13 T.C. 351 (1949)

Payments received on certificates of indebtedness issued by a corporation in registered form are considered amounts received in exchange for those certificates and are thus taxable as capital gains, even if the payments are partial and the certificates are not fully retired.

Summary

Howard Carleton Avery received payments on certificates of indebtedness issued by the Maple Grove Cemetery Association. The Tax Court addressed whether the gain realized from these payments was taxable as ordinary income or as a long-term capital gain under Section 117(f) of the Internal Revenue Code. The court held that the certificates were indeed certificates of indebtedness issued by a corporation in registered form, and the payments received constituted a partial retirement of those certificates. Therefore, the gain was taxable as a capital gain rather than ordinary income. This decision clarified the tax treatment of such certificates, establishing that partial payments qualify as amounts received in exchange for the certificates.

Facts

Petitioner, Howard Carleton Avery, owned certificates of indebtedness issued by the Maple Grove Cemetery Association. These certificates represented a right to a portion of the proceeds from the sale of cemetery lots. Avery acquired these certificates for valuable consideration more than six months before January 1, 1944. During 1944, Avery received $20,863.26 from the Association on these certificates, with $7,224.15 exceeding the cost basis. The certificates were issued under an agreement where the Association paid half of the proceeds from lot sales to certificate holders. These certificates were registered on the Association's books and transferable upon surrender of the certificate.

Procedural History

Avery reported a gain from the payments received on his 1944 income tax return, but the Commissioner of Internal Revenue determined a deficiency, arguing the gain should be taxed as ordinary income, not capital gains. The Tax Court was petitioned to resolve this dispute.

Issue(s)

Whether the amounts received by the petitioner in the taxable year on certificates issued by the Maple Grove Cemetery Association over the cost thereof are taxable as ordinary income or as a long-term capital gain under Section 117(f) of the Internal Revenue Code.

Holding

Yes, because the certificates were certificates of indebtedness issued by a corporation in registered form, and the payments received constituted a partial retirement of those certificates. Therefore, the gain was taxable as a capital gain rather than ordinary income.

Court's Reasoning

The Tax Court relied on Section 117(f) of the Internal Revenue Code, which stipulates that amounts received upon the retirement of certificates of indebtedness issued by a corporation in registered form are to be considered as amounts received in exchange therefor. The Court referenced American Exchange Nat. Bank v. Woodlawn Cemetery, <span normalizedcite="194 N.Y. 116">194 N. Y. 116, affirming that similar certificates were considered nonnegotiable certificates of indebtedness. The court rejected the Commissioner's argument that there was no 'retirement' because Avery still held the certificates. Citing Edith K. Timken, 6 T.C. 483, the court stated: "Each payment on the note pro tanto retired it. We see nothing in the statute to justify a contrary conclusion." The court noted that each sale of a lot reduced the source of payment on the certificates, leading to their eventual worthlessness, thus constituting a partial retirement with each payment. The court emphasized that Section 117(f) does not require the obligations to be for a fixed amount or prescribe a time limit on their retirement.

Practical Implications

This decision provides clarity on the tax treatment of payments received on certificates of indebtedness issued by cemetery associations and similar entities. It establishes that such payments can be treated as capital gains rather than ordinary income, provided the certificates are in registered form and issued by a corporation. This ruling impacts how similar financial instruments are analyzed for tax purposes, allowing taxpayers to potentially benefit from the lower capital gains tax rates. It influences legal practice by setting a precedent for treating partial payments on indebtedness certificates as a 'retirement' under Section 117(f), even if the certificates are not fully redeemed. This case has been cited in subsequent tax cases involving the characterization of income from similar financial instruments, reinforcing its relevance in tax law.

