3 T.C. 390 (1944)

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When a taxpayer acquires stock through a testamentary option at a price below market value, the basis for determining gain or loss upon a subsequent sale of the stock is the price paid for the stock, not the fair market value of the option plus the price paid.

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Summary

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J. Gordon Mack was granted an option in his father's will to purchase shares of stock from the testamentary trustees at half the market price. Mack exercised this option, purchased shares, and then sold them at a profit. The Tax Court addressed whether the basis for calculating gain on the sale should include the fair market value of the option itself, in addition to the purchase price. The court held that the basis was solely the amount Mack paid for the shares. This decision emphasizes that the acquisition of the stock, not the inheritance of the option, is the taxable event.

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Facts

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John S. Mack's will granted his son, J. Gordon Mack, the option to purchase 20,000 shares of G. C. Murphy Co. stock from his testamentary trustees within ten years of his death, at half the average market price. The will stipulated the 'average market price' was the mean between the high and low prices of the stock during the six months preceding the purchase. J. Gordon Mack purchased five shares at $34.06 per share on November 25, 1940. The fair market value of the stock on the date of his father's death (September 27, 1940) was $78 per share. He then sold these shares on December 31, 1940, for $69.224 per share.

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Procedural History

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Mack reported a short-term capital loss on his 1940 income tax return, calculating his basis using a formula that included the value of the option. The Commissioner of Internal Revenue determined a deficiency, arguing the basis was only the amount Mack paid for the stock. Mack petitioned the Tax Court for a redetermination of the deficiency.

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Issue(s)

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Whether the basis for determining gain or loss on the sale of stock acquired through a testamentary option is the price paid for the stock, or that amount plus the fair market value of the option itself.

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Holding

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No, because what the petitioner sold was the stock, not the option. The option was personal to the petitioner and could not be transferred. The basis is the cost of the stock which was the amount the petitioner paid the trustees.

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Court’s Reasoning

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The court relied on *Helvering v. San Joaquin Fruit & Investment Co.*, *297 U.S. 496*, stating that Mack

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