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Realization of Income in Deferred Payment Sales

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Comments

REALIZATION OF INCOME IN DEFERRED PAYMENT SALES

I. INTRODUCTION

Whenever there is a change in the economic status of a taxable entity the question arises as to whether the change should have federal income tax consequences. Generally accepted accounting principles would not permit recording mere appreciation in value (though footnote or parenthetical disclosure of some current values is common). Despite the logic of reflecting changes in value as a measure of managerial skill and as a current value of the enterprise assets, the accountant refuses to approve income realization, largely on the basis of accounting conservatism, income being realized only when there is an actual sale or exchange of the asset.[1] This income realization principle has contributed to a similar principle of income tax law that an appreciation in property value, without more, will not be subject to income taxation. The classic case of *Eisner v. Macomber* held that a stock dividend was not income within the sixteenth amendment.[2] Thus, some kind of change in property ownership must occur before an appreciation in value will be recognized for tax purposes.

Even when there is a sale or exchange of property, the taxpayer has several possible arguments to defer or postpone taxation. In *Burnet v. Logan*[3] the Supreme Court rejected the assessment of tax because the property received in the exchange was too speculative to be valued at the time of sale. The Court placed considerable emphasis on the idea that the government would not lose tax on the sale, since the property received in exchange would eventually be converted into cash at which time the tax could be collected. By virtue of the principle of nonrecognition, Congress has expressly excluded certain other transactions such as those included in qualifying corporate reorganizations from taxation. Probably the most far-reaching statutory provision is that which allows a taxpayer to select the cash receipts and disbursements method for reporting income.[4] This alternative enables him to defer realization of income in a transaction that would clearly result in realization of income under accrual method accounting theory. For example, a sale on account would clearly result in income at the time of sale using the accrual method, but realization of income prior to the receipt of cash would be at odds with the principles of cash basis reporting.

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1. H. FINNEY AND H. MILLER, PRINCIPLES OF ACCOUNTING, INTRODUCTORY 361 (5th ed. 1957).
2. Eisner v. Macomber, 252 U.S. 189 (1920).
3. 283 U.S. 404 (1931).
4. INT. REV. CODE of 1954, § 446(c)(1).

Although the form of the transactions in the cases to be discussed are varied, a typical situation is found in the case of *Heller Trust v. Comm'r*,[5] decided recently by the Ninth Circuit. There the taxpayer on the cash receipts and disbursements method of reporting found the rental of duplexes an unprofitable enterprise and decided to sell out. Sales were made to various individuals. To illustrate, assume one of the duplex sales resulted in the taxpayer receiving the following: (a) a $5,000 cash down payment; (b) buyer's assumption of a $30,000 mortgage; and (c) a contractual obligation in the face amount of $15,000, bearing six percent interest and payable in $150 monthly installments. Assume the taxpayer's basis in the property to be $35,000. Since the cash plus the liability assumed equal the basis, any gain to be recognized would depend on the treatment given the contractual obligation. In such a situation in *Heller*, the Tax Court ruled for the government and found a fair market value for the contract payments of fifty percent of face value.[6] The Ninth Circuit affirmed relying in part on the "clearly erroneous" rule.[7] In the example above, there would be a $7,500 recognized gain on the sale, and the transaction would be considered "closed."[8] Had the court found no fair market value for the contract, there would be no taxable gain at the time of sale. The transaction

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5. 382 F.2d 675 (9th Cir. 1967).

6. Joan E. Heller Trust, 34 P-H Tax Ct. Mem. 1823 (1965).

7. 382 F.2d. 675 (9th Cir. 1967). The "clearly erroneous" rule is a fundamental rule used in judicial review of lower court for administrative agency findings of fact when there is no jury. "A finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." United States v. Gypsum Co., 333 U.S. 364, 395 (1948). In Comm'r v. Duberstein, 363 U.S. 278, 289 (1960), where the question was whether certain transfers were gifts or compensation for services, the Supreme Court discussed the applicability of the "clearly erroneous" rule:

> Decision of the issue presented in these cases must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case. The nontechnical nature of the statutory standard, the close relationship of it to the data of practical human experience, and the multiplicity of relevant factual elements, with their various combinations, creating the necessity of ascribing the proper force to each, confirm us in our conclusion that primary weight in this area must be given to the conclusions of the trier of fact.

Although clearly more technical than the gift question, the finding of a fair market value is probably within the *Duberstein* language, as will become more apparent from the remainder of this comment.

8. The taxpayer would take the $7,500 as his basis in the obligation. If he were able to sell the installment contract, the proceeds from the sale would receive capital gains treatment. However, if the obligation was held and the obligor made payments, then any payments received in excess of basis would be ordinary income, since the payments would not be a "sale or exchange" within Section 1222 of the Internal Revenue Code of 1954. Tombari v. Commissioner, 299 F.2d 889 (9th Cir. 1962). Where there is no intent to sell such a contract the taxpayer should argue for a high fair market value for the obligation to assure capital gains treatment on the sale rather than ordinary income on subsequent collection. Whenever a taxpayer argues for an "open" transaction (a transaction in which property of no fair market value is received), he should keep in mind that if the argument is unsuccessful, a low fair market value is likely to be placed on the obligation, and future gains will probably be ordinary income.

would be considered "open", and as payments were made the taxpayer would recognize gain in the full amount of each payment. Had the taxpayer in *Heller* been on the accrual method, the court could have required accrual of the face amount of the installment contract ($15,000).

This comment will consider the extent to which a taxpayer must, because he received written evidence of the buyer's obligation to pay money in the future, recognize income at the time of the sale. The obligation received could be a simple promissory note, negotiable paper, a note secured by a mortgage, or as in *Heller* an installment contract. Although the availability of installment sales reporting under section 453[9] is an important consideration in the area, the comment will not deal with that aspect of the problem. A brief history of the pertinent statutory language and a consideration of what this language has come to mean to both accrual and cash basis taxpayers will be considered in the remainder of the article.

