CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 099

June 20, 1958

SALE OF ASSETS ON A DEFERRED BASIS: CONTRACT OF SALE

Syllabus:

A contract of sale, which is not secured by other evidence of indebtedness, does not have a fair market value equal to its face for the purposes of gain or loss, and consequently only that portion received in the taxable year need be reported.

Taxpayer entered into a contract to sell certain stock under which he received a down payment and the balance of the purchase price was to be paid in installments over a ten year period. Taxpayer, reporting on a cash receipts basis, deducted the entire cost from the payment received in the year of the sale and wishes to report the subsequent payments as capital gain. The Franchise Tax Board computed the capital gain measured by the difference between the cost of the stock and the total contract price. Advice is requested whether the contract of sale, which is not secured by other evidence of indebtedness has a fair market value equal to its face value for purpose of gain or loss.

In order to use the installment method of reporting gain a timely election must be made at the time the return is filed, which taxpayer failed to do. The cost recovery used by the taxpayer, however, is a proper method of reporting the gain in this case.

The courts have held that a contract of sale alone has no readily realizable fair market value. That in the absense of other negotiable evidence of indebtedness, the contract has intrinsic value only, which in no sense approximates fair market value. Perry v Comm., 152 F2d 183; Johnston, 14 TC 560; Cowden, 9 TCM 1148. Consequently, the entire gain cannot be assessed in the year of sale. Since taxpayer recovered his cost in the year of sale, the remaining installments will be reported as capital gain.