T.C. Memo. 1943-170

A corporation does not realize taxable gain when it deals in its own treasury stock for the purpose of capital readjustment rather than as if it were trading in the shares of another corporation for profit.

Summary

Coastal Oil Storage Co. reacquired shares of its own stock from a departing shareholder and held them as treasury stock. Later, facing increased business and a need for capital, it issued these treasury shares to a shareholder who had loaned the company money, crediting the loan balance. The Commissioner of Internal Revenue argued this was a taxable capital gain. The Tax Court held that this transaction was a capital readjustment, not a speculative stock trade, and therefore not subject to income tax under Treasury Regulations.

Facts

Coastal Oil Storage Co. (Petitioner) was in the oil and gas well cementing business.

J.V. Calvert, owning 1/6 of the company’s stock, wanted to leave the business.

On January 23, 1939, Petitioner bought back Calvert’s 12.5 shares for $375, representing 1/6 of the company’s net worth, and held them as treasury stock.

Petitioner’s business grew, requiring more working capital.

E.E. Swift, a shareholder, loaned Petitioner over $30,000.

On May 31, 1939, Petitioner issued the treasury shares to Swift, crediting $6,600 (1/6 of net assets post-issuance) against Swift’s loan notes.

The Commissioner determined a deficiency, claiming a $6,225 taxable capital gain from the stock resale.

Procedural History

The Commissioner of Internal Revenue determined a tax deficiency against Coastal Oil Storage Co.

Coastal Oil Storage Co. petitioned the Tax Court to contest the deficiency.

The Tax Court reviewed the Commissioner’s determination.

Issue(s)

1. Whether the issuance of treasury stock by Coastal Oil Storage Co. to a shareholder, in exchange for debt reduction, constitutes a taxable gain for the

corporation under Section 19.22(a)-16 of Regulations 103.

Holding

1. No, because the transaction was a capital readjustment intended to raise capital, not a dealing in its own shares as if they were shares of another corporation for profit.

Court's Reasoning

The court relied on Regulation 103, Section 19.22(a)-16, which states that whether a corporation's dealings in its own stock result in taxable gain depends on the nature of the transaction.

The regulation specifies that original issuance of stock is not taxable, but dealing in treasury stock can be if it's akin to dealing in another corporation's stock.

The court cited *Dr. Pepper Bottling Co. of Mississippi, 1 T.C. 80*, which held that stock transactions for capital readjustment are not taxable.

The court distinguished cases cited by the Commissioner (*Allen v. National Manufacture & Stores Corporation*, *Trinity Corporation*, *Brown Shoe Co. v. Commissioner*, *Pittsburgh Laundry, Inc.*), noting those cases involved profit-seeking motives absent here.

The court reasoned that Petitioner's acquisition of stock from Calvert was to remove a shareholder, and the issuance to Swift was to obtain needed capital, not to speculate in its own stock.

"From the stipulated facts it seems entirely clear that when on January 23, 1939, petitioner acquired from one of its stockholders, J. V. Calvert. 12½ shares of its authorized and issued capital stock by paying over to him a ratable portion of the corporation's net assets… it was not acquiring the shares as it would acquire the shares of another corporation for a subsequent resale at a profit. It was acquiring these shares because Calvert desired to sever his relations with petitioner and the remaining stockholders desired that this be done."

The court further reasoned that if the company had canceled the treasury stock and then issued new stock to Swift, it would clearly be a non-taxable capital transaction, and the actual method used was functionally equivalent.

Practical Implications

This case clarifies that not all transactions involving a corporation's treasury stock result in taxable income.

It establishes a distinction between taxable "dealing" in own stock and non-taxable capital readjustments.

The key factor is the purpose and context of the transaction: if the primary purpose is to adjust the corporation's capital structure (e.g., raising capital, changing ownership), it is less likely to be considered taxable gain.

This ruling is important for corporations managing their capital and stock, allowing flexibility in treasury stock transactions without automatically triggering income tax consequences, provided the transactions are genuinely for capital purposes and not speculative trading.

Later cases would likely analyze the specific facts and circumstances to determine whether a treasury stock transaction is more akin to a capital readjustment or a profit-seeking venture.

