6 T.C. 1105 (1946)

In a tax-free exchange of property for stock, the basis of the property exchanged is substituted for the basis of the stock received, and this substituted basis must be adjusted for depreciation and other factors as provided by the Internal Revenue Code.

Summary

Samuel Rissman petitioned the Tax Court challenging the Commissioner's disallowance of a long-term capital loss deduction claimed from the sale of stock in three corporations. The IRS argued Rissman failed to prove ownership and basis. The Tax Court determined Rissman owned 24 shares in each corporation. It addressed the calculation of the stock's basis, focusing on whether the initial property transfers to the corporations were tax-free exchanges. The court found they were, requiring a substituted basis. Ultimately, the court partly sided with the Commissioner, adjusting the claimed loss by disallowing certain components of the basis calculation and denying a separate expense deduction due to lack of substantiation.

Facts

In 1941, Samuel Rissman sold stock in 714 Buena Building Corporation, 737 Cornelia Building Corporation, and Forty-Third Michigan Corporation. He and others had transferred real properties to these corporations in 1928 in exchange for stock. Rissman claimed a long-term capital loss on his 1941 tax return. The IRS disallowed the loss, arguing Rissman failed to prove his ownership and the stock's cost basis. The transfers in 1928 involved real properties previously acquired through cash, mortgages, and property exchanges. A 1935 agreement among the stockholders involved the cancellation of inter-company debts.

Procedural History

Rissman filed a petition with the Tax Court contesting the Commissioner's deficiency determination. The Commissioner disallowed the long-term capital loss and a portion of a claimed expense deduction. The Tax Court reviewed the evidence and legal arguments to determine the correctness of the Commissioner's adjustments.

Issue(s)

1. Whether the Commissioner erred in disallowing the long-term capital loss claimed by Rissman from the sale of stock.

2. Whether the Commissioner erred in disallowing a portion of the expense deduction claimed by Rissman.

Holding

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1. No, the Commissioner did not fully err; Rissman is entitled to a reduced loss deduction because the Court determined the appropriate basis for the stock, disallowing certain components of Rissman's original calculation, including items related to intercompany debt and an unsubstantiated property exchange.

2. Yes, the Commissioner properly disallowed a portion of the expense deduction because Rissman failed to provide sufficient evidence to substantiate the claimed expenses.

Court's Reasoning

The Tax Court first determined that Rissman owned 24 shares of stock in each corporation, rejecting his claim of ownership for the one share issued to his wife. Regarding the basis of the stock, the court analyzed whether the 1928 transfers qualified as tax-free exchanges under Section 112(b)(5) of the Revenue Act of 1928, which requires the transferors to be in control of the corporation immediately after the exchange and receive stock substantially in proportion to their prior interests. The court found that these conditions were met, meaning the basis of the properties transferred should be substituted for the basis of the stock received.

The court then addressed the specific components of Rissman's basis calculation. It disallowed the inclusion of an alleged equity value for the Clark Street property because Rissman failed to prove its depreciated cost. The Court stated that since petitioner has failed to prove the depreciated cost of the Clark Street property as of the date of the exchange in 1924… it follows that no figure of cost can be allowed in the computation for the Clark Street property as a part of the substituted basis.

The court also disallowed the inclusion of canceled intercompany loans, distinguishing the case from *Helvering v. American Dental Co.*, 318 U.S. 322 (1943). It reasoned that in this case, the debt was forgiven not by a stockholder to the corporation, but between the corporations themselves. This transaction among the three corporations did not effect any change in petitioner's substituted basis.

Finally, the court upheld the disallowance of a portion of the expense deduction because Rissman failed to provide adequate substantiation for the expenses claimed.

Practical Implications

Rissman v. Commissioner clarifies the application of Section 112(b)(5) (and its successor provisions) regarding tax-free exchanges and emphasizes the importance of accurate basis calculations when property is transferred to a controlled corporation in exchange for stock. It serves as a reminder that taxpayers must substantiate all elements of their basis claims with reliable evidence, including the depreciated cost of properties exchanged. The case also highlights the requirement of proper pleading before the Tax Court. Taxpayers must specifically raise issues in their petitions and amend them if necessary to conform to the evidence presented at

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trial. Failing to do so can preclude the court from considering arguments or evidence not properly raised in the pleadings.

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