3 T.C. 169 (1944)

A corporation does not realize taxable gain when it disposes of treasury shares as part of a broader capital restructuring plan, where the disposition is not akin to dealing in the shares of another corporation for profit.

Summary

Cluett, Peabody & Co. purchased its own stock for a profit-sharing plan that never materialized. Years later, during a capital restructuring, it disposed of these treasury shares. The Commissioner of Internal Revenue argued that the company realized a taxable gain. The Tax Court disagreed, holding that the disposition of treasury shares was an integral part of the recapitalization, not a separate transaction akin to dealing in the shares of another corporation for profit. The court emphasized the lack of profit motive behind the initial acquisition and subsequent disposition, viewing it as a capital adjustment.

Facts

From 1931 to 1933, Cluett, Peabody & Co. acquired 4,100 shares of its common stock for a proposed employee profit-sharing plan. This plan was never implemented. In 1937, the company amended its charter, splitting its common shares three-for-one. It offered shareholders rights to subscribe to additional shares, including 12,303 shares derived from the original treasury stock. The company aimed to raise additional working capital for business expansion. A prospectus detailed the offering, stating the proceeds would fund plant improvements and increase working capital, addressing the need to avoid undistributed profits tax. All but 1,874 of the offered shares were subscribed for by stockholders.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Cluett, Peabody & Co.’s 1937 income tax, asserting the company realized a taxable gain on the disposition of the treasury stock. The company challenged this determination in the Tax Court. The case was submitted on a stipulation of facts.

Issue(s)

1. Whether the disposition of treasury stock by Cluett, Peabody & Co. in 1937, as part of a capital stock adjustment, constitutes a taxable gain to the corporation.

Holding

1. No, because the disposition of the treasury shares was an integral part of the corporation’s plan to restructure its capital and raise additional funds, not a transaction akin to dealing in the shares of another corporation for profit.

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Court’s Reasoning

The court relied on Treasury Regulations 94, Article 22(a)-16, which dictates that a corporation realizes gain or loss from dealing in its own shares if it does so as it might in the shares of another corporation. The court found that Cluett, Peabody & Co.’s disposition of treasury shares was not motivated by profit. The initial acquisition aimed to facilitate a profit-sharing plan, and the later disposition was part of a broader capital restructuring. The accounting treatment further supported this conclusion, as the shares were not carried as an asset, and the proceeds were assigned to capital and capital surplus accounts, not treated as earnings or profits. The court distinguished this case from situations where treasury shares are sold merely as a sale for profit. The court stated,

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