Estate of Frane v. Commissioner, 99 T. C. 364 (1992)

The cancellation of an installment obligation upon the seller's death is a taxable event under section 453B(f), resulting in recognition of income on the decedent's final tax return.

Summary

In Estate of Frane, the Tax Court ruled that the cancellation of installment obligations upon the seller's death triggers income recognition under section 453B(f). Robert E. Frane sold stock to his children in exchange for installment notes, which were to be canceled upon his death. The court held that this cancellation constituted a taxable disposition, with gain recognized on Frane's final tax return, not the estate's return. The decision clarified that section 453B(f) applies to such transactions and that the 6-year statute of limitations under section 6501(e) was applicable due to inadequate disclosure on the tax return.

Facts

Robert E. Frane sold shares of Sherwood Grove Co. to his four children in 1982, receiving promissory notes with a 20-year term and a cancellation clause that extinguished the remaining debt upon his death. Frane died in 1984, after receiving only two payments. The estate did not report any gain from the canceled notes on its tax return, arguing that no taxable event occurred. The IRS asserted that the cancellation triggered income recognition under either section 691 or section 453B.

Procedural History

The IRS issued a deficiency notice to the estate for the fiscal year ending June 30, 1985, and another notice to Frane's widow for their 1984 joint return. The cases were consolidated and submitted to the Tax Court on stipulated facts. The court reviewed the applicability of sections 691 and 453B, ultimately deciding under section 453B(f).

Issue(s)

1. Whether the estate realized income in respect of a decedent under section 691 due to the cancellation of the installment obligations upon Frane's death?
2. In the alternative, whether the cancellation of the installment obligations upon Frane's death resulted in recognition of income under section 453B, reportable on the decedent's final joint return?
3. Whether the 6-year period of limitations under section 6501(e) applied to Frane's final joint income tax return?

Holding

1. No, because the cancellation did not result in income in respect of a decedent

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under section 691, as the income was properly includable in the decedent's final return under section 453B.
2. Yes, because the cancellation of the installment obligations upon Frane's death constituted a taxable disposition under section 453B(f), requiring the recognition of gain on Frane's final return.
3. Yes, because the disclosure on the tax return was insufficient to apprise the IRS of the omitted income, triggering the 6-year statute of limitations under section 6501(e).

Court's Reasoning

The court applied section 453B(f), which treats the cancellation of an installment obligation as a disposition other than a sale or exchange. The court rejected the estate's argument that the cancellation was merely a contingency affecting the purchase price, stating that the total purchase price was fixed at the time of sale. The legislative history of section 453B(f) supported the court's interpretation, aiming to prevent circumvention of tax liability through cancellation of obligations. The court also clarified that section 453B(c), which excludes transmissions at death from section 453B, did not apply to cancellations under section 453B(f). For the statute of limitations issue, the court found that the tax return did not adequately disclose the nature and amount of the omitted income, thus the 6-year period applied.

Practical Implications

This decision impacts estate planning and tax reporting involving installment sales with cancellation provisions upon the seller's death. Attorneys should advise clients that such cancellations trigger immediate income recognition under section 453B(f), reportable on the decedent's final return. This ruling underscores the importance of clear disclosure on tax returns to avoid extended statute of limitations under section 6501(e). Practitioners should review existing installment agreements and consider the tax implications of cancellation clauses, potentially restructuring transactions to mitigate tax consequences. Subsequent cases like Estate of Bean v. Commissioner have applied this ruling, reinforcing its significance in tax law.

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