Reed v. Commissioner, 6 T.C. 455 (1946)

The holding period of a capital asset, for purposes of determining capital gains tax, begins when the taxpayer acquires ownership of the asset, not merely when an executory contract for its purchase is formed.

Summary

The Tax Court determined that the petitioners' holding period for stock began on March 28, 1940, when they paid for and received the shares, and not on March 6, 1940, the date of an earlier agreement to purchase the stock. Because the petitioners sold the stock on September 10, 1941, they did not hold it for the required 18 months to qualify for long-term capital gains treatment. The court emphasized that an executory contract to purchase does not vest ownership until the transaction is completed and the stock is transferred.

Facts

Earl F. Reed and his associates agreed with Campbell to purchase up to $100,000 worth of Campbell Transportation Co. stock that Campbell was to acquire from John W. Hubbard. Due to Campbell's financial difficulties, the initial plan was altered. A.E. Dyke acquired 1,250 shares of Hubbard's stock, with an agreement that Campbell would later acquire a portion of those shares from Dyke for sale to Reed and his associates. On March 28, 1940, Campbell split his own certificate for 1,250 shares and issued several smaller certificates in his name, which he immediately turned over to Reed and his associates, who paid for the shares plus accrued interest from March 6. The petitioners sold the stock on September 10, 1941.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income tax, contending that the profit from the sale of Campbell Transportation Co. stock was a short-term capital gain. The petitioners argued for long-term capital gain treatment. The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether the petitioners' holding period for the Campbell Transportation Co. stock began on March 6, 1940 (the date of the purchase agreement), or on March 28, 1940 (the date the shares were transferred and paid for). Whether the sale date was July 31, 1941 (as initially contended by the respondent), or September 10, 1941 (as determined by the court).

Holding

1. No, because the petitioners did not acquire ownership of the stock until March 28, 1940, when the shares were transferred and paid for. An executory contract

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does not constitute ownership. 2. The sale date was September 10, 1941, because that was the date the sale was finalized, as demonstrated by evidence presented in the related case of Albert E. Dyke.

Court's Reasoning

The court relied on the definition of "capital assets" in Section 117(a)(1) of the Internal Revenue Code as "property held by the taxpayer." Citing *McFeely v. Commissioner*, 296 U.S. 102, the court stated that "to hold property is to own it. In order to own or hold one must acquire. The date of acquisition is, then, that from which to compute the duration of ownership or the length of holding." The court reasoned that prior to March 28, 1940, Reed and his associates only had an executory contract for the purchase of stock, which did not vest title in them. Ownership transferred only when the shares were physically transferred to them on March 28, 1940, and they paid for them. Therefore, the holding period began on March 28, 1940. The court also determined, based on evidence from a related case, that the sale occurred on September 10, 1941, making the holding period less than 18 months.

Practical Implications

Reed v. Commissioner clarifies that the holding period for capital gains purposes commences upon acquiring ownership of the asset, not upon the formation of an agreement to purchase. This decision is crucial for tax planning, as it dictates when an investor's holding period begins, impacting whether gains are taxed as short-term or long-term capital gains. Attorneys and tax advisors must carefully examine the details of asset transfers to accurately determine the start of the holding period. Subsequent cases applying this ruling often focus on pinpointing the exact date of transfer of ownership, considering factors like delivery of the asset and payment of consideration. This case emphasizes the importance of documenting the precise date of asset acquisition to substantiate claims for long-term capital gains treatment.

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