II. Statutory Analysis

A. *History*

The important language of the Internal Revenue Code on sales of property is found in section 1001:[10]

> (a) Computation of gain or loss.—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis. . . .
> (b) Amount realized.—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

The section was originally enacted in the Act of 1918, sec. 202(b), which read:

> When property is exchanged for other property, the property received in exchange shall for the purpose of determining gain or loss be treated as the equivalent of cash to the amount of its fair market value, if any . . . .[11]

In 1921, this section was changed to read:

> [O]n an exchange of property, real, personal or mixed, for any other such property, no gain or loss shall be recognized unless the property received in exchange has a readily realizable market value . . . .[12]

The change in 1921 reflects a desire to get away from the presumption of taxation that the 1918 Act made in exchanges of property by requiring a "readily realizable market value" instead of just a fair market value.[13]

Only three years later, in 1924, the section was again changed:

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9. Int. Rev. Code of 1954, § 453.
10. Int. Rev. Code of 1954, § 1001.
11. Revenue Act of February 24, 1919, ch. 18, § 202(b), 40 Stat. 1057.
12. Revenue Act of November 23, 1921, ch. 136, § 202(c), 42 Stat. 227.
13. H.R. Rep. No. 350, 67th Cong., 1st Sess. (1921).

> The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.[14]

According to the committee reports, the "readily realizable market value" language had caused great administrative difficulty and department rulings on the matter had been unsatisfactory.[15] The primary criticism was that the language could "not be applied with accuracy or with consistency."[16] Since the 1924 amendment, however, the pertinent language of the Code has not been changed.

B. *Analysis*

In *Heller,* the question was whether the installment contract the taxpayer received had a "fair market value" within section 1001 at the time of the sale. "Fair market value" is generally defined as that price which a willing buyer would pay to a willing seller after negotiations in which neither party was acting under compulsion."[17] According to the Internal Revenue Service, "the fair market value of property is a question of fact, but only in rare and extraordinary cases will property be considered to have no fair market value."[18] The Service's position could work a hardship on taxpayers. Even though the taxpayer may be unwilling to sell his obligation at a "willing buyer's" offered price, the obligation may have a fair market value for tax purposes. This could lead to a situation where the taxpayer is forced into a sale he views as undesirable, but necessary in order to get the cash to pay the tax. For example, in *Heller* the court arrived at a fair market value of fifty percent of the face value of the obligation, while the taxpayer may have been unwilling to sell for less than eighty-five percent of face value because of his view of the obligor's financial status, the discounted value of the contract to him, and other factors.

Section 1001 makes no reference to the method of accounting the taxpayer employs.[19] Read literally, the section merely requires that there be a finding of "fair market value" for the installment obligation or promissory note. The courts, however, have distinguished between cash and accrual basis taxpayers. One of the leading cases on the point is *Harold W. Johnston.*[20] There the taxpayer sold corporate stock by contract in return for the buyer placing certain sums in escrow

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14. Revenue Act of June 2, 1924, ch. 234, § 202(c), 43 Stat. 256.
15. S. REP. No. 398, 68th Cong., 1st Sess. (1924); H.R. REP. No. 179, 68th Cong., 1st Sess. (1924). There is no indication why the 1924 Act did not return to the language of the 1918 Act, but it could be argued that this reflects a Congressional desire to be less rigorous in taxing property exchanges than under the 1918 Act.
16. S. REP. No. 398, *supra* note 15.
17. Goldstein v. Comm'r, 298 F.2d 562, 567 (9th Cir. 1962).
18. Treas. Reg. § 1.1001-1(a) (1957). This rather "hard nosed" attitude on the part of the Service may have been the kind of thing Congress had in mind when it changed the law from "fair market value" to "readily realizable market value" in the 1921 Act.
19. INT. REV. CODE of 1954, § 1001.
20. 14 T.C. 560 (1950).

from which future contract payments could be made. In deciding whether the cash basis taxpayer was to recognize income at the time of sale, the court emphasized the taxpayer's cash basis status and concluded that valuing the contract would be entirely inconsistent with cash basis reporting. The court noted that if a contract or right to future payment was required to be valued, then there would be little distinction between cash basis and accrual basis taxpayers. Similar reasoning is found in *Sterling v. Ham.*[21] In that case the court said that in deferred payment contract cases involving cash basis taxpayers, fair market value must mean something more than marketability; it "obviously refers to ready convertibility into cash of some evidence of indebtedness like a promissory note."[22] Thus, the test for cash basis taxpayers has become whether the deferred payment contract is the equivalent of cash rather than whether there is a fair market value as section 1001 would seem to indicate. The "equivalent of cash" test bears a striking resemblance to the "readily realizable market value" test of the 1921 Code.[23]

III. Accrual Basis Taxpayers

A. *General Rule*

The general rule that accrual basis taxpayers must follow in realizing income is that "it is the *right* to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues."[24] There is no apparent reason why this rule should not be applied to deferred payment sales. The Regulations, however, in permitting deferred payment treatment of real property sales not qualifying for installment reporting, do not expressly exclude accrual basis taxpayers.[25] Since section 1001 also makes no reference to the taxpayer's accounting method,[26] the inference could be drawn that accrual basis taxpayers may use the deferred payment approach or record the obligation at the fair market value rather than face value. In *C. W. Titus, Inc.*,[27] it was held that the accrual method does not prevent deferred sales treatment. However, in *George L. Castner Co.*,[28] some twenty years later, the principles of accrual accounting were held to override the inferential arguments permitting the same treatment for cash and accrual basis taxpayers. In *Castner,* the court applied the usual accrual rules to a deferred payment sale of

21. 3 F. Supp. 386 (S. D. Me. 1933).
22. *Id.* at 388. *Accord,* Milton S. Yunker, 26 T.C. 161 (1956).
23. Revenue Act of November 23, 1921, ch. 136, § 202(c), 42 Stat. 227. In construing this section of the 1921 Code, the Board of Tax Appeals has said,
> [I]n determining whether a promise to pay is the equivalent of cash we must examine into all the facts and circumstances and if the promise to pay has a readily realizable market value, *i.e.,* so that cash may be readily substituted for it, then it is . . . cash income and returnable as such.

