6 T.C. 10 (1946)

For a note to be considered “in registered form” under Internal Revenue Code Section 117(f) (now Section 1271), entitling its retirement proceeds to capital gains treatment, the obligor must track ownership to prevent unregistered transfers, not merely keep records of the debt.

Summary

Victor and Joseph Gilbert sought to treat proceeds from the retirement of certain notes as capital gains under Section 117(f) of the Internal Revenue Code. The Commissioner argued the notes were not “in registered form,” thus the proceeds constituted ordinary income. The Tax Court held that merely recording the debt on the obligor’s books or in a county register did not constitute being “in registered form.” The court emphasized that “registered form” requires a system to prevent unregistered transfers to protect the holder. Therefore, the proceeds were taxable as ordinary income.

Facts

In 1927, Joseph Gilbert sold property, receiving cash, a first mortgage, and two notes secured by mortgages. Later, Joseph assigned portions of these notes to Victor Gilbert and others. The obligor made payments on the notes to both Joseph and Victor in subsequent years. The notes and mortgages were recorded in the obligor’s books and in the county register.

Procedural History

The Commissioner determined deficiencies in Joseph Gilbert’s income taxes for 1938, 1939, and 1940, and in Victor Gilbert’s income taxes for 1940. The Commissioner argued the payments received upon the retirement of the notes should be taxed as ordinary income, not as capital gains. The cases were consolidated in the Tax Court.

Issue(s)

1. Whether the notes retired by the obligor were “in registered form” within the meaning of Section 117(f) of the Internal Revenue Code, thus entitling the proceeds to capital gains treatment.
2. Whether Joseph E. Gilbert had recovered his entire cost basis in the notes in prior years, making the entire amount collected in the tax years at issue fully taxable.

Holding

1. No, because simply recording the notes on the obligor’s books or in a county register does not meet the requirement of being “in registered form” under Section 117(f).

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2. No, because the Commissioner previously accepted Joseph E. Gilbert's method of pro-rata allocation between cost recovery and income in 1933 and failed to demonstrate an error in that previous acceptance.

Court's Reasoning

The court relied on *Gerard v. Helvering*, 120 F.2d 235, which defined "in registered form" as a practice where the holder of coupon bonds can surrender them for a registered bond tracked on the obligor's books, preventing invalid unregistered transfers. The court distinguished *Stoddard v. Commissioner*, 141 F.2d 76, noting that *Stoddard* did not address the meaning of "in registered form." The court quoted *Gerard v. Helvering*, stating that the purpose of registration is "to protect the holder by making invalid unregistered transfers, and the bond always so provides upon its face." The court also cited *McClain v. Commissioner*, 311 U.S. 527, to reinforce the definition of

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