J.P. Morgan & Co. v. Commissioner, 8 T.C. 30 (1947)

A partnership is not considered an “individual” within the meaning of Section 24(b)(1)(B) of the Internal Revenue Code, which disallows losses from sales between an individual and a corporation where the individual owns more than 50% of the corporation’s stock.

Summary

J.P. Morgan & Co., a partnership, sold assets to J.P. Morgan & Co., Inc., a trust company. The Commissioner disallowed losses claimed by the partners on this sale, arguing that Section 24(b)(1)(B) of the Internal Revenue Code applied because the partners owned more than 50% of the trust company’s stock. The Tax Court held that the loss should be recognized because the sale was between a partnership and a corporation, not between an individual and a corporation as stipulated in the code. The court reasoned that the term “individual” does not include a partnership.

Facts

J.P. Morgan & Co. was a valid New York partnership. On March 30, 1940, the partnership transferred assets valued at $597,098,131.87 to J.P. Morgan & Co., Inc., a trust company. The trust company assumed the partnership’s liabilities of $584,832,737.78 and paid the difference of $12,265,394.09 to the partnership. The partners individually signed the sale agreement, which included a personal covenant not to engage in similar business under the same name. Additionally, the partnership transferred “contributed securities” which the trust company believed it could not legally purchase. The partnership agreed to transfer the defaulted securities “on behalf of our partners”.

Procedural History

The Commissioner disallowed the losses claimed by the partners on their 1940 income tax returns. The taxpayers, the individual partners of J.P. Morgan & Co., petitioned the Tax Court for a redetermination of the deficiency. This case represents the Tax Court’s initial determination.

Issue(s)

1. Whether the sale of assets from the partnership of J.P. Morgan & Co. to J.P. Morgan & Co., Inc. constituted a sale “between an individual and a corporation” within the meaning of Section 24(b)(1)(B) of the Internal Revenue Code.

2. Whether the transfer of “contributed securities” should be considered a loss on sale, or a contribution to capital.

Holding

1. No, because the term “individual” as used in Section 24(b)(1)(B) does not include a partnership; therefore, the loss disallowance rule does not apply to sales between a partnership and a corporation.

2. No, because the transfer of defaulted securities constituted a contribution to capital surplus of the trust company, and was thus not a sale or exchange resulting in a closed transaction giving rise to gain or loss.

Court’s Reasoning

The court reasoned that the term “individual” should be given its ordinary meaning, which does not include a partnership. The court emphasized that under New York law, the partnership, and not the individual partners, owned the assets. The interests of the partners were merely their respective shares of the profits and surplus. The court noted that Congress had specifically addressed partnerships in other sections of the Internal Revenue Code, demonstrating its awareness of how to include partnerships when intended. The court stated that Section 24(b) is expressly restrictive in character, and should not arbitrarily extend the boundary of the prohibited classes to include those not specifically mentioned or within the natural and ordinary meaning of the terms used.

As to the defaulted securities, the court held that the partnership was acting as an agent of the individual partners in transferring these to the trust company. By making the transfer, the partners made a contribution to the capital of the trust company. There was therefore no sale or exchange to give rise to a loss.

Practical Implications

This case clarifies that Section 24(b)(1)(B) of the Internal Revenue Code, and its successors, should be interpreted narrowly. The term “individual” does not encompass partnerships, even if the partners collectively own a controlling interest in the corporation involved in the transaction. Tax advisors should carefully examine the form of the transaction to determine whether a sale is technically between an individual and a corporation, or whether other entities, such as partnerships, are involved. This ruling highlights the importance of adhering to the plain meaning of statutory language in tax law. Later cases may distinguish J.P. Morgan by focusing on situations where a partnership is merely a conduit for individual action.