John B. Atkins, 9 B.T.A. 140, 151 (1927).
24. Spring City Foundry Co. v. Comm'r, 292 U.S. 182, 184-185 (1934).
25. Treas. Reg. § 1.453-6 (1958), T.D. 6916, 1967 Int. Rev. Bull. No. 1, at 198.
26. Int. Rev. Code of 1954, § 1001.
27. 33 B.T.A. 928 (1936).
28. 30 T.C. 1061 (1958).

personalty and in effect overruled *Titus*. In a later case the Tax Court applied *Castner* to a sale of real property.[29]

B. *Importance of Fair Market Value*

An accrual basis taxpayer will have little, if any, success with an argument that there is no fair market value for the obligation he receives. This is because the main question as far as he is concerned is whether there is an unconditional right to receive money.[30] If such a right exists, then the obligation will be treated as income at the full face value[31] regardless of the present fair market value. Putting the rule in the language of section 1001, the Tax Court has said, "[A]n accrual basis taxpayer does not treat an unconditional right to receive money as property received, but rather as money received to the full extent of the face value of the right."[32]

C. *Uncollectibility*

If there is doubt as to the collectibility of the obligation, income will still be recognized, but the taxpayer may be due a present deduction for possible future bad debts.[33] The Tax Court has, however, recognized an exception to the realization requirement when there is substantial doubt as to the collectibility of the obligation.[34] The court reasoned that "[w]here sufficient doubt as to collectibility exists when a right to receive an amount arises, there does not exist an unconditional right in the taxpayer to receive since the doubt as to collectibility is sufficient to place a condition on the right to receive."[35] Probably what the court had in mind was a rather extreme case of insolvency. The court noted that expert testimony as to fair market value was relevant in cases of accrual basis taxpayers only insofar as it evidenced the obligor's inability to pay.[36] Thus, only in cases of serious collection problems would an accrual basis taxpayer not be required to record an unconditional right to receive money in the future at the full face amount.

D. *Conditionality*

There still remains the possibility that the accrual basis taxpayer will have a defense that there is no unconditional right to receive money in the future. For example, a contract might provide that upon default of any installment the buyer forfeits all past payments, and the contract is at an end. In this situation the pur-

29. First Savings and Loan Ass'n, 40 T.C. 474 (1963).
30. Jones Lumber Co., 36 P-H Tax Ct. Mem. 433 (1967); Warren G. Morris, 32 P-H Tax Ct. Mem. 746 (1963).
31. Spring City Foundry Co. v. Comm'r., 292 U.S. 182 (1934); Warren G. Morris, *supra* note 30.
32. First Savings and Loan Ass'n, 40 T.C. 474, 487 (1963).
33. INT. REV. CODE of 1954, § 166(c); Spring City Foundry Co. v. Comm'r 292 U.S. 182 (1934).
34. Jones Lumber Co., 36 P-H Tax Ct. Mem. 433 (1967).
35. *Id.* at 442.
36. *Ibid.*

chaser has no personal liability to make future payments, so there is nothing to accrue.[37]

In other contracts there are actual conditions which the seller must perform before he has a right to payment. Conditions that relate to matters other than the right to receive money in the future would not be important (*e.g.*, conditions affecting assignability). However, when certain conditions must be performed before there is a right to receive future payments, no income will be recognized (and the transaction will remain "open") until all such conditions have been performed. For example, a requirement that the seller make future delivery of title to the buyer is a condition that will deny income recognition.[38] Delivery of title to an escrow holder, however, will result in income at time of delivery, provided the buyer has no further conditions to perform.[39] This is true even though the seller retains a right to reenter and repossess in the event of payment default.[40]

E. *Contingencies*

If the right to receive money under the contract is subject to contingencies, that may or may not occur, the accrual basis taxpayer should not have to recognize income.[41] In *Cassatt v. Comm'r*[42] there was a sale of a brokerage partnership with the buyer promising to pay twenty-five percent of fees received from the partnership's old customers. Since there was no obligation on the buyer to continue the brokerage business or to solicit any business from old partnership customers, the court considered the twenty-five percent "commission" dependent on too many contingencies to be realized at the time of sale.

A rather interesting case involving contingencies is that of *Frost Lumber Industries v. Comm'r*.[43] There a sale of land was made to the government for $6.25 per acre in 1935 subject to the government's title examination and the seller's delivery of the deed. The taxpayer decided to record the deed prior to the end of 1935 to avoid property taxes on the land. At the time of the recording it was known that the plat descriptions were not entirely accurate and, consequently, no one would know exactly what the eventual contract amount would be until the title examination was completed. The title examination was completed in 1936 and the tax question in the case was whether income should be reported in 1935 as the taxpayer desired, or in 1936. The court allowed the taxpayer to accrue a reasonable estimate on his 1935 return saying, "[t]hough the computation may be undetermined, if the basis for the computation is unchangeable and though the exact amount may be unknown, if it is not unknowable, the item in such cases is to be treated, for tax purposes, as accrued income."[44] The court's analysis seems dubi-

37. Calvin T. Graves, 17 B.T.A. 1318 (1929).
38. Perry v. Comm'r, 152 F.2d 183 (8th Cir. 1945); Comm'r v. Union Pacific R. R., 86 F.2d 637 (2d Cir. 1936); Old Farmers Oil Co., 12 B.T.A 203 (1928).
39. Comm'r v. Union Pacific R. R., *supra* note 38.
40. Harris Trust and Savings Bank, 24 B.T.A. 498 (1931).
41. Burnet v. Logan, 283 U.S. 404 (1931).
42. 137 F.2d 745 (3rd Cir. 1943).
43. 128 F.2d 693 (5th Cir. 1942).
44. *Id.* at 694.

ous in the light of the usual "open" transaction cases, but the court may have followed its stated policy of giving the benefit of doubt to the taxpayer.[45]

IV. Cash Basis Taxpayers

A. *Introduction*

It would be a rare situation indeed where a cash basis system of accounting would reflect income in the generally accepted accounting sense of the word. The accrual concept is fundamental and vital to the accurate measurement of income in most situations. There are, however, at least three reasons why Congress permits tax returns to be prepared on the cash basis even though the system may not accurately reflect "income."[46] First, most individual taxpayers do not keep books of account or even understand how such would be done. Thus, it is important from an administrative standpoint that some taxpayers be permitted to report on the cash basis. Second, the income that would otherwise have been accrued will eventually be reported on future tax returns and therefore, no tax will be lost because of the use of the cash basis system.[47] But the most important reason is the policy of not requiring a taxpayer to pay tax on income which is not represented by cash received as of the date of the return.[48] Such a policy does "mathematical justice between the government and taxpayer."[49] It should be noted, however, that cash accounting affords the taxpayer a greater opportunity to control the timing of taxable income than does the accrual method. But the extent of income distortion is limited by the Code requirement that whatever accounting method is used must "clearly reflect income."[50] The reader should consider the impact of these policies on the particular point of law to be discussed in the remainder of this comment.

