Hollywood Properties, Inc. v. Commissioner, 19 T.C. 231 (1952)

When a corporation acquires property from its stockholders for an agreed consideration (the proceeds from the sale of the property), the corporation's basis in the property is its cost, not the transferor's basis.

Summary

Hollywood Properties, Inc. acquired properties from its stockholders under an agreement to sell the properties and pay the proceeds to the stockholders up to a stipulated amount. The Commissioner argued that the properties were a contribution to the corporation's paid-in surplus, resulting in a zero basis because the transferors' basis was not shown. The Tax Court held that the transfer was for an agreed consideration, not a contribution to capital. The court determined the corporation's basis was its cost which was equal to the proceeds of the sales that they were contractually obligated to pay to the transferors. Since there was no deficiency regardless of the approach, the court decided against the Commissioner.

Facts

- Hollywood Properties, Inc. (Petitioner) was formed by stockholders who transferred properties to it.
- The agreement stipulated that the Petitioner would sell the properties and pay the proceeds of the sales to the stockholders up to a specific lump sum.
- The Commissioner argued the properties were a contribution to the paid-in surplus.
- Petitioner claimed a loss on its tax return, which the Commissioner disputed.

Procedural History

The Commissioner determined a deficiency in the Petitioner's income tax. The Petitioner appealed to the Tax Court, contesting the Commissioner's determination of basis.

Issue(s)

1. Whether the properties were acquired by the Petitioner as a contribution to its paid-in surplus, thereby requiring the use of the transferors' basis under Section 113(a)(8)(B) of the Internal Revenue Code.
2. If the properties were not a contribution to paid-in surplus, whether the Petitioner's basis is its cost, represented by its agreement to turn over the proceeds of the sales to its transferors.

Holding

1. No, because the contemporaneous agreements demonstrated that the transaction was a transfer for an agreed consideration, not a contribution to

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capital or paid-in surplus.
2. Yes, because the Petitioner's agreement to turn over proceeds from the property sales to its transferors represents the cost incurred by the Petitioner.

Court's Reasoning

The court reasoned that the transaction was not a contribution to capital or paid-in surplus because contemporaneous agreements showed it was a transfer for an agreed consideration. The court cited *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 187, and *Savinar Co.*, 9 B.T.A. 465, 467. The court stated, "The contemporaneous agreements show that the transaction was not a contribution to capital or paid-in surplus, but a transfer for an agreed consideration; and the mere adoption of bookkeeping notations not in accord with the facts and later corrected is insufficient to sustain any such position." The court also rejected the Commissioner's reliance on sections 113(a)(8)(A) and 112(b)(4) of the Internal Revenue Code, stating that the properties were not transferred "solely" for the Petitioner's stock or securities. The court concluded that Petitioner's basis was its cost, represented by its agreement to turn over the proceeds of the sales to its transferors. The court cited *Meyer v. Nator Holding Co.*, 136 So. 636; *Smith v. Loftis*, 150 So. 645, supporting the fact that even though the petitioner did not exist at the time of the original agreement, its creation pursuant to the contract and acceptance of the property imposed on it an obligation to perform.

Practical Implications

This case clarifies the distinction between a contribution to capital and a transfer for consideration in the context of corporate acquisitions of property from shareholders. It emphasizes the importance of examining the contemporaneous agreements to determine the true nature of the transaction. For practitioners, it serves as a reminder that bookkeeping entries alone are not determinative of the tax treatment of a transaction. It also illustrates that a corporation created to fulfill a contract is bound by the terms of that contract. This ruling impacts how businesses structure transactions involving transfers of property between shareholders and corporations, ensuring that the basis is determined according to the economic reality of the deal. Later cases applying this ruling would likely focus on whether fair consideration was exchanged, or whether the transfer more closely resembled a contribution to capital. If the corporation was merely acting as an agent of the stockholders, then any gain or loss from the dispositions of the property would be attributable to its principal (controlling stockholders), who are not before the court.

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