Marvin E. DeBough v. Commissioner of Internal Revenue, 142 T. C. No. 17 (U. S. Tax Court 2014)

In DeBough v. Commissioner, the U. S. Tax Court ruled that a taxpayer must recognize previously excluded gain under Section 121 when reacquiring a principal residence under Section 1038. Marvin DeBough sold his home on an installment basis, excluding $500,000 of gain under Section 121. After the buyers defaulted, DeBough reacquired the property. The court held that, absent a resale within one year as provided by Section 1038(e), previously excluded Section 121 gain must be recognized under the general rules of Section 1038. This decision clarifies the interaction between these tax provisions and impacts how taxpayers must account for gains from reacquired properties.

Parties

Marvin E. DeBough, Petitioner, versus Commissioner of Internal Revenue, Respondent. At the trial level, DeBough was represented by Matthew L. Fling, while the Commissioner was represented by John Schmittdiel and Randall L. Eager.

Facts

Marvin E. DeBough purchased his personal residence and 80 acres of mixed-use land in 1966 for $25,000. On July 11, 2006, he sold the property to Stonehawk Corp. and Catherine Constantine Properties, Inc. (the buyers) for $1,400,000 under a contract for deed. DeBough received $250,000 at the time of sale and an additional $250,000 in 2007, and $5,000 in 2008. He excluded $500,000 of gain from the sale under Section 121 of the Internal Revenue Code. In 2009, the buyers defaulted on the contract, and DeBough reacquired the property on July 29, 2009. DeBough reported $97,153 in long-term capital gains for 2009 but later amended his return to remove this gain. The Commissioner determined that DeBough should recognize $448,080 in long-term capital gains for 2009, including the previously excluded $500,000 under Section 121.

Procedural History

The Commissioner issued a notice of deficiency dated June 18, 2012, determining that DeBough was required to recognize $443,644 in long-term capital gains for the 2009 tax year. This amount was later recalculated to $448,080 to account for an omitted payment. DeBough timely filed a petition with the U. S. Tax Court seeking redetermination of the deficiency. The Tax Court, with Judge Nega presiding, upheld the Commissioner’s determination, requiring DeBough to recognize the previously excluded gain under Section 121 upon reacquisition of the property.

Issue(s)

Whether a taxpayer must recognize long-term capital gain previously excluded under Section 121 upon reacquisition of a principal residence under Section 1038

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when the property is not resold within one year of reacquisition?

Rule(s) of Law

Section 1038 of the Internal Revenue Code provides that no gain or loss results from the reacquisition of real property sold on an installment basis if the seller reacquires the property in satisfaction of the debt secured by it. However, under Section 1038(b), gain must be recognized to the extent that money or other property received before reacquisition exceeds the gain reported as income prior to reacquisition. Section 1038(e) provides an exception for principal residences reacquired and resold within one year, treating the resale as part of the original sale transaction and allowing the Section 121 exclusion to apply.

Holding

The Tax Court held that DeBough was required to recognize long-term capital gain on the reacquisition of his principal residence under Section 1038, including the $500,000 gain previously excluded under Section 121, because he did not resell the property within one year of reacquisition as required by Section 1038(e).

Reasoning

The court's reasoning focused on the interplay between Sections 1038 and 121. It noted that Section 1038(e) explicitly addresses the reacquisition of principal residences but limits its relief to situations where the property is resold within one year. The absence of any broader exception in Section 1038 led the court to conclude that the general rule of Section 1038(b) applies, requiring recognition of gain to the extent of money received before reacquisition, including gain previously excluded under Section 121. The court rejected DeBough's argument that the absence of specific language mandating recapture of Section 121 gain meant that such gain should not be recaptured, citing the statutory canon of construction expressio unius est exclusio alterius. Additionally, the court emphasized that the tax treatment should reflect the economic reality of DeBough's situation, as he had received $505,000 in cash before reacquiring the property. The decision aligns with fundamental federal income tax principles that gross income includes any accession to wealth clearly realized and over which the taxpayer has dominion.

Disposition

The Tax Court entered a decision for the Commissioner, requiring DeBough to recognize $448,080 in long-term capital gains for the 2009 tax year.

Significance/Impact

The DeBough decision clarifies the interaction between Sections 1038 and 121 of the Internal Revenue Code, establishing that gain previously excluded under Section 121 must be recognized upon reacquisition of a principal residence under Section

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1038 if the property is not resold within one year. This ruling has significant implications for taxpayers engaging in installment sales of their principal residences, as it affects the tax consequences of reacquiring such properties upon buyer default. The decision underscores the importance of considering the specific statutory exceptions and general rules when planning and reporting tax transactions involving reacquired properties.

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