Whether an obligation has a fair market value or is the equivalent of cash can only be decided "after a consideration of all the attendant circumstances."[51] As discussed above, the Service takes the position that property will almost always have a fair market value.[52] The courts have not, however, been quite so eager to find a fair market value and even less inclined to find cash equivalency. The following is a discussion of the factors the courts have considered important in resolving the cases.

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45. *Ibid.*
46. "It is unfortunate that Congress or the Treasury permitted the cash basis of reporting income to become fixed in our taxing system."R. Montgomery, Federal Income Tax Handbook 620 (1938-39).
47. The significance of this argument may be reduced when considered in the light of the date of death stepped-up basis provisions of the Code. Int. Rev. Code of 1954, § 1014.
48. Eisner v. Macomber, 252 U.S. 189 (1920).
49. Comm'r v. Garber, 50 F.2d 588, 591 (9th Cir. 1931).
50. Int. Rev. Code of 1954, § 446(b). For a discussion of what circumstances will prevent the cash method from clearly reflecting income see Michael Drazen, 34 T.C. 1070 (1960).
51. Howard H. Perelman, 41 T.C. 234, 242 n. 11 (1963).
52. Treas. Reg. § 1.1001-1(a) (1957).

B. *Transferability*

Nearly all sales on open account are assignable and frequently are assigned. But to require income recognition at the time of the sale would be a gross infringement on cash basis accounting. This illustrates the fact that legal assignability of a contract is only a minimum requirement, and other factors must be shown before cash equivalency is established. The receipt of a debt instrument is taxable income to a cash basis taxpayer only if it is capable of being converted readily into cash.[53] In order to be convertible into cash, the payee must have the power to sell or to pledge the instrument for a loan.[54] It has been held, however, that a restriction on the assignment of a mortgage that did not exceed one year and was for the purpose of allowing the buyer to investigate the seller's representations did not deprive the mortgage debt of a fair market value at the time of the sale.[55] However, where a contract is nonassignable at the date of its receipt, the fact that the parties may later agree to its assignability does not alter its character for tax purposes at the time of its receipt.[56] Also, an assignable instrument that is in escrow and not capable of being possessed by the owner will not be the equivalent of cash.[57]

Because a negotiable instrument is usually more readily disposable than a nonnegotiable instrument, negotiability will often be a positive influence in finding cash equivalency. The older cases often emphasized this point.[58] Recent cases, however, have tended to consider the distinction between negotiable and nonnegotiable instruments to be illusory and not a controlling factor in finding cash equivalency.[59] For instance, the Fifth Circuit has stated:

> The income tax law deals in economic realities, not legal abstractions, and the reach of the income tax law is not to be delimited by technical refinements or mere formalism.
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> A promissory note, negotiable in form, is not necessarily the equivalent of cash. Such an instrument may have been issued by a maker of doubtful solvency or for other reasons such paper might be denied a ready acceptance in the market place.[60]

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53. One does get a feeling from Pinellas Ice and Cold Storage Co. v. Comm'r, 287 U.S. 462 (1933), that a short term obligation may be the equivalent of cash merely because of its short duration.

54. McLaughlin v. Comm'r, 113 F.2d 611 (7th Cir. 1940). It is equally clear that the obligation must be reduced to writing. Estate of W. F. Williamson, 29 T.C. 51 (1957).

55. Levine v. Comm'r, 324 F.2d 298 (3rd Cir. 1963).

56. E. P. Greenwood, 34 B.T.A. 1209 (1936).

57. McLaughlin v. Comm'r, 113 F.2d 611 (7th Cir. 1940).

58. Comm'r v. Garber, 50 F.2d 588 (9th Cir. 1931); Bedell v. Comm'r, 30 F.2d 622, (2d Cir. 1929); Nina J. Ennis, 17 T.C. 465 (1951); Harold W. Johnston, 14 T.C. 560 (1950); Dudley T. Humphrey, 32 B.T.A. 280 (1935).

59. Heller Trust v. Comm'r, 382 F.2d 675 (9th Cir. 1967); Cowden v. Comm'r, 289 F.2d 20 (5th Cir. 1961); Phillips v. Frank, 295 F.2d 629 (9th Cir. 1961). *But see* Joseph Marcello, Jr., 43 T.C. 168 (1964); Gunderson Bros. Eng'r. Corp., 42 T.C. 419 (1964).

60. Cowden v. Comm'r, *supra* note 59 at 24.

The fact that the parties intend the instrument solely as evidence of the debt and not as payment may override the instrument's negotiable aspect.[61] If there is a complete failure of any fair market value for the instrument, there will certainly be no income realized even though the instrument is negotiable.[62] On the other hand, nonnegotiable instruments have frequently been found the equivalent of of cash.[63] It seems, then, that the importance of negotiability lies in the fact that the instrument may be transferred free of defenses the maker may have; thereby making it more marketable.[64]

C. *Marketability*

As previously noted, fair market value is defined as the price that a willing buyer and a willing seller would agree upon, neither being under any compulsion to buy or sell. The earlier cases seem to be in some disagreement as to whether this standard should be applied to a cash basis taxpayer in the deferred payment situation. Judge Learned Hand said that deferred payment land contracts could be sold but that a buyer and seller would have to "haggle" over each particular contract.[65] His concept of a market seems to require a number of similar contracts selling at the same discount. A few years later, the Eighth Circuit stated that while a ready market was helpful as evidence it was not a requirement for finding fair market value.[66] It seems, however, that since the contract must be the equivalent of cash for a cash basis taxpayer to recognize income, the finding of a ready market would be essential. A recent Fifth Circuit case has required that the instrument be of the type that is frequently transferred to a lender or an investor at a reasonable discount.[67] The Tax Court has also denied cash equivalency when the contract was not of the type commonly sold in the community.[68] The Court of Claims has stated that the instrument must be "readily converted into cash in the ordinary course of business."[69] This latter test would seem to be the most stringent by requiring a ready or ordinary market.

