Forrester A. Clark v. Commissioner, 1943 Tax Court Memo 24 (1943)

In a taxable exchange of property, the basis of the acquired property is its cost, which is equal to the fair market value of the property surrendered in the exchange.

Summary

The case concerns the proper basis for bonds received by a taxpayer in exchange for stock and assets. The Tax Court held that the bonds acquired a new basis equal to their cost, which was the fair market value of the stock and assets surrendered in the exchange. The court rejected the Commissioner’s argument that the bonds retained the basis of the stock. The court further determined that the fair market value of the bonds at the time of the exchange was at least $147,976.30, resulting in no taxable gain in the years at issue. The court also disallowed the Commissioner’s claim of recoupment for a prior overpayment.

Facts

The taxpayer, Forrester A. Clark, received bonds from a new company, Delaware, in exchange for stock and assets of an old company, American. Delaware had no accumulated earnings or profits. The Commissioner argued that the bonds retained the basis of the stock Clark had previously held. Clark contended that the bonds acquired a new basis equal to their fair market value at the time of the exchange.

Procedural History

The Commissioner determined deficiencies in the taxpayer’s income tax. The taxpayer appealed to the Tax Court, contesting the Commissioner’s determination of the basis of the bonds and the resulting taxable gain.

Issue(s)

1. Whether the bonds acquired a new basis in the taxpayer’s hands, or retained the basis of the stock he had previously held.

2. If the bonds acquired a new basis, what was that basis?

3. Whether the Commissioner could recoup a prior overpayment by the taxpayer.

Holding

1. Yes, because the transaction was a taxable exchange, and the bonds acquired a new basis.

2. The new basis was the cost of the bonds, which was the fair market value of the stock and assets surrendered in the exchange.

3. No, because sections 607 and 609 of the Revenue Act of 1928 require a refund of

overpayments even if the collection of taxes for other periods is barred by limitations.

Court's Reasoning

The court reasoned that the transaction was a taxable exchange, not a tax-free reorganization. Therefore, the bonds acquired a new basis. The general rule under section 113 of the revenue acts is that basis is cost. The court stated, "Just as the cost of property purchased for cash is the amount of money given for it, so it would seem to follow in a strict sense that the cost of property acquired in an exchange is what the recipient parts with, that is, the value of the property given in exchange." The court found that the fair market value of the stock and assets transferred was substantially equal to the fair market value of the bonds at that time. The court determined the fair market value of the bonds to be at least $147,976.30. Regarding recoupment, the court cited *McEachern v. Rose*, 302 U.S. 56 (1937), emphasizing that Congress intended to require refunds of overpayments even when the collection of taxes for other periods is barred by limitations.

Practical Implications

This case clarifies the basis rules for property acquired in a taxable exchange. It emphasizes that the basis of the acquired property is its cost, which is determined by the fair market value of the property surrendered. This principle is crucial for determining gain or loss upon subsequent disposition of the acquired property. The case also reinforces the limitations on the government's ability to recoup prior overpayments when the collection of deficiencies for those periods is barred by the statute of limitations. This case serves as a reminder to taxpayers to accurately value property exchanged in taxable transactions and to be aware of the limitations on the government's ability to adjust tax liabilities for closed years. Later cases would cite this for the principle that in an arm's length transaction, the values of the exchanged items are presumed to be equal.