



LEXSEE REV RUL 80-58

Revenue Ruling 80-58

Rev. Rul. 80-58; 1980-1 C.B. 181; 1980 IRB LEXIS 502

January 1980

[*1]

SUBJECT MATTER: Section 1001.-Determination of Amount of and Recognition of Gain or Loss

APPLICABLE SECTIONS:

26 CFR 1.1001-1: Computation of gain or loss. (Also Sections 61, 1038; 1.61-6, 1.1038-1.)

TEXT:

Reconveyance of real property to seller. No gain is recognized under *section 1001 of the Code* on the sale of land by a taxpayer who accepts reconveyance of the land and returns the buyer's funds in the taxable year of the sale. If the reconveyance occurs after the taxable year of sale, the seller reports the sale in the taxable year of sale and acquires a new basis in the property when it is reconveyed equal to the amount paid for the reconveyance.

ISSUE

In the situations described below, what are the federal income tax consequences of a reconveyance to a taxpayer of property previously sold by the taxpayer?

FACTS

Situation 1: In February 1978, *A*, a calendar year taxpayer, sold a tract of land to *B* and received cash for the entire purchase price. The contract of sale obligated *A*, at the request of *B*, to accept reconveyance of the land from *B* if at any time within nine months of the date, of sale, *B* was unable to have the land rezoned for *S*'s business purposes. If there were a reconveyance, under the contract, *A* and *B* would be [*2] placed in the same positions they were prior to the sale.

In October 1978, *B* determined that it was not possible to have the land rezoned and notified *A* of its intention to reconvey the land pursuant to the terms of the contract of sale. The reconveyance was consummated during October 1978, and the tract of land was returned to *A*, and *B* received back all amounts expended in connection with the transaction.

Situation 2: Same as above, except that the period within which *B* could reconvey the property to *A* was one year. In January 1979, *B* determined that it was not possible to have the land rezoned and notified *A* of its intention to reconvey the land pursuant to the terms of the contract of sale. The reconveyance was consummated during February 1979, and the tract of land was returned to *A*. *B* received back all amounts expended in connection with the transaction.

LAW AND ANALYSIS

Section 61 (a) (3) of the Internal Revenue Code provides that, except as otherwise provided, gross income means all income from whatever source derived, including gains derived from dealings in property.

Section 1001 (c) of the Code provides that, except as otherwise provided, the entire amount of gain or loss, determined [*3] under *section 1001*, on the sale or exchange of property shall be recognized.

The legal concept of rescission refers to the abrogation, canceling, or voiding of a contract that has the effect of releasing the contracting parties from further obligations to each other and restoring the parties to the relative positions that they would have occupied had no contract been made. A rescission may be effected by mutual agreement of the parties, by one of the parties declaring a rescission of the contract without the consent of the other if sufficient grounds exist, or by applying to the court for a decree of rescission.

The annual accounting concept requires that one must look at the transaction on an annual basis using the facts as they exist at the end of the year. That is, each taxable year is a separate unit for tax accounting purposes. *See Security Flour Mills Co. v. Commissioner*, 321 U.S. 281, 88 L. Ed. 725, 64 S. Ct. 596, 1944-1 C.B. 526 (1944), Ct. D. 1603, 1944 C.B. 526.

In *Penn v. Robertson*, 115 F.2d 167 (4th Cir. 1940), the taxpayer was a participant in an employees' stock benefit fund created by the directors of the company without the approval of the shareholders. Under the plan [*4] the taxpayer was credited with earnings from the fund for the years 1930 and 1931. In 1931, as a result of suits filed by a shareholder, the directors of the company passed a resolution whereby the plan would be rescinded as to all participants in the plan who agreed to relinquish their previous credits and rights. The United States Court of Appeals held that although the plan was rescinded for 1930, the annual accounting period principle required the determination of income at the close of the taxable year without regard to subsequent events. That is, the rescission in 1931 was disregarded for purposes of determining 1930 taxable income.

With regard to whether the 1931 income should be taxed, the Court of Appeals said in the *Penn* case that the rescission in 1931 extinguished what otherwise would have been taxable income for that year.

The facts of the *Penn* case are similar to those in *Situation 1* and *Situation 2*. In *Penn*, earnings were credited in 1930 and 1931 and there was a rescission in 1931 (that was intended to affect both years). *Situation 1* relates to the earnings credited in 1931, the year of the rescission; and *Situation 2* relates to the earnings credited in 1930, that is, [*5] a year different from the year of the rescission.

In *Situation 1* the rescission of the sale during 1978 placed *A* and *B* at the end of the taxable year in the same positions as they were prior to the sale. Thus, in light of the *Penn* case, the original sale is to be disregarded for federal income tax purposes because the rescission extinguished any taxable income for that year with regard to that transaction. *See Rev. Rul. 74-501, 1974-2 C.B. 98*, which holds that there is no adjustment to the basis of the old stock where a shareholder exercised stock rights and paid the subscription price for the new stock, which subscription price was later returned to the shareholder in the same taxable year in which the rights were issued because the market price of the stock had depreciated to a price below the subscription offer.

In *Situation 2*, as in *Situation 1*, there was a completed sale in 1978. However, unlike *Situation 1*, because only the sale and not the rescission occurred in 1978, at the end of 1978 *A* and *B* were not in the same positions as they were prior to the sale. Again, in light of the *Penn* [*6] case, the rescission in 1979 is disregarded with respect to the taxable events occurring in 1978.

In both situations, the annual accounting period principle requires the determination of income at the close of the taxable year without regard to subsequent events.

HOLDINGS

In *Situation 1*, no gain on the sale will be recognized by *A* under *section 1001 of the Code*.

In *Situation 2*, *A* must report the sale for 1978. In 1979, when the property was reconveyed to *A*, *A* acquired a new basis in the property, which was the price paid to *B* for such reconveyance.

See *section 1038 of the Code* for treatment of reacquisition of real property where a secured indebtedness to the original seller is involved.