7 T.C. 793 (1946)

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A corporation that purchases its own bonds at a discount is liable for taxes on the resulting income, unless it can demonstrate it was in an unsound financial condition at the time of the purchase, and amendments to tax laws eliminating the unsound financial condition requirement are not retroactively applied.

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Summary

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Bush Terminal Buildings Co. purchased its bonds at less than face value in 1940. The Tax Court addressed whether the amendment to Section 22(b)(9) of the Revenue Act of 1939 by the Revenue Act of 1942 was retroactive, eliminating the requirement to prove "unsound financial condition." The court held the amendment was not retroactive. Further, the court found the evidence did not demonstrate that Bush Terminal was in an "unsound financial condition" in 1940. Consequently, the gain resulting from the discharge of indebtedness by purchasing its bonds was taxable. The court also addressed whether the corporation could deduct the losses that had been incurred by an affiliated corporation in previous years.

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Facts

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Bush Terminal Buildings Co. (petitioner) owned and operated loft buildings, renting space to industrial concerns. Bush Terminal Co. (Terminal) owned all of petitioner's common stock. From 1910 to 1926, petitioner issued first mortgage bonds. In 1940, petitioner purchased its bonds in the open market at a discount. The bonds were guaranteed by Terminal. In November 1934, Terminal filed for reorganization under Section 77-B of the Bankruptcy Act, and petitioner filed a similar petition in 1936, stating it was unable to meet its debts. A reorganization plan was approved in 1937, but it did not reduce liabilities, only deferred due dates. As of December 31, 1939, Bush Terminal Railroad Co. was indebted to petitioner. A compromise settlement was arranged in 1940. During the consolidated return period from 1919 through 1933, the losses of Railroad were taken advantage of by the group on consolidated returns.

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Procedural History

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The Commissioner determined deficiencies in petitioner's income and declared value excess profits taxes for 1940. The Tax Court addressed several issues, including the taxability of income from bond purchases, deductibility of bad debt loss, net operating loss carry-over, and reorganization expenses.

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Issue(s)

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1. Whether the respondent erred in increasing petitioner's taxable income due to the discharge of indebtedness from purchasing its own bonds at less than face value?

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2. Whether petitioner sustained a deductible bad debt loss resulting from a settlement of indebtedness from an affiliated corporation and, if so, what is the amount of such deductible loss?

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3. Whether the respondent erred in restoring accrued interest to the computation of net operating loss carry-over?

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4. Whether the petitioner was entitled to additional deductions for expenses incurred in a 77-B proceeding?

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Holding

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1. No, because the 1942 amendment to Section 22(b)(9), eliminating the

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