6 T.C. 1134 (1946)

When the sale of stock is subject to conditions and the stock is held in escrow, the sale date for capital gains tax purposes is the date the conditions are fulfilled and the stock is delivered, not the date the agreement is signed or preliminary approvals are received.

Summary

Dyke purchased stock in March 1940. In March 1941, he and other shareholders agreed to sell their stock to another company, contingent on ICC approval and other conditions, with the shares placed in escrow. The delivery date was extended to September 10, 1941, by which time all conditions were met, and the buyer paid for and received the stock. The Tax Court held that the sale occurred on September 10, 1941. Since Dyke held the stock for over 18 months, only two-thirds of the gain was taxable, reversing the Commissioner's determination of a short-term capital gain.

Facts

Albert Dyke purchased 625 shares of Campbell Transportation Co. stock on March 6, 1940, for $150,000. On March 10, 1941, Dyke and other Campbell Transportation Co. stockholders entered into an agreement to sell their shares to Mississippi Valley Barge Line Co., subject to Interstate Commerce Commission (ICC) approval. The stock was placed in escrow with Mercantile Bank & Trust Co. The agreement contained several conditions, including ICC approval by September 22, 1941, and satisfactory financial conditions of Campbell Transportation Co.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Dyke's 1941 income tax, treating the profit from the stock sale as a short-term capital gain, taxable at 100%. Dyke challenged this determination in the Tax Court, arguing that the gain should be treated as a long-term capital gain, with only 66 2/3% includible in gross income because the stock was held for more than 18 months. The Tax Court ruled in favor of Dyke.

Issue(s)

Whether the sale of stock occurred before or after the 18-month holding period necessary for long-term capital gains treatment under Section 117 of the Internal Revenue Code when the sale was contingent on ICC approval and other conditions, with the stock held in escrow until those conditions were met.

Holding

Yes, the sale occurred on September 10, 1941, because that was the date all conditions of the escrow agreement were fulfilled and the buyer paid for and received the stock. Therefore, Dyke held the stock for more than 18 months.

Court's Reasoning

The court relied on the escrow agreement, which stipulated that the sale would be consummated and the purchase price paid on the delivery date, defined as the 10th day of the month following notice of ICC approval. The court emphasized that Mississippi Co. had no obligation to pay until all conditions were met. The court distinguished the date of ICC approval (July 31, 1941) from the actual sale date, noting that several conditions remained to be satisfied, including closing the books of Campbell Transportation Co. The court cited *Lucas v. North Texas Lumber Co.*, stating, "Consequently unconditional liability of vendee for the purchase price was not created in that year." The court also noted that the extension of the delivery date to September 10, 1941, was a legitimate business necessity, not a tax avoidance scheme.

Practical Implications

This case clarifies that for capital gains tax purposes, the sale date in an escrow arrangement is the date all conditions precedent are satisfied, and the buyer is legally obligated to pay. Attorneys should carefully structure escrow agreements to clearly define the conditions for release and the date of transfer of ownership. This ruling affects how stock sales involving regulatory approvals or other contingencies are analyzed for tax purposes. Later cases have cited Dyke for the proposition that the substance of a transaction, as defined by legally binding agreements and conditions, determines the timing of a sale for tax purposes, not simply the preliminary steps or intentions of the parties.