With the emphasis on a "market" rather than "a willing buyer," the business community's attitude often plays a major role in the outcome of the case. The question of marketability is clearly a subject for expert testimony, and courts often rely on such evidence.[70] Because the taxpayer bears the burden of proof as to fair

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61. Samuel Segel, 34 P-H Tax Ct. Mem. 1237 (1965), *aff'd,* Estate of Segel v. Comm'r, 370 F.2d 107 (2d Cir. 1966).
62. Miller v. United States, 235 F.2d 553 (6th Cir. 1956).
63. *E.g.,* Heller Trust v. Comm'r, 382 F.2d 675 (9th Cir. 1967); Kaufman v. Comm'r, 372 F.2d 789 (4th Cir. 1966); Kuehner v. Comm'r, 214 F.2d 437 (1st Cir. 1954).
64. Gunderson Bros. Eng'r. Corp., 42 T.C. 419, 432 (1964).
65. Bedell v. Comm'r, 30 F.2d 622, 624 (2d Cir. 1929).
66. Whitlow v. Comm'r, 82 F.2d 569 (8th Cir. 1936). The court applied the usual fair market value definition.
67. Cowden v. Comm'r, 289 F.2d 20, 24 (5th Cir. 1961).
68. Curtis R. Andrews, 23 T.C. 1026 (1955).
69. Edelman v. United States, 329 F.2d 950, 954 (Ct. Cl. 1964).
70. *E.g.,* Sterling v. Ham, 3 F. Supp. 386 (S. D. Me. 1933); Phipps Indus. Land Trust, 32 P-H Tax Ct. Mem. 1963 (1963); Anton M. Meyer, 3 B.T.A. 1329 (1926).

market value, he runs a substantial risk if no expert testimony is offered denying the existence of a market. The importance of an expert's testimony is emphasized by the rule that such testimony of an existent market for the instrument will require the court to find a fair market value unless there is "substantially contrary evidence."[71] An example of "substantially contrary evidence" is where a particular contract was contingent upon a liquor license being continued. This contingency overcame the fact that the contract right was a type that was regularly exchanged.[72] Also, evidence that the taxpayer made efforts to sell the contract but failed, indicates no cash equivalency.[73] On the other hand, advertisements relating to similar obligations[74] and the fact that the sales transaction was embodied in a standard form used in the community,[75] have been used to indicate that a market of ready buyers exists. The taxpayer's own belief as to an existing market has also been cited as a consideration.[76]

D. *Conditions*

The ease with which an instrument may be transferred will depend in part on the extent to which the debtor is unconditionally obligated to make all payments. Where a contract imposes no personal liability on the buyer, but provides only for forfeiture in the event of default, the contract will have no fair market value.[77] In the deferred payment contract cases it has been said that the instrument must evidence an unconditional right to receive money in the future before it will have a fair market value.[78] If the terms of the contract leave nothing for the buyer or seller to do except make and receive payments, the obligation has met the test.[79] But a finding of fair market value will be defeated when the obligor at the date of the transfer of the instrument has set-off rights against payment of the obligation.[80] Also, the Eighth Circuit has said that where both the "obligation to pay and the obligation to pass title [are] in the future, there is an element of uncertainty in the transaction and the promise has no 'market value,' fair or unfair."[81]

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71. Miller v. United States, 235 F.2d 553 (6th Cir. 1956); Mott v. Comm'r, 139 F.2d 317 (6th Cir. 1943).
72. Estate of Clarence W. Ennis, 23 T.C. 799 (1955).
73. Cambria Development Co., 34 B.T.A. 1155 (1936); D. M. Stevenson, 9 B.T.A. 552 (1927).
74. Phipps Indus. Land Trust, 32 P-H Tax Ct. Mem. 1963 (1963).
75. Kaufman v. Comm'r, 372 F.2d 789 (4th Cir. 1966).
76. Leonard Hyatt, 30 P-H Tax Ct. Mem. 1789 (1961).
77. Kaufman v. Comm'r, 372 F.2d 789 (4th Cir. 1966).
78. Cowden v. Comm'r, 289 F.2d 20 (5th Cir. 1961); Bedell v. Comm'r, 30 F.2d 622 (2d Cir. 1929); Axe v. United States, 191 F. Supp. 671 (D. Kan. 1961).
79. Kuehner v. Comm'r, 214 F.2d 437 (1st Cir. 1954); Williams v. U.S., 185 F. Supp. 615 (D. Mont. 1960).
80. Cowden v. Comm'r, 289 F.2d 20 (5th Cir. 1961).
81. Perry v. Comm'r, 152 F.2d 183, 188 (8th Cir. 1945). *Accord,* Bedell v. Comm'r, 30 F.2d 622 (2d Cir. 1929). The analysis might be questioned, since title could be conveyed to the purchaser of the contract thereby eliminating any purchaser hesitancy based on the seller's future conveyance. Admittedly the future conveyance condition would make sale of the obligation a more cumbersome and less desirable financial transaction, but this would affect the extent of marketability

It should be noted, however, that the fact that the deed is delivered into escrow for future delivery may enhance marketability to the extent that the obligation will be the equivalent of cash.[82]

It is possible that a condition attached to an obligation to pay would only affect the amount of the fair market value rather than being determinative of whether a fair market value exists. In *Joan E. Heller Trust*[83] a purchaser of the taxpayer's contracts may have been required to maintain the subdivision swimming pool and provide garbage service for the homeowners. In dictum the Tax Court said if such conditions were required, they would only affect the extent to which the contracts would be discounted.[84] It is certainly open to question, however, whether the contracts would have a readily realizable market value in such a situation.

E. *Contingencies*

Very closely related to conditionality is the question of contractual contingencies. In the leading case of *Burnet v. Logan*,[85] stock in a closely held corporation was sold to a larger solvent corporation. The seller received a cash down payment plus a right to receive money based on mineral tonnage that would be extracted from the transferred property. The Commissioner estimated the tonnage and made the necessary calculations to arrive at a present value for the contract. The United States Supreme Court rejected the Commissioner's determination and said that the income tax law did not require that a value be placed on all property a taxpayer received at the time of receipt. The Court reasoned that the income tax liability of the seller could ultimately be determined without resort to "mere estimates, assumptions, and speculation." It was noted that the occasioning of the contingency was so speculative in amount that income should not have been recognized until the contingency actually occurred.[86] The result in such a situation is that the taxpayer may avail himself of the deferred payment approach and properly demand a return of capital before realizing any income. Understandably the Service has attempted to restrict the holding in *Logan* to its facts.[87]

In *Axe v. United States*,[88] the fact situation can be characterized as follows. The testator left Blackacre to his wife (W) for life and then to his daughter (D) in fee. If D predeceased W then other devisees were to take upon W's death. W and D entered into a contract to sell Blackacre. The buyer made a $20,000 down payment and set a fund aside with enough money to purchase life insurance on D

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rather than the existence of it. It would be an anomaly, however, if a cash basis taxpayer were required to recognize income because of the cash equivalency of the contract, while an accrual basis taxpayer need not accrue income because of the condition.

