12 T.C. 1196 (1949)

A securities dealer can treat securities transferred from its inventory to an investment account as capital assets, provided the securities are segregated and handled differently from those held for sale to customers in the ordinary course of business.

Summary

Carl Marks & Co., a dealer in foreign securities, transferred domestic and some foreign securities from its inventory to an investment account. The Tax Court addressed whether gains from the sale of these securities were taxable as ordinary income or capital gains. The court held that the securities transferred to the investment account were held for speculative or investment purposes and thus qualified for capital gains treatment under sections 117 and 711(a)(1)(B) of the Internal Revenue Code. The critical factor was the purpose for which the securities were held after the transfer, not their initial purpose.

Facts

Carl Marks & Co. was a large dealer in foreign securities. On December 29, 1941, the company transferred domestic and foreign securities from its dealer inventory to a newly created investment account. The decision was influenced by the decline in foreign security values due to the U.S. entry into World War II. The company believed holding these securities for long-term appreciation would be more profitable than reselling them to customers. Domestic securities were always purchased for investment, never for sale to customers.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Carl Marks & Co.’s excess profits tax, arguing that gains from the sale of the securities should be treated as ordinary income, not capital gains. The Tax Court reviewed the Commissioner’s determination.

Issue(s)

1. Whether domestic securities, originally acquired for investment but carried in the dealer account, should be treated as capital assets when sold.
2. Whether foreign securities, originally acquired for resale but transferred to an investment account, should be treated as capital assets when sold.
3. Whether a securities dealer needs the Commissioner’s permission to transfer securities from inventory to an investment account and treat them as capital assets.

Holding

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1. Yes, because the domestic securities were always held for investment purposes, regardless of where they were carried on the books.
2. Yes, because the foreign securities were converted to investments on December 29, 1941, and subsequently held for that purpose.
3. No, because taxpayers may not include in inventory securities which were shown to be held for investment or speculation rather than for dealer purposes.

Court's Reasoning

The court emphasized the importance of the purpose for which the securities were held after the transfer. The court noted that the company took significant steps to segregate the securities transferred to the investment account, both physically and on its books. This segregation, coupled with the fact that the securities were managed differently from those in the dealer account, demonstrated that they were held for investment purposes. The court rejected the Commissioner's argument that securities once acquired for resale must forever retain their dealer status. The court also rejected the argument that the company needed the Commissioner's permission to transfer the securities, stating, "We do not understand that section 22(c) or the regulations go so far as to say that each time a dealer in securities in fact transfers certain of his securities from inventory to an investment account he must get permission from the Commissioner to do so before he can treat them as capital assets." The court cited Regulations 111, which states that securities inventoried may include only those held for purposes of resale and not for investment.

Practical Implications

This case clarifies that securities dealers can hold securities for investment purposes, and those securities can qualify for capital gains treatment even if they were initially held for resale. The key is demonstrating a clear intent to hold the securities for investment, evidenced by segregation, different management, and a lack of resale activity. This case impacts how securities firms manage their inventory and investment accounts and how they report gains and losses from the sale of securities. It highlights the importance of documenting the intent behind holding specific securities, which impacts tax liabilities. It also confirms that taxpayers are not required to ask the Commissioner for permission each time securities are transferred from inventory to an investment account.

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