2 T.C. 827 (1943)

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When a corporation reacquires its own shares and holds them as treasury stock, the subsequent exchange of those shares in a corporate reorganization is considered a disposition of property with a cost basis, not an ‘issuance’ of stock.

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Summary

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Firestone reacquired its own shares on the open market and held them as treasury stock. Later, Firestone exchanged these treasury shares for shares of Schacht Rubber Manufacturing Co. in a tax-free reorganization. Subsequently, Firestone exchanged some of the Schacht shares back for Firestone shares. The central issue was determining the basis for calculating gain or loss on this later exchange. The Tax Court held that the basis should be Firestone’s cost for the treasury shares, not the original Schacht shareholders’ basis, because the exchange of treasury shares was not an ‘issuance’ of stock under Section 113(a)(7) of the tax code. This distinction is critical as it impacts how the company calculates its taxable gains or losses.

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Facts

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1. In 1929, Firestone purchased 15,384 of its own common shares on the open market for $590,781.96, holding them as treasury shares.r
2. In 1937 and 1939, Firestone exchanged these 15,384 treasury shares for all 600 outstanding shares of Schacht in a tax-free reorganization under Section 112(g)(1)(B) of the Revenue Act of 1936.r
3. In July 1939, Firestone decided to relinquish control of Schacht and exchanged 306 Schacht shares for 7,844 Firestone common shares.r
4. The Commissioner argued that Firestone’s basis in the Schacht shares was $100 per share, the original shareholders’ cost, relying on Section 113(a)(7).r
5. Firestone contended that its basis should be its cost for the Firestone treasury shares used in the initial acquisition of Schacht, citing Section 113(a)(6).r

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Procedural History

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1. The Commissioner determined a deficiency in Firestone's income tax for the fiscal year ending October 31, 1939.r
2. Firestone contested the deficiency, arguing that the Commissioner incorrectly determined the basis for computing gain or loss in the exchange of Schacht shares for Firestone shares.r
3. The Tax Court reversed the Commissioner's determination, holding that Firestone's basis was correct. The decision will be entered under Rule 50.r

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Issue(s)

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1. Whether the exchange of Firestone treasury shares for Schacht shares in the initial reorganization constituted an 'issuance' of stock under Section 113(a)(7) of the Internal Revenue Code.r
2. Whether Firestone's basis in the Schacht shares, for purposes of calculating gain or loss on the subsequent exchange, should be the cost of the Firestone treasury shares or the transferors' basis in the Schacht shares.r

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Holding

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1. No, because the exchange of Firestone's treasury shares was not an 'issuance' of stock but rather a disposition of property with a cost basis.r
2. The basis for the Schacht shares should be Firestone's cost for the treasury shares (pro rata portion of the original purchase cost), because the initial exchange was not considered an issuance of stock under the tax code, thus allowing the company to use its cost basis in the reacquired shares.r

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Court’s Reasoning

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1. The court reasoned that an ‘issuance’ of shares typically does not have a cost basis, while a disposition of treasury shares does. Therefore, the exception in Section 113(a)(7) regarding the ‘issuance’ of stock does not apply to the exchange of treasury shares.r
2. The court distinguished between an issuance of shares and a disposition of treasury shares, stating that “for the purpose of an inquiry as to basis, there is a difference between an issuance of shares and a disposition of treasury shares, in that the former do not have a cost and the latter do.”r
3. The court rejected the Commissioner’s argument that the transferors’ cost should be used as Firestone’s basis, as this would disregard the actual cost Firestone incurred in purchasing its own shares.r
4. The dissenting opinion argued that the term

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