13 T.C. 755 (1949)

A securities dealer can hold securities as a capital asset for investment purposes, and the profit from the sale of those securities is taxable as a capital gain rather than ordinary income, even if the dealer also sells similar securities to customers in the ordinary course of business.

Summary

Stifel, Nicolaus & Co., an investment banking firm, purchased shares of Wisconsin Hydro-Electric Co. stock. The Commissioner of Internal Revenue argued that the profit from the sale of these shares should be taxed as ordinary income because Stifel was a securities dealer. Stifel contended that 900 of the shares were bought and held as an investment and should be taxed as a capital gain. The Tax Court held that the 900 shares were indeed a capital asset because Stifel demonstrated they were purchased as a long-term investment and not held for sale to customers in the ordinary course of its business. The court emphasized that a dealer can also be an investor.

Facts

- Stifel, Nicolaus & Co. is an investment banking firm engaged in buying, selling, and underwriting securities, and acting as a broker.
- The firm purchased 1,000 shares of Wisconsin Hydro-Electric Co. preferred stock on August 18, 1944.
- Prior to this purchase, the firm had been studying the stock as an investment proposition, learning about the company's reorganization and potential acquisition.
- The shares were initially recorded in the firm's "Miscellaneous Stocks" account and included in its 1944 inventories.
- On January 3, 1945, the board of directors authorized holding 900 of these shares as an investment, not for resale in the ordinary course of business. The remaining 100 were kept in the trading account for potential covering purchases.
- These 900 shares were then segregated in a new account called "Wisconsin Hydro Elec. 6% Pfd. Inventory Acct."
- The firm did not offer these shares to its customers or include them in circulars.
- In July 1945, Stifel sold 972 shares (including the 900) to F. J. Young & Co., who was seeking a large block of the stock.

Procedural History

- The Commissioner determined that the gain from the sale of all 972 shares was taxable as ordinary income.
- Stifel conceded that the profit on 72 shares was ordinary income but argued

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that the profit on the 900 shares was a capital gain.
- The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether the gain from the sale of 900 shares of Wisconsin Hydro-Electric Co. stock was taxable as ordinary income or as a capital gain under Section 117(a)(1) of the Internal Revenue Code.

Holding

No, the gain from the sale of the 900 shares was taxable as a capital gain because the shares were held as a long-term investment and were therefore capital assets.

Court's Reasoning

The Tax Court reasoned that the evidence demonstrated Stifel intended to hold the 900 shares as a long-term investment. This was supported by the following:

- Testimony from Stifel's president that the shares were purchased for investment purposes.
- The board of directors' resolution to hold the shares as an investment.
- The segregation of the shares into a separate account on the firm's books.
- The fact that the shares were never offered for sale to customers or included in the firm's circulars.

The court relied on the principle articulated in prior cases, such as *E. Everett Van Tuyl, 12 T.C. 900*, that a taxpayer may be a dealer as to some securities and an investor as to others. Quoting I.T. 3891, C.B. 1948-1, p. 69, the court stated that "Where securities are acquired and held by a dealer in securities solely for investment purposes, such securities will be recognized as capital assets…even though such securities are of the same type or of a similar nature as those ordinarily sold to the dealer's customers." The court rejected the Commissioner's argument that the shares were held as stock in trade, finding no reason to discredit the testimony and evidence presented by Stifel.

Practical Implications

This case clarifies that securities dealers can hold securities for investment purposes, separate from their activities as dealers. To establish investment intent, dealers should:

- Document the investment purpose at the time of purchase, preferably in board meeting minutes.
- Segregate the securities in a separate account on the firm's books.
- Refrain from offering the securities for sale to customers in the ordinary course of business.

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This decision provides a framework for analyzing similar cases where the characterization of securities held by dealers is at issue. It demonstrates that the intent and actions of the taxpayer are critical in determining whether securities are held for investment or for sale to customers, regardless of the taxpayer’s primary business.

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