4 T.C. 1065 (1945)

To qualify for capital gains treatment under Section 117(f) of the Revenue Act of 1938 upon the retirement of corporate securities, the securities must have been in registered form for at least the minimum holding period specified in Section 117(b).

Summary

The Luries sought to treat the profit from the retirement of Hilton Hotel Co. preferred income notes as capital gains. The notes, initially issued without registration, were registered in August 1940 and retired in 1941. The Tax Court ruled against the Luries, holding that to qualify for capital gains treatment under Section 117(f), the securities must have been in registered form for at least the 18-month minimum holding period required by Section 117(b). Last-minute registration to take advantage of favorable tax treatment was impermissible.

Facts

In 1938, the Luries acquired preferred income notes of Hilton Hotel Co. of California as part of a larger acquisition of the company's securities. The notes were initially issued without a formal registration process, although the application to issue them contemplated registration. In August 1940, the company requested that the noteholders return the notes for registration. The Luries complied, and the notes were registered in Louis Lurie's name. In 1941, the notes were retired, resulting in a profit for the Luries. The Luries sought to treat this profit as a capital gain on their 1941 tax returns.

Procedural History

The Commissioner of Internal Revenue determined that the profit from the note retirement constituted ordinary income, not capital gain. The Luries petitioned the Tax Court for a redetermination of the deficiency. The Tax Court upheld the Commissioner's determination.

Issue(s)

Whether the gain realized from the retirement of the preferred income notes qualifies for capital gains treatment under Section 117(f) of the Revenue Act of 1938, given that the notes were not in registered form for at least the 18-month minimum holding period required by Section 117(b).

Holding

No, because to qualify under Section 117(f), the securities retired must have been in registered form for at least the minimum period of 18 months provided by Section 117(b).

Court's Reasoning

The Tax Court addressed the legislative history of Section 117(f), noting it was enacted to address the question of whether the retirement of bonds constituted a "sale or exchange." The court rejected the Luries' argument that registration at the time of retirement was sufficient, stating that such an interpretation would allow taxpayers to manipulate the tax consequences of retirement for their own benefit, undermining the uniformity of tax treatment. The court also rejected the argument that because the notes were capital assets held for more than two years, the registration period was irrelevant. The court reasoned that Section 117(f) provides the *only* mechanism to treat note retirements as a sale or exchange. The court stated, "in our opinion there can be no doubt that, taking all the provisions of section 117 into consideration and having due regard for the purposes of the section, to come within section 117 (f) the notes must be, at the very least, in registered form for the minimum period provided by section 117 (b). This period is 18 months."

Practical Implications

This case clarifies that merely having securities in registered form at the time of retirement is insufficient to qualify for capital gains treatment under Section 117(f) (and similar subsequent provisions). The securities must be held in registered form for at least the minimum holding period required to qualify for long-term capital gain treatment. This decision prevents taxpayers from strategically registering securities just before retirement to take advantage of more favorable tax rates. The case highlights the importance of adhering strictly to the statutory requirements for capital gains treatment and underscores the principle that tax laws should be interpreted to prevent opportunistic tax avoidance. Later cases have cited *Lurie* for the proposition that the substance, not merely the form, of a transaction must satisfy the requirements for preferential tax treatment.

