5 T.C. 623 (1945)

Sales of securities on the open market, even when followed by near-simultaneous purchases of the same securities by related parties, do not constitute sales "between members of a family" that would disallow loss deductions under Section 24(b) of the Internal Revenue Code.

Summary

John P. McWilliams and his family engaged in a series of stock sales and purchases through the New York Stock Exchange to create tax losses. McWilliams would sell stock and his wife or mother would simultaneously purchase the same stock. The IRS disallowed the loss deductions, arguing the transactions were indirectly between family members, prohibited under Section 24(b) of the Internal Revenue Code. The Tax Court, relying on a prior case, held that because the transactions occurred on the open market with unknown buyers and sellers, they did not constitute sales "between members of a family" and thus the losses were deductible.

Facts

John P. McWilliams managed his own, his wife's, and his mother's investment accounts. To establish tax losses, McWilliams would instruct his broker to sell specific shares of stock at market price for one account (e.g., his own) and simultaneously purchase a like number of shares of the same stock for another related account (e.g., his wife's). The sales and purchases were executed on the New York Stock Exchange through brokers, with the purchasers and sellers being unknown to the McWilliams family. The wife and mother had separate estates and bank accounts.

Procedural History

The Commissioner of Internal Revenue disallowed the capital losses claimed by John P. McWilliams, Brooks B. McWilliams (John's wife), and the Estate of Susan P. McWilliams (John's mother) on their income tax returns for 1940 and 1941. The McWilliamses petitioned the Tax Court for a redetermination of the deficiencies. The cases were consolidated for hearing.

Issue(s)

Whether losses from sales of securities on the New York Stock Exchange, where similar securities are simultaneously purchased by related family members, are considered losses from sales "directly or indirectly between members of a family" within the meaning of Section 24(b)(1)(A) of the Internal Revenue Code, thus disallowing the deduction of such losses.

Holding

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No, because the sales and purchases occurred on the open market with unknown third parties; therefore, they were not sales “between members of a family” as contemplated by Section 24(b)(1)(A) of the Internal Revenue Code.

Court’s Reasoning

The Tax Court relied heavily on its prior decision in *Pauline Ickelheimer, 45 B.T.A. 478*, which involved similar transactions between a wife and a trust controlled by her husband. The court reasoned that because the securities were sold on the open market to unknown purchasers, the subsequent purchase of the same securities by a related party did not transform the transactions into indirect sales between family members. The court stated that, “It is apparent that the sales of the bonds were made to purchasers other than the trustee of the trust. The fact that petitioner’s husband as trustee purchased the bonds from the open market shortly thereafter does not convert the sales by petitioner and the purchases by her husband as trustee into indirect sales *between* petitioner and her husband as trustee.” The court found no legal basis to treat these open market transactions as indirect sales between family members, even though the transactions were designed to generate tax losses.

Practical Implications

This case clarifies that transactions on public exchanges, even if strategically timed to benefit related parties, are not automatically considered indirect sales between those parties for tax purposes. The key factor is the involvement of unknown third-party buyers and sellers in the open market. This ruling suggests that taxpayers can engage in tax-loss harvesting strategies without automatically triggering the related-party transaction rules, provided the transactions occur on a public exchange. However, subsequent legislation and case law may have narrowed the scope of this ruling. It is crucial to examine the current state of the law to determine whether such transactions would still be permissible.

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