

Belcher v. Patterson
63-2 USTC ¶ 9678, 12 AFTR2d 5179 (N.D. Ala. 1963)
(rem'g sub. nom. Abernathy v. Patterson)

[1954 Code Sec 453(d)]

Installment obligations: Disposition: Mortgage foreclosure: Year of gain.---On remand from the Fifth Circuit, the District Court held that the gain realized on the extinguishment of an installment obligation following a mortgage foreclosure of a tract of land sold by a partnership in 1950 was taxable as capital gain in 1954, the year in which the mortgagor transferred its right of redemption in satisfaction, extinguishment and settlement of the installment obligation at other than face value. The gain was not taxable in 1953, the year the foreclosure sale took place, because the mortgagor still had a statutory right of redemption under Alabama law which did not expire for two years, unless relinquished by the mortgagor within the two-year period. The gain realized was taxable as capital gain because the original sale of the tract subject to the mortgage was the sale of a capital asset. Back reference ¶ 12871.70.

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Findings of Fact, Conclusions of Law and Order

LYNNE, District Judge: Pursuant to the extended opinion of the United States Court of Appeals for the Fifth Circuit remanding the above styled case to this Court for a determination of the following issue:

"The second question raised in the Director's appeal is whether the District Court erred in refusing to make a determination of the specific year in which the Allendale mortgage foreclosure became a taxable event to the partnership."

this Court has taken a submission of that issue, upon the pertinent facts shown in the record on appeal and the stipulation of additional facts by counsel for the respective parties, and hereby make and enter the following findings of fact and conclusions of law upon such issue.

Findings of Fact

1. William Albert Belcher and wife, Nell Vandergrift Belcher, individually and Nell Vandergrift Belcher as trustee respectively for Mary Earnestine Belcher Abernathy, William Albert Belcher, Jr., Van Elam Belcher and Katherine Ann Belcher, part-hers under the name of Belcher Land and Timber Company, a partnership, sold to Atlanta Highway Estates, Inc., a corporation, on July 15,, 1950 certain land constituting a capital asset of the partnership known as

the Allendale tract for the total consideration of \$727,200 of which ~537-.36 was paid in cash on the closing of the transaction and the balance of \$673,964 was evidenced by a promissory note secured by a mortgage on certain real estate in the Allendale tract as described therein bearing interest at 4% to payment date of January 15, 1953, said mortgage being the Allendale mortgage referred to in the extended opinion of the Court of Appeals (Plaintiff's Exhibit 5,3).

2. The gain from the sale of the land in the Allendale tract secured by the Allendale mortgage was properly reported as an installment sale in the partnership income tax return for 1950, with the gain taxable as a capital gain. The gain as reported in the 1950 partnership return is as follows:

Sale of Land – Installment Sale		Gain
581.76 Acres – Allendale Tract		
Sale – 7/15/50	\$727,200.00	
Cost Acquired 11/4/43	\$103,041.68	
Profit Earned – 85.85%	\$624,158.32	
Collections		
1950	\$53,236.00	\$45,703.11

3. The gain on collections on the sale of the land in the Allendale tract was taxable at capital gain rates as an installment sale in 1950 and subsequent years in which collections were made.

4. Default was made by the mortgagor in the Allendale mortgage and the partnership caused foreclosure of the mortgage under the power of sale therein in the year 1953. The partnership bid in the property not theretofore released from the mortgage for \$500,000 and the property covered by the mortgage not theretofore released from the lien of the mortgage was conveyed to the partnership by foreclosure deed (Plaintiff's Exhibit 5.2).

5. After the foreclosure sale, a suit for a deficiency judgment was instituted on June 2, 1953 on behalf of the partnership against the mortgagor in the Circuit Court of Jefferson County, Alabama, case No. 29301-X, for a deficiency in the amount of \$180,558.75, plus interest, as the balance due on the promissory note of the mortgagor executed on July 15, 1950 in the face amount of \$673,964.00.