82. Comm'r v. Moir, 45 F.2d 356 (7th Cir. 1930).

83. 65 P-H Tax Ct. Mem. 1823 (1965).

84. *Id.* at 1669. On appeal the Ninth Circuit agreed with the Tax Court on this point. Heller Trust v. Comm'r, 382 F.2d 675 (9th Cir. 1967).

85. 283 U.S. 404 (1931).

86. *Id.* at 412-413.

87. Rev. Rul. 58-402; 1958-2 CUM. BULL. 15.

88. 191 F. Supp. 671 (D. Kan. 1961).

(with the buyer as beneficiary) to cover the possibility D would predecease W. If W predeceased D, then D was to receive whatever money remained in the insurance fund. The Commissioner sought to tax D on the value of the fund set aside. The court agreed that there was a very small probability W would outlive D but held there was sufficient uncertainty to deny the imposition of an income tax. Analytically the presence of a contingency should be relevant only insofar as it affects the contract's cash equivalency.[89] In the *Axe* case the contingency was such that a purchase of D's right to the fund would involve risks not normally found in financial transactions and it is therefore unlikely that the right to the fund would have wide marketability. As a final note on the problem of contingencies, it should be pointed out that if negotiable notes are given in a sale, their marketability will be unaffected by any contingency in the contract of sale.[90]

F. *Security*

The function of security in a debtor-creditor relationship is to assure the creditor that he will be paid even though the debtor fails to perform his obligation. Since this obviously would have an impact on the marketability of the debt instrument, courts often make note of the extent to which security was given to support the obligation.[91] In *Miller v. United States*,[92] notes were secured by a second mortgage that was subordinated to a first mortgage equal to ninety percent of the property value. Because of this and other factors, the court thought the probability of ultimate payment of the notes was too uncertain to require present income realization. On the other hand, in a Second Circuit case,[93] the taxpayer had a second mortgage securing the obligation, where the first mortgage covered only fourteen percent of the property value. The court found a fair market value for the mortgage and used the difference in the size of collateral to distinguish the case from *Miller*.

It should be noted that the presence of security is important only insofar as it affects the marketability of the obligation and not because it aids the creditor in deriving present cash from the debtor. For example, in *Leroy G. Evans*[94] the taxpayer had adequate security in the form of savings and loan passbooks, but could get no cash from the savings accounts until the debtor defaulted on some future payment. The Board of Tax Appeals properly reasoned, that the high

89. The Court of Claims has said there is no taxable income resulting from an attorney's contingent fee contract in a will contest, where the contest had been decided favorably, but the value of the estate (on which the percentage fee was based) would not be known until the next tax year. The court concluded the contract receipts were entirely too speculative at this point to permit ready saleability. Edelman v. United States, 329 F.2d 950 (Ct. Cl. 1964).

90. Walter I. Bones, 4 T.C. 415 (1944).

91. *E.g.*, Campagna v. United States, 290 F.2d 682 (2d Cir. 1961); McLaughlin v. Comm'r, 113 F.2d 611 (7th Cir. 1940); Schlemmer v. United States, 94 F.2d 77 (2d Cir. 1938); Dudley T. Humphrey, 32 B.T.A. 280 (1935).

92. 235 F.2d 553 (6th Cir. 1956).

93. Campagna v. United States, 290 F.2d 682 (2d Cir. 1961).

94. 5 B.T.A. 806 (1926).

liquidity of the collateral does not require a finding of cash equivalency where the holder is unable to take advantage of such liquidity.[95]

G. *Obligor's Financial Status*

How well the obligation is secured may not be as important to the typical investor as the status of the obligor's ability to pay. If the obligor is of known financial weakness or unable to make payments as they mature, then the obligation will be difficult to sell at a reasonable discount and may be held to have no cash equivalency. Likewise, the fact that the obligor does not live in the taxpayer's community or is unknown there might defeat a finding of cash equivalency.[96] The nature of the obligor's source of future income may also be important. For instance, in *D. M. Stevenson*[97] the buyer's intended speculative use of the property and his present financial weakness were, together, enough to deny cash equivalency to a land contract.

The buyer's ability and willingness to pay the entire purchase price at the time of contracting may be very significant. In *Williams v. United States*[98] after the taxpayer had accepted the buyer's bid, the buyer offered to pay the full purchase price in cash. The seller, however, on his own initiative, devised an escrow agreement under which the money could be transferred. The escrow was to make periodic payments to the seller. By this procedure the seller hoped to avail himself of the installment sales accounting method. The court held that the seller was in constructive receipt of the money when the buyer offered cash, and any self-imposed limitation such as putting the money in escrow would not change the seller's tax status.[99]

In *Kuehner v. Comm'r*,[100] a similar factual situation exisited in a sale of stock. The seller was to deliver the stock, and the buyer was to deliver $65,000, to the same designated trustee. Each year for five years $13,000 was to be paid the seller and ten shares of stock were to be delivered to the buyer. Although the question of constructive receipt was not discussed, the court found cash equiva-

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95. *Id.* at 809. The security need not be collateral but may be in the form of a guarantor's signature. Curtis R. Andrews, 23 T.C. 1026 (1955).

96. Joliet-Norfolk Farm Corp., 8 B.T.A. 824 (1927). It is immaterial that the taxpayer has a particular expertise in collecting such obligations, since it is the marketability of the obligation that is important. Wingate E. Underhill, 45 T.C. 489 (1966).

97. 9 B.T.A. 552 (1927). The buyer of the land was to use it for the purpose of growing mint commercially, which had never been done in the area before. *But see* Wells Amusement Co. v. Comm'r, 70 F.2d 208 (4th Cir. 1934), where even though the subject matter of the sale was a highly speculative theater business there was a finding of fair market value for the obligations received in the sale.

98. 219 F.2d 523 (5th Cir. 1955).

99. Williams v. United States, 219 F.2d 523 (5th Cir. 1955). *Accord,* Williams v. United States, 185 F. Supp. 615 (D. Mont. 1960). A full discussion of the doctrine of constructive receipt is outside the scope of this comment. The Regulations define constructive receipt as occurring when an amount is "credited to [taxpayer's] account, set apart for him, or otherwise made available so that he may draw upon it at any time." Treas. Reg. § 1.451-2 (1957) as amended; T.D. 6723; 1964 INT. REV. BULL. No. 1 at 73.

