9 T.C. 448 (1947)

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A corporation does not realize taxable income when it deals in its own shares for the purpose of securing employee loyalty and incentivizing performance, rather than as a speculative investment.

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Summary

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Batten, Barton, Durstine & Osborn, Inc. (BBDO), an advertising agency, sold shares of its treasury stock to employees in 1939 and 1941. The Commissioner of Internal Revenue determined that the gains from these sales were taxable income to BBDO. The Tax Court held that the sales were primarily intended to incentivize employees and maintain loyalty, not for speculative profit, and therefore the gains were not taxable. The key factor was that BBDO's dealings in its own stock were not the same as dealing in the stock of another company for profit.

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Facts

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BBDO's success depended on its creative staff. Upon its organization in 1928, the initial stockholders donated 20% of their shares to the company treasury. The purpose was to have shares available to award to talented and valuable employees. BBDO also purchased shares from stockholders over time, holding these as treasury stock. The company then sold the treasury stock to employees. Sales were made at book value with no price negotiation. Employees could resell shares back to the company at their original cost under certain conditions. BBDO did not treat treasury stock as an asset on its balance sheet.

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Procedural History

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The Commissioner of Internal Revenue assessed deficiencies against BBDO for income tax, declared value excess profits tax, and excess profits tax for 1939 and 1941, based on the gains from the sale of treasury stock. BBDO challenged the Commissioner's determination in the Tax Court.

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Issue(s)

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Whether BBDO's gains from selling its treasury stock to employees in 1939 and 1941 constitute taxable income under Section 22(a) of the Internal Revenue Code and Section 19.22(a)-16 of Regulations 103.

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Holding

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No, because BBDO was not dealing in its own shares as it might in the shares of another corporation; its primary purpose was to incentivize and retain valuable employees, not to generate speculative profit.

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Court's Reasoning

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The court focused on the intent and nature of the transactions. The applicable regulation, Section 19.22(a)-16 of Regulations 103, stated that if a corporation deals in its own shares

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