidences of indebtedness" of Coast Federal, as they were not readily tradable and were akin to delayed payments.

2. Yes, because the Silvermans met all the statutory requirements of section 453, allowing them to report the gain from the disposition of their stock on the installment method.

Court's Reasoning

The court's decision was based on the interpretation of section 453 of the Internal Revenue Code, which allows for installment sale treatment when at least one payment is received after the close of the taxable year in which the disposition occurs. The court referenced the Supreme Court's decision in Paulsen v. Commissioner, which characterized similar certificates of deposit as having predominant debt characteristics. The Silvermans' certificates were not readily tradable or payable on demand, aligning with the statutory exceptions to the definition of "payment" under section 453(f)(3). The court rejected the IRS's argument that the certificates were cash equivalents, finding that they did not meet the criteria for cash equivalence under Ninth Circuit precedent. The court emphasized that the Silvermans were looking to Coast Federal for payment, not to a third party or escrowed funds, which distinguished this case from others where installment sale treatment was denied. The court also noted the legislative intent behind section 453 was to defer tax until actual payment was received, supporting the Silvermans' position.

Practical Implications

This decision clarifies that non-withdrawable certificates of deposit can be treated as deferred payment obligations in installment sales, provided they are not readily tradable or payable on demand. Taxpayers involved in similar transactions can defer recognizing gain until they receive payment, which is particularly relevant in corporate reorganizations or mergers involving financial instruments. Legal practitioners should consider this ruling when advising clients on structuring transactions to minimize immediate tax liabilities. The decision also underscores the importance of understanding the specific terms of financial instruments received in exchanges, as these can significantly impact tax treatment. Subsequent cases have cited Estate of Silverman in analyzing the applicability of the installment method, further solidifying its precedent in tax law.

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