100. 214 F.2d 437 (1st Cir. 1954).

lency because a fixed sum, secured and unconditional was irrevocably set aside for the seller. The important fact in *Williams,* which is lacking in *Kuehner,* is that the buyer had bid on the land and the seller had accepted. It was only later that the seller decided to set up the escrow arrangement. That is, there seems to have been agreement between the parties when the seller on his own initiative decided an escrow provision was needed. During this period of agreement before the escrow provision was put in the contract, the seller was in constructive receipt of the money. In *Kuehner* the facts do not indicate how, when, or why the trust provision was inserted into the contract, but it appears that the provision was a product of contract negotiations. Therefore, a constructive receipt argument in *Kuehner* would be more difficult to make than in *Williams.* At any rate, the tax planner should always be alert to the constructive receipt argument of *Williams* and how it might be overcome where the deferred payment aspect of the contract was a product of haggling.

In *Cowden v. Comm'r,*[101] a contract in excess of $500,000 was entered into in 1951 providing for approximately one-half payment in January, 1952, and the other half in January, 1953. The solvent purchaser was ready and willing to make the entire payment when the contract was entered into. The Tax Court emphasized this factor in holding that the contract was the equivalent of cash.[102] The Fifth Circuit, however, did not consider the buyer's willingness to be relevant to the issue of cash equivalency. The case was remanded to the Tax Court with instructions to disregard the buyer's offer of payment in determining the existence of cash equivalency.[103]

Implicit within the cases discussed above is the motive of the taxpayer-seller to defer taxable income. "As a general rule a tax avoidance motive is not to be considered in determining the tax liability resulting from a transaction."[104] In the situation where the seller has the choice of receiving either money or a deferred payment contract and he chose the latter, it is immaterial that his sole motive was to avoid taxes. So long as the choice is a bargained-for part of the contract, as in *Cowden* and *Kuehner,* and not a unilateral afterthought on the part of the seller, as in *Williams,* the seller can avoid immediate tax liability.

Subsequent timely payment of the obligation will often indicate an obligor's financial status at the time the contract was made. Evidence of subsequent payments will probably be admitted by the courts.[105] In *Whitlow v. Comm'r,*[106] the court said, "[W]hile evidence that notes are promptly paid is by no means conclusive of the value of the notes when made, yet it certainly has some bearing

101. 289 F.2d 20 (5th Cir. 1961).
102. Frank Cowden, 32 T.C. 853 (1959).
103. Cowden v. Comm'r, 289 F.2d 20, 25 (5th Cir. 1961). On remand Frank Cowden, 30 P-H Tax Ct. Mem. 1237 (1961).
104. Cowden v. Comm'r, *supra* note 103, at 23.
105. Campagna v. U. S., 290 F.2d 682 (2d Cir. 1961); Doric Apartment Co. v. Comm'r, 94 F.2d 895 (6th Cir. 1938); Wells Amusement Co. v. Comm'r, 70 F.2d 208 (4th Cir. 1934).
106. 82 F.2d 569 (8th Cir. 1936).

upon their value at that time."[107] Other cases are in accord with *Whitlow* but usually do not explain in what way subsequent payments are relevant.[108] In *Miller v. United States,*[109] notes were received in the sale of a business. There was direct evidence that the notes had no fair market value at the time of sale, since they were considered speculative. The court denied that a showing of subsequent payments could permit an inference of prior value that would overcome the direct evidence of no fair market value. It would seem that if the obligor's financial status is in issue, subsequent payments should be admitted as evidence even if, as the *Miller* court reasoned, it is not particularly strong evidence.

The buyer's willingness to pay will undoubtedly be affected by the amount of down payment he has made at the time of sale. Accordingly, the courts have cited the size of the down payment as a consideration in deciding whether cash equivalency exists.[110] For instance, ten percent down payment has been held to give the buyer important equity and lend to the marketability of the obligation.[111] It should be noted, however, that substantial down payment is probably not as important as other factors in the situation.[112] For example, in *Cambria Development Co.*[113] a forty percent down payment was not considered so significant as to override other economic factors affecting the marketability of a contract made in 1931.

H. *Extent of Discount*

When a debt instrument is sold the buyer will often purchase for less than the face value of the obligation, or at a discount. The amount of the discount is established mainly by two considerations: the cost of using money and the risk of not receiving payments when due. When a deferred payment contract is purchased at a discount which reflects only the cost of money, it is an indication that the obligation carries very little risk of collection. For this reason some cases have considered the amount by which an obligation is discounted to be a factor indicating cash equivalency.[114] The cash equivalency test of *Cowden v. Comm'r* requires that the instrument be "frequently transferred to lenders or investors at a discount not substantially greater than the generally prevailing premium for the use of money. . . ."[115] Probably the rule is one of evidence more than anything

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107. *Id.* at 571.
108. *See* cases cited note 105 *supra.*
109. 235 F.2d 553 (6th Cir. 1956).
110. Heller Trust v. Comm'r, 382 F.2d 675 (9th Cir. 1967); Comm'r v. Moir, 45 F.2d 356 (7th Cir. 1930).
111. Heller Trust v. Comm'r, *supra* note 110.
112. In D. M. Stevenson, 9 B.T.A. 552 (1927), there was a ten percent down payment as in *Heller,* but the speculative nature of the contract was considered overriding.
113. 34 B.T.A. 1155 (1936).
114. *E.g.,* Guffey v. U. S., 222 F. Supp. 461 (D. Ore. 1963); Cowden v. Comm'r, 289 F.2d 20 (5th Cir. 1961). Where an obligation is non-interest bearing this would only mean the discount would be greater, but the presence of the non-interest factor has been cited as affecting cash equivalency. Jay A. Williams, 28 T.C. 1000 (1957).
115. 289 F.2d 20, 24 (5th Cir. 1961).

else, since an obligation purchased at a substantial discount would indicate that it is highly speculative and not the equivalent of cash.

