8 T.C. 30 (1947)

Section 24(b)(1)(B) of the Internal Revenue Code, which disallows losses from sales or exchanges between an individual and a corporation where the individual owns more than 50% of the corporation's stock, does not apply to sales between a partnership and a corporation, unless the partnership itself is considered an "individual" under the statute.

Summary

J.P. Morgan & Co., a partnership, transferred assets to J.P. Morgan & Co., Inc., a trust company. The Commissioner disallowed losses claimed on the transfer, arguing it was a sale between an individual and a corporation under Section 24(b)(1)(B) of the Internal Revenue Code because the partners owned more than 50% of the trust company's stock. The Tax Court held that the term "individual" in the statute does not include a partnership; therefore, the losses were improperly disallowed, except for losses related to contributed securities which were treated as capital contributions.

Facts

J.P. Morgan & Co., a New York partnership, transferred assets worth $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 of J.P. Morgan & Co. collectively owned more than 50% of the trust company's stock. In addition to these assets, certain "contributed securities" were transferred separately. The transfer agreement named each partner individually, and they each signed it.

Procedural History

The Commissioner of Internal Revenue disallowed losses claimed by the partners on their individual income tax returns stemming from the asset transfer. The taxpayers, the partners of J.P. Morgan & Co., petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

1. Whether the transfer of assets from the partnership to the trust company constituted a sale "between an individual and a corporation" under Section 24(b)(1)(B) of the Internal Revenue Code.

2. Whether the term "individual" as used in Section 24(b)(1)(B) includes a partnership.

3. Whether the transfer of the "contributed securities" resulted in a deductible loss.

Holding

1. No, because the transaction was between a partnership and a corporation, not an individual and a corporation.

2. No, because in its ordinary meaning and in the context of the statute, “individual” does not include a partnership.

3. No, because the transfer of the contributed securities constituted a contribution to capital, not a sale or exchange.

Court’s Reasoning

The court reasoned that the term “individual” should be taken in its usual, everyday meaning. Citing Black’s Law Dictionary, the court noted that “individual” denotes a single person as distinguished from a group or class, and commonly, a private or natural person as distinguished from a partnership or corporation. The court found nothing in the context of Section 24(b)(1)(B) to suggest a different meaning. The legislative history indicated the provision aimed to close loopholes involving sales between family members and controlled corporations. Partnerships were treated separately in revenue acts. The court emphasized that New York law, which controls, considers the partnership, not the individual partners, as owning the assets. Regarding the “contributed securities,” the court found that transferring these constituted a contribution to the capital of the trust company, thereby increasing the value of the partners’ stock. This was not a sale or exchange giving rise to a deductible loss. The court stated, “In transferring the defaulted securities the partnership was not engaging in any function of the partnership. It was merely acting as the agent of the individual partners.”

Practical Implications

This case clarifies that Section 24(b)(1)(B) does not automatically apply to transactions between partnerships and corporations, even if the partners collectively own a majority of the corporation’s stock. Legal practitioners must carefully analyze the nature of the transaction and the ownership of assets under applicable state law. The ruling highlights the importance of distinguishing between a partnership acting on its own behalf versus acting as an agent for its partners. This case informs how courts interpret tax statutes, emphasizing a strict construction of restrictive provisions and reliance on the ordinary meaning of terms, unless the legislative history clearly indicates a different intent. Later cases would need to determine if similar transactions could be recharacterized under different legal doctrines, like the step-transaction doctrine, to achieve a different tax outcome.