STATE OF ALABAMA DEPARTMENT OF REVENUE,	§	STATE OF ALABAMA DEPARTMENT OF REVENUE
	§	ADMINISTRATIVE LAW DIVISION
v.	§	DOCKET NO. INC. 86-112
GARY W. & TANYA W. BELL 2575 Dalton Drive	§	
Pelham, Alabama 35124,	§	
Taxpayers.	§	

ORDER

This case involves a disputed income tax preliminary assessment entered by the Revenue Department against Gary W. & Tanya W. Bell (hereinafter "Taxpayers") concerning the year 1984. A hearing was held in the matter on August 12, 1986 at which the Taxpayers were represented by Mr. Grant McDonald, CPA, and the Department was represented by assistant counsel Mark Griffin. Based on the evidence taken at the hearing, and in consideration of the arguments and authorities presented by both parties through post-hearing briefs, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

In 1984, the Taxpayers sold 2,500 share of common stock for a contract price of $327,500.00. The Taxpayer's cost basis in the stock was $2,500.00. The Taxpayers received $227,500.00 as partial payment on the contract in 1984. On their 1984 federal and Alabama income tax returns, the Taxpayers reported $225,000.00 ($227,500.00 less cost basis of $2,500.00) as taxable income. The Department audited the Taxpayers and determined that the $100,000.00 balance

due on the contract should have been reported as income by the Taxpayers in 1984. According to the Department, the unpaid balance was not excludable from taxable income under the installment sale provision, Code of Alabama 1975, §40-18-7(c), because more than 40% of the total contract amount was received in the initial payment.

The Taxpayers argue that the $100,000.00 was not taxable in 1984 because under the cost recovery method of accounting, payments to be received in the future are not reportable until received if they are contingent or otherwise unlikely to be paid in full. In support of their argument, the Taxpayers contend that the present financial status of the stock purchaser is so questionable and tenuous as to make uncertain full payment of the amount due.

CONCLUSIONS OF LAW

Succinctly stated, the cost recovery method of reporting income provides that if the amount of an obligation to be received in the future is uncertain, or the right to receive the payments are so contingent or speculative that the fair market value cannot be ascertained, then the income is not reportable until received. Warren Jones Company v. C.I.R., 524 F.2d 288; see generally, 1986 C.C.H. Fed. Tax Reporter §§2831.063, 2831.887, and 4460.1436. The cost recovery accounting method is akin to the "open transaction" doctrine, which provides that if a right to receive future income is so contingent upon uncertain facts and circumstances, then the income is not reportable until actually received. Estate of Stahl

v. C.I.R., 442 F.2d 324.

Further, if a taxpayer receives periodic payments pursuant to a contract under which payments are a certainty, such payments will be allocated for reporting purposes between return of cost (cost basis) and the receipt of taxable income. However, where there is uncertainty of payment, payments will be considered as a return of cost, and no gain will be reported until the full cost basis has been returned. Willhoit v. C.I.R., 308 F.2d 259; Liftin v. Commissioner, 36 T.C. 909.

There is no dispute that the installment sale provisions of §40-18-7(c) are inapplicable. More than forty percent of the contract amount was received in the initial installment, in violation of the installment sale provisions in effect during the year in question. Thus, the determinative issue is whether the debt was so contingent or uncertain that it was not reportable in 1984 under the above discussed reporting methods.

The deciding factors are whether the amount of the debt can be determined, and whether the right to receive the debt is legally fixed. From the evidence, it is clear that the amount of the debt, $100,000.00, is certain, as is the debtor's obligation to pay. Accordingly, the $100,000.00 should have been reported by the Taxpayers' in 1984. If the debt is determined to be uncollectible in a later year, then a bad debt deduction would then be appropriate.

The fact that the debtor, although clear in amount and legally fixed, may not be paid in full because of the debtor's financial insecurity is insufficient cause to defer reporting of the income to a later year. In Parkersburg State Bank v. United States, 33 AFTR.2d 74-529, the court, on the issue of the reportability of future payments, stated as follows:

> You are instructed that a land sale contract does not have an ascertainable fair market value (and thus is not reportable) if, at the time of the contract, it is not possible to tell with substantial certainty the amount, if any, the taxpayer might receive in the future under the contract. A mere possibility that a debtor may not pay his debt is not enough, however, to support a conclusion that a land contract does not have an ascertainable fair market value. In order for you to find that the land contract in question did not have an ascertainable fair market value in 1968, you must find that the probability of the future payment on the contract would be so contingent, uncertain, or indefinite as to be pure speculation. (emphasis supplied)

The above considered, it is hereby determined that the $100,000.00 debt in issue should have been included as taxable income by the Taxpayers in 1984, and accordingly, that the Department acted properly in entering the assessment in issue. The Revenue Department is hereby directed to make said assessment final as entered, with appropriate interest as required by law.

Done this 31st day of October, 1986.

BILL THOMPSON
Chief Administrative Law Judge