10 T.C. 260 (1948)

When a solvent corporation repurchases its own bonds at a discount, the discount is taxable income unless the repurchase constitutes a gratuitous forgiveness of debt by the bondholder.

Summary

Edmont Hotel Co., a solvent corporation, purchased its own bonds at a discount. The Tax Court addressed whether the discount constituted taxable income. The court held that the discount on bonds acquired from a closely connected seller (National Hotel Co.) was a gratuitous forgiveness of debt and not taxable income. However, the discount on a bond acquired from an unrelated seller (William Day) was taxable income because there was no evidence of a personal or business relationship that would indicate gratuitous forgiveness. This case distinguishes between related and unrelated party transactions when determining taxable income from debt discharge.

Facts

Edmont Hotel Co. issued bonds secured by a deed of trust on its property. W.L. Moody, Jr., acquired all of Edmont Hotel Co.'s stock. Moody and his controlled corporations, National Hotel Co. and News Publishing Co., acquired a substantial portion of Edmont's bonds at a discount. The National Hotel Co. managed Edmont's hotel operations, finances, and taxes. Edmont's paying agent then purchased some of these bonds from National Hotel Co. and one bond from William M. Day, both at 50% of face value. Edmont was solvent during this period and deducted interest expenses on its tax returns.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Edmont's income tax, including the discount from the bond repurchase as taxable income. Edmont Hotel Co. petitioned the Tax Court, arguing the discount was a gratuitous forgiveness of debt and thus not taxable. The Tax Court partly upheld and partly overturned the Commissioner's determination.

Issue(s)

1. Whether the discount realized by Edmont Hotel Co. on the purchase of its bonds from National Hotel Co. constituted taxable income or a gratuitous forgiveness of debt?

2. Whether the discount realized by Edmont Hotel Co. on the purchase of its bond from William M. Day constituted taxable income or a gratuitous forgiveness of debt?

Holding

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1. No, because the purchase from National Hotel Co. represented a gratuitous forgiveness of debt due to the close relationship between the parties.

2. Yes, because there was no evidence suggesting a personal or business relationship between Edmont and Day that would indicate a gratuitous forgiveness of debt.

Court's Reasoning

The court distinguished the case from *United States v. Kirby Lumber Co., 284 U.S. 1*, which generally holds that a corporation's purchase of its own bonds at a discount results in taxable gain. The court cited *Helvering v. American Dental Co., 318 U.S. 322*, stating, "The fact that the motives leading to the cancellations were those of business or even selfish, if it be true, is not significant. The forgiveness was gratuitous, a release of something to the debtor for nothing, and sufficient to make the cancellation here gifts within the statute." Because the National Hotel Co. was closely connected to Edmont, the court reasoned that the discount represented a gratuitous forgiveness. However, the court declined to extend this doctrine to the transaction with Day, stating that doing so

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