Hussey v. Commissioner, 156 T. C. No. 12 (2021)

In Hussey v. Commissioner, the U. S. Tax Court ruled that Richard S. Hussey must adjust the basis of his depreciable real properties in the same year as the sale of the properties and the discharge of qualified real property business indebtedness (QRPBI), rather than the following year. This decision clarifies the timing of basis reductions under I. R. C. sections 108 and 1017, impacting how taxpayers handle debt discharge and property sales in the same tax year.

Parties

Richard S. Hussey, as Petitioner, and the Commissioner of Internal Revenue, as Respondent. Hussey was the taxpayer seeking relief from income tax deficiencies and penalties, while the Commissioner represented the government's interests in enforcing tax laws.

Facts

In 2009, Richard S. Hussey purchased 27 investment properties, assuming loans totaling $1,714,520 from a single bank. By 2012, facing financial difficulties, Hussey sold 16 of these properties, 15 of which were sold at a loss, resulting in a discharge of $754,054 in qualified real property business indebtedness (QRPBI) by the bank. In 2013, he sold seven more properties at a loss. Hussey's tax returns for 2012, 2013, and 2014 were prepared by a tax law firm, the Kohn Partnership, following advice from his financial adviser and a large accounting firm. The dispute centered on the timing of basis adjustments due to the QRPBI discharge and whether additional debt was discharged in 2013, as well as potential accuracy-related penalties for 2013 and 2014.

Procedural History

The Commissioner issued a notice of deficiency to Hussey on July 3, 2018, for tax years 2013 and 2014, asserting deficiencies and accuracy-related penalties. Hussey filed a petition with the U. S. Tax Court challenging these determinations. The court reviewed the case under a de novo standard, focusing on the correct application of the Internal Revenue Code sections in question.

Issue(s)

1. Whether, under I. R. C. sections 1017(a) and (b)(3)(F)(iii) and 108(c)(2)(B), Hussey must reduce the bases of his real properties for 2012 or 2013 due to the sale of depreciable real properties in 2012?
2. Whether Hussey received a discharge of debt in 2013?
3. Whether Hussey is liable for accuracy-related penalties under I. R. C. section 6662 for tax years 2013 and 2014?

Rule(s) of Law

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1. I. R. C. section 108(a)(1)(D) allows for the exclusion of discharge of qualified real property business indebtedness (QRPBI) from income if the taxpayer reduces the basis of depreciable real property.
2. I. R. C. section 1017(a) generally requires basis reductions to occur in the year following the debt discharge, but section 1017(b)(3)(F)(iii) mandates immediate basis reduction if property is sold in the same year as the discharge.
3. I. R. C. section 6662 imposes accuracy-related penalties for substantial understatements of income tax or negligence, but these can be avoided if the taxpayer shows reasonable cause and good faith reliance on professional advice.

Holding

1. Hussey must reduce the bases of his depreciable real properties in 2012, as required by I. R. C. section 1017(b)(3)(F)(iii), because he sold the properties in the same year as the QRPBI discharge.
2. Hussey did not receive a discharge of debt in 2013, as the bank's actions were recorded as a charge-off and a loan loss reserve recovery, not a discharge.
3. Hussey is not liable for accuracy-related penalties under I. R. C. section 6662 for 2013 and 2014 due to his good faith reliance on professional tax advice.

Reasoning

The court applied a strict interpretation of the relevant statutes. For the first issue, it relied on the plain language of section 1017(b)(3)(F)(iii), which requires basis reduction immediately before the disposition of property if the property was taken into account under section 108(c)(2)(B) in the same year as the discharge. The court rejected Hussey's argument that the basis reduction could be deferred to 2013 because his remaining properties' bases exceeded the discharged amount, finding no such provision in the statute. For the second issue, the court found that the bank's records indicated a charge-off and a loan loss reserve recovery, not a discharge, and the lack of Forms 1099-C for 2013 supported this finding. On the third issue, the court found that Hussey had reasonable cause and acted in good faith, relying on the expertise of the Kohn Partnership, which had over 30 years of tax law experience. The court considered Hussey's lack of tax or accounting background and his extensive efforts to seek professional advice, concluding that he was not liable for penalties.

Disposition

The court affirmed the requirement for Hussey to reduce the bases of his depreciable real properties in 2012, held that no debt was discharged in 2013, and ruled that Hussey was not liable for accuracy-related penalties for 2013 and 2014. The case was set for further proceedings under Rule 155 to determine the computational adjustments needed.

Significance/Impact

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This case clarifies the timing of basis reductions under I. R. C. sections 108 and 1017, emphasizing that when a taxpayer sells property in the same year as a QRPBI discharge, the basis reduction must occur immediately before the sale. This ruling impacts how taxpayers and their advisers handle debt discharge and property sales, particularly in the context of short sales and loan modifications. Additionally, the case reinforces the importance of good faith reliance on professional tax advice in avoiding accuracy-related penalties, providing guidance for taxpayers in similar situations. Subsequent courts have cited this case in addressing similar issues, and it has practical implications for tax planning and compliance in real estate transactions involving debt discharge.

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