14 T.C. 307 (1950)

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A corporation’s dealings in its own stock are not taxable as a gain if the transactions are intended to satisfy contractual obligations or equalize shareholdings, rather than to generate profit as it might with the shares of another company.

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Summary

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H.W. Porter & Co. purchased its own stock from a deceased shareholder’s estate as required by the corporate charter and resold these shares to other stockholders and employees. The Tax Court addressed whether the excess of the selling price over the purchase price of these shares was taxable income to the corporation. The court held that because the corporation was not dealing in its shares as it would in shares of another corporation, but rather to maintain control within the organizing group, the gains were not taxable. The court also addressed the reasonableness of an addition to a reserve for bad debts, finding it deductible.

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Facts

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H.W. Porter & Co. was formed by former employees of Johns-Manville Co. to install insulating equipment. Its corporate charter stipulated that stockholders wishing to dispose of shares had to first offer them to the company at book value. The purpose of this provision was to keep control within the original group of associates. On numerous occasions, the company acquired its own shares from stockholders or their estates. Upon the death of a director, F.J. Byrne, the company purchased his shares as required by the charter. Later, the company reissued some of these shares at a higher price, leading to a dispute over whether the gain was taxable. Additionally, the Commissioner disallowed a deduction for an addition to the company’s reserve for bad debts.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in H.W. Porter & Co.’s excess profits tax for 1943, including a gain on the sale of its own shares and disallowing an addition to a reserve for bad debts. The Tax Court reviewed the Commissioner’s determination, focusing on the taxability of the gain from the sale of treasury stock and the deductibility of the addition to the bad debt reserve.

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Issue(s)

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1. Whether the gains from a corporation’s sale of its treasury stock to stockholders and employees are taxable income when the corporation is merely satisfying charter obligations and not dealing in its own shares as it might with shares of another corporation.

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2. Whether the addition to the reserve for bad debts claimed by the corporation was reasonable and deductible for tax purposes.

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Holding

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1. No, because H.W. Porter & Co. was not dealing in its own shares as it might in the shares of another corporation, but rather to satisfy contractual obligations to maintain control within the organizing group.

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2. Yes, because on the evidence presented, the addition to the reserve for bad debts was reasonable in amount and therefore deductible.

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Court’s Reasoning

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The Tax Court reasoned that while gains from dealing in corporate stock are generally taxable, an exception exists when a corporation deals in its own shares not for prospective profit, but to satisfy contractual obligations, equalize shareholdings, or eliminate a retiring participant. The court noted that the corporation's charter required it to purchase shares from deceased stockholders, and its subsequent sale of those shares was part of a plan to maintain control within the original group of associates, not to generate profits as it would with shares of another company. Regarding the bad debt reserve, the court found that the addition was reasonable considering the significant increase in the company's accounts receivable and the uncertainties of wartime business conditions. The court stated,

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