4 T.C. 248 (1944)

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A loss from the expiration of a stock warrant is treated as a short-term capital loss if the warrant had no value at the beginning of the tax year, even if the warrants were originally purchased many years prior.

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Summary

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Alvin and Pearl Spring sought to deduct a loss from unexercised stock warrants in 1940. The warrants, purchased in 1930, allowed the purchase of Burco, Inc. stock at $15/share. The stock never reached that price, and the warrants expired in 1940. The Tax Court held that the loss was not deductible as a worthless security under Section 23(g)(2) of the Internal Revenue Code because the warrants were worthless before 1940. Further, it held the loss was attributable to the failure to exercise an option under Section 117(g)(2), resulting in a non-deductible short-term capital loss because the taxpayers had no short-term gains to offset it.

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Facts

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In 1930, Alvin Spring bought 1,500 stock warrants for Burco, Inc. at a total cost of $5,250. These warrants allowed him to purchase Burco, Inc. common stock at $15 per share until January 2, 1940.

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Burco, Inc.’s stock price never reached $15 per share between 1930 and 1940. The warrants ceased to have market quotations after 1937. Spring tried unsuccessfully to sell the warrants in 1938 and 1939.

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Burco, Inc. remained in business throughout this period. The warrants expired unexercised on January 2, 1940.

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Procedural History

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The Springs filed a joint income tax return for 1940, later amending it to claim a long-term capital loss on the expired warrants. The Commissioner of Internal Revenue denied the deduction. The Tax Court was petitioned to redetermine the deficiency.

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Issue(s)

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Whether the loss sustained from the expiration of the stock warrants should be treated as (1) a loss from securities becoming worthless under Section 23(g)(2) of the Internal Revenue Code, or (2) a loss attributable to the failure to exercise an option under Section 117(g)(2) of the Internal Revenue Code?

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Holding

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No, and Yes. The Tax Court held against the petitioners, because, regardless of which section applied, the loss was not deductible in 1940. If the loss was from worthlessness, it occurred before 1940 when the warrants ceased to have value. If the loss was from failure to exercise an option, it was a short-term capital loss that could not be deducted due to the taxpayers having no short-term capital gains.

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Court’s Reasoning

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The court analyzed the history of Sections 23(g)(2) and 117(g)(2) to understand their application. It noted that pre-1938, losses from worthless securities were treated differently from losses from unexercised options. The Revenue Act of 1938 combined losses from worthless stock and stock rights under Section 23(g), subjecting them to capital asset treatment. Losses from failure to exercise options were explicitly

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categorized as short-term capital losses under Section 117(g)(2), regardless of holding period.

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The court found that the warrants had no value at the start of 1940, as evidenced by their lack of market quotations since 1937 and Spring's inability to sell them in 1938 and 1939. As the court stated: "As of the close of 1939 the value of the options, for all practical purposes, had become extinct." Thus, if Section 23(g)(2) applied, the loss wasn't deductible in 1940. Even if Section 23(g)(2) applied, the warrants became worthless before 1940.

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The court concluded that Section 117(g)(2) governed the situation, as the only event in 1940 was the expiration of warrants that were already worthless. The court reasoned that

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