2 T.C. 1024 (1943)

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This case clarifies the tax treatment of proceeds from the sale of mineral rights, losses on worthless stock, bad debt deductions, and the deductibility of stock transfer taxes.

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Summary

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Alice G.K. Kleberg involved several tax issues related to the petitioner's income in 1934. The Tax Court addressed whether the proceeds from the sale of mineral rights qualified for capital gains treatment, the deductibility of losses from worthless stock and bad debts from the Kleberg Town & Improvement Co., and the deductibility of stock transfer taxes paid during the incorporation of King Ranch Corporation. The court determined that proceeds from the sale of mineral rights qualified for capital gains treatment, the Kleberg Town & Improvement Co. stock became worthless in 1934, and the stock transfer taxes were deductible. The court's rationale centered on the nature of the transactions, the timing of asset valuation, and the taxpayer's liability for the taxes in question.

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Facts

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In 1919, Robert J. Kleberg, Sr. (petitioner's husband), received a 3/32 mineral interest in Henrietta M. King's land as compensation for services. This became community property. In 1933, Kleberg, as executrix of her husband's estate, joined a mineral lease with Humble Oil & Refining Co. Simultaneously, Kleberg sold her royalty rights from this 3/32 interest to the King estate for a fixed sum payable in two installments in 1933 and 1934. The Kleberg Town & Improvement Co. stock, gifted to petitioner in 1918, became a point of contention. In 1934, Kleberg formed the King Ranch Corporation and paid revenue stamps for the stock issuance.

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Procedural History

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The Commissioner of Internal Revenue assessed a deficiency in Kleberg's 1934 income tax. Kleberg petitioned the Tax Court to challenge this assessment. Previous cases involving the same parties regarding the 1933 tax year were referenced, particularly concerning the deductibility of losses related to the Kleberg Town & Improvement Co.

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Issue(s)

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1. Whether the proceeds from the sale of mineral rights qualify for capital gains treatment and a holding period exceeding 10 years?

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2. Whether the petitioner sustained a deductible loss on the Kleberg Town & Improvement Co. stock in 1934?

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3. Whether the petitioner is entitled to a bad debt deduction related to her interest in the Kleberg Town & Improvement Co.?

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4. Whether the stock transfer stamp tax paid during the King Ranch Corporation's formation is deductible?

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Holding

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1. Yes, because the 1933 agreement constituted a sale of a capital asset held for more than 10 years.

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2. Yes, because the stock became worthless in 1934.

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3. Yes, because the debt became partially worthless in 1934, and the petitioner properly charged it off.

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4. Yes, because the petitioner was equally liable for the stamp tax under the revenue act.

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Court’s Reasoning

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The court reasoned that the 1933 agreement was a sale of a capital asset (mineral rights) held since 1919 when the rights were conveyed to her husband, thus qualifying for long-term capital gains treatment under Section 117 of the Revenue Act of 1934. Regarding the Kleberg Town & Improvement Co. stock, the court determined its worthlessness in 1934 based on the company’s insolvency and liquidation status. The court considered prior litigation, invoking res judicata to establish that the stock had value at the beginning of 1934. They emphasized that the absence of a formal dividend declaration when the company’s capital stock was reduced in 1918 did not negate the existence of a valid debt. Finally, the court found the stock transfer tax deductible under Section 23(c) of the Revenue Act of 1934, emphasizing the taxpayer’s direct liability for the tax. The court referenced Magruder v. Supplee, 316 U.S. 394, stating, “In general taxes are deductible only by the person upon whom they are imposed.”

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