The cases, however, do not necessarily follow the *Cowden* rule. In *Wells Amustment Co. v. Comm'r*[116] the Board of Tax Appeals found a fair market value of forty-five percent of the face value, and the Fourth Circuit affirmed the income realization to the cash basis taxpayer. Likewise, in *Heller Trust v. Comm'r*[117] the contracts were included in the taxpayer's income, even though they could be purchased at between forty and seventy percent of face value.[118] In these cases there is a substantial risk factor indicated by the rather large discounts. Where future payment is dubious, the propriety of requiring immediate income realization is questionable. The difficulty is that the taxpayer may have to convert the instrument into cash at the large discount. In most cases the sale of speculative obligations held by a party to the transaction (who would normally be more informed of the situation than an investor) would be undesirable.

I. *Time to Maturity*

The length of time which an obligation is to be outstanding would not be important in most cases. Where the obligation is short-term, however, it is possible that income will have to be realized at the time of sale. In *Pinellas Ice and Cold Storage Co. v. Comm'r,* the taxpayer argued that his four-month notes were "securities" within the tax free reorganization provisions. The court denied the taxpayer's contention, saying:

> It would require clear language to lead us to conclude that Congress intended to grant exemption to one who sells property and for the purchase price accepts well secured, short-term notes (all payable within four months), when another who makes a like sale and receives cash certainly would be taxed. We can discover no good basis in reason for the contrary view and its acceptance would make evasion of taxation very easy. In substance the petitioner sold for the equivalent of cash; the gain must be recognized.[119]

Although the *Pinellas Ice* case did not involve a deferred payment issue, the language has been applied in cases involving such questions.[120] In *Wolfson v. Reinecke,*[121] notes of approximately six month duration were given in the sale of a partnership interest. In finding cash equivalency the court cited *Pinellas Ice* to emphasize the short term character of the obligation.[122]

It should be noted, however, that the short duration of the deferred payment

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116. 70 F.2d 208 (4th Cir. 1934).
117. Heller Trust v. Comm'r, 382 F.2d 675 (9th Cir. 1967).
118. *See also* Doric Apartment Co. v. Comm'r, 94 F.2d 895 (6th Cir. 1938), where mortgage notes worth eighty percent of face value were included in taxable income.
119. 287 U. S. 462, 469 (1933).
120. Wolfson v. Reinecke, 72 F.2d 59 (7th Cir. 1934); Estate of Eugene Merrick Webb, 30 T.C. 1202 (1958); Walter I. Bones, 4 T.C. 415, 422 (1944).
121. 72 F.2d 59 (7th Cir. 1934).
122. *Id.* at 60.

period is probably not as important as other factors. In *Comm'r v. Moir*,[123] a leasehold was sold in 1920 with a $45,000 down payment and delivery of the deed in escrow. The remaining purchase price of $150,000 was paid in 1921. The contract was held the equivalent of cash because of the substantial down payment and the 1920 delivery of the deed.[124] In *Bedell v. Comm'r*[125] a contract was made in 1919 with delivery and closing three months later in 1920. No cash equivalency was found, largely because payment was conditioned on future delivery of the deed and the absence of the taxpayer's receiving some negotiable instrument. The point is that in both *Bedell* and *Moir* the period of deferment was fairly short, yet the courts seized upon other factors to decide the issue of cash equivalency. However, it would seem that the fact that an obligation is relatively short term may have a bearing on the question of marketability and in this respect can be an important factor.

J. *Parties' Intent*

If the transaction involves a note or other debt instrument, and the parties intend the instrument only as evidence of the obligation and not as receipt of payment, the courts may not require income realization. In *Schlemmer v. United States*,[126] each of two partners was voted a $30,000 salary in 1929. By 1930, the partnership was unable to pay the salaries, so the partners signed and delivered to each other notes for the $30,000. All direct evidence indicated the notes were not taken as payment, "but only as more permanent evidence of debt."[127] The court looked upon the transaction as a mere change in the form of property and not as a justification for a finding of present income. In this respect, it would seem that if the parties agreed not to negotiate the note there would be even stronger indication that they intended the obligation only as evidence of payment and not payment itself.[128]

V. Conclusion

Section 1001 of the Internal Revenue Code states that the "fair market value" of the property received shall be included in determining gain or loss on the sale of property.[129] Yet accrual basis taxpayers include the face value of obligations received rather than the fair market value. And for cash basis taxpayers cash equivalency rather than fair market value is the criterion for realization. Thus, in planning a sale of property for deferred payment treatment, the accounting

123. 45 F.2d 356 (7th Cir. 1930).
124. *Cf.* Alice Kleberg, 43 B.T.A. 277 (1941).
125. 30 F.2d 622 (2d Cir. 1929).
126. 94 F.2d 77 (2d Cir. 1938).
127. *Id.* at 78. For other cases citing the parties' intent as an important factor, see San Jacinto Life Insurance Co., 34 B.T.A. 186 (1936); Samuel Segel, 34 P-H Tax Ct. Mem. 1237 (1965), *aff'd*, Estate of Segel v. Comm'r, 370 F.2d 107 (2nd Cir. 1966); McLaughlin v. Comm'r, 113 F.2d 611 (7th Cir. 1940).
128. Dudley T. Humphrey, 32 B.T.A. 280 (1935).
129. Int. Rev. Code of 1954, § 1001.

method of the seller is usually more important than the language of the Code.[130] For an accrual basis taxpayer the most important aspect of the obligation received is whether it evidences an unconditional right to receive money. For the cash basis taxpayer the key is the liquidity of the obligation, which may be affected by any number of factors. Unconditionality and liquidity are troublesome areas of the law. As one court put it, they are areas of "every mind for itself."[131] However, there is one saving grace for the tax planner. Where a taxpayer tries for deferred payment treatment and fails, it may still be possible to elect installment reporting under section 453.[132]

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130. Of course, cases like Heller Trust v. Comm'r, 382 F.2d 675 (9th Cir. 1967), do not seem to make so clear a distinction in the treatment of cash basis taxpayers and recognize income to the extent of the *fair market value* of the obligation received, even where the lack of liquidity is evident in the 50% or so discount that would be required if the obligations were sold.

131. Frost Lumber Industries v. Comm'r, 128 F.2d 693, 694 (5th Cir. 1942).

132. INT. REV. CODE of 1954, § 453. Mamula v. Comm'r, 346 F.2d 1016 (9th Cir. 1965). In permitting an election of installment reporting to be considered timely which would otherwise be late, and therefore denied, the Internal Revenue Service generally requires good faith in the original decision to report on the deferred payment basis and a finding of facts that "indicate no election inconsistent with the installment election had been made with respect to the sale." Rev. Rul. 65-297, 1965-2 CUM. BULL. 152.