Securities Corporation v. Commissioner, 4 T.C. 503 (1944)

In a corporate reorganization, the exchange of a short-term demand note for stock does not qualify as a tax-free exchange of securities, and a loss can be recognized on such an exchange.

Summary

Securities Corporation sought to deduct a loss on the sale of stock acquired through a 77B reorganization. The Tax Court addressed whether the original receipt of the stock in exchange for various interests in a predecessor company was a taxable event, establishing a new basis, or a tax-free exchange, preserving the original basis. The court held that the exchange of common stock (for nothing), bonds and preferred stock (for new stock), and an unsecured demand note (for stock) had different tax consequences. The exchange of the demand note was deemed a taxable event because it was not an exchange of "stock or securities".

Facts

Securities Corporation (petitioner) held various interests in an old company, including common stock, preferred stock, bonds, and an unsecured demand note. The old company underwent a 77B reorganization due to insolvency. Under the reorganization plan, the petitioner received common stock in the new company in exchange for its bonds, preferred stock, and the unsecured demand note. The petitioner received nothing for its common stock in the old company. The creditors received 48% of the new stock, the secured creditors received 42%, and the petitioner received 6% for the unsecured note.

Procedural History

The Commissioner disallowed the petitioner's claimed loss deduction on the sale of stock. The Tax Court was tasked with determining the basis of the stock sold by petitioner, which depended on whether the original exchange during the reorganization was taxable or not.

Issue(s)

1. Whether the exchange of property for stock in the 77B reorganization qualified for non-recognition of gain or loss under Section 112(b)(5) of the Internal Revenue Code?

2. Whether the exchange of stock or securities for stock or securities in the reorganization qualified for non-recognition under Section 112(b)(3)?

3. Whether the exchange was covered by Section 112(l), added by the Revenue Act of 1943, thus preventing the recognition of loss?

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Holding

1. No, because Section 112(b)(5) requires an identity of interest and control of 80% in the same persons after the exchange, which was not met in this case.

2. No, in part, because the unsecured demand note exchanged for stock was not a

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