6. The mortgagor threatened to redeem from the foreclosure sale.

7. Under date of July 26, 1954 the mortgagor executed a deed conveying to the partnership the equity of redemption with the understanding and agreement that in consideration thereof the deficiency judgment suit would be settled and dismissed and that the entire liability under the installment obligation would be completely satisfied, extinguished and settled at less than face value and complete satisfaction of the installment obligation at less than face value was thereby accomplished. (Plaintiff's Exhibit 51).

8. The installment obligation thereby satisfied was a capital asset and the face value thereof was \$673,964.00.

9. The Allendale mortgage foreclosure did not become a taxable event to the partnership in the year 1953 because the mortgagor under Alabama law had a statutory right of redemption within two years *from* the date of foreclosure unless sooner extinguished by voluntary act of mortgagor.

10. The Allendale mortgage foreclosure became a taxable event to the partnership in the year 1954 because the right of redemption of the mortgagor was extinguished by the quit claim deed transferring the equity of redemption to the partnership in consideration of the settlement of the deficiency foreclosure suit without liability and the satisfaction, extinguishment and settlement of: all liability of the mortgagor under the installment obligation. secured by the mortgage by the satisfaction of the installment obligation, at other than face value, that: is, at less than face value. The taxable gain of the partnership on the Allendale mortgage foreclosure occurred in 1954 and is properly computed as follows:

Face value of obligation	\$673,964.00
LESS: Income returnable if obligation paid in full	578,598.09
Basis of Installment obligation	\$ 95,385.91
Value of property acquired in satisfaction of installment obligation as fixed by bid price of foreclosure deed	500,000.00
LESS: basis of installment obligation	95,365.91
Net gain in 1954	404,634.00

11. The net gain of \$404,634.09 is taxable in the year 1954 at capital gain rates and not at ordinary rates.

Conclusions of Law

1. The gain on the Allendale mortgage foreclosure is taxable in the year 1954 under the Provisions of Section 453 (d) of Internal Revenue Code-Of 1954 relating to gain or loss on disposition of installment obligations at other than face value.

2. The face value Of the installment Obtigation in 1954 which was satisfied at less than face value was \$673,964.00.

3. The gain on the mortgage foreclosure of the Allendale tract was not taxable in the year 1953 for the reason that the mortgagor had a statutory right of redemption. which did not, expire for two years unless extinguished by the mortgagor prior to the expiration of the two year period.

4.The transfer of the right of redemption in the year 1954 by quit claim deed from the mortgagor to the partnership resulted in the satisfaction, extinguishment and settlement of the installment obligation at other than face value.

5. In as much as the original sale of the Allendale tract which was subject to the Allendale mortgage in

1950 was the sale of a capital asset, the gain realized in 1954 off the extinguishment of the installment obligation at other than face value is taxable at capital gain rates and not at ordinary income tax rates.

6. In conformity with the foregoing findings of fact and conclusions of law submitted to the Court on the foregoing issue:

[Judgment of Court]

IT IS ORDERED, ADJUDGED AND DECREED by the Court that the amount, if any, which plaintiffs are otherwise entitled to recover or to be refunded in the year 1954 shall be offset by plaintiffs' share of the taxable gain of the Partnership in the year 1954 resulting from the satisfaction of installment obligations of the Allendale transaction at other than face value computed at Capital gain rates.

And the Court hereby retains jurisdiction of this case for such other orders, judgments and decrees as may be necessary and proper.

Final Judgment

Pursuant to the opinion and mandate of the United States Court of Appeals for the Fifth Circuit in the above styled cause, the final judgment entered in the above styled cause on November 23, 1960 is hereby vacated and:

It is ORDERED, ADJUDGED, and, DECREED by the Court as follows

1. That the plaintiffs have and recover nothing from the defendant on the claim for refund sued upon for the year 1952.
2. That the plaintiffs have and recover nothing from the defendant on the claim for refund sued upon for the year 1954.
3. That the plaintiffs have and recover from the defendant the sum of \$1,515.38 on the claim for refund sued upon for the year 1955, together with interest as provided by law, and costs.