Modesto Dry Yard, Inc. v. Commissioner, 14 T.C. 374 (1950)

Losses from the sale or exchange of capital assets held for more than six months are excluded when computing excess profits net income for base period years under Section 711(b)(1)(B) of the Internal Revenue Code.

Summary

Modesto Dry Yard, Inc. sought to exclude a 1938 loss from the sale of raisin futures contracts when calculating its excess profits tax credit for 1943 and 1944. The company argued the loss stemmed from the sale of capital assets (futures contracts) held for more than six months, making it excludable under Section 711(b)(1)(B) of the Internal Revenue Code. The Tax Court agreed with Modesto Dry Yard, holding that the raisin futures contracts were capital assets and, having been held for more than six months, the loss from their sale should be excluded from the calculation of excess profits net income.

Facts

Modesto Dry Yard, Inc. bought fresh fruit, dried it, and sold it unpackaged to packers. In early 1937, the company purchased futures contracts for dried apricots and raisins as a speculation, not for resale to its customers. These contracts were for the future delivery of packed dried fruits. All but one contract were sold in 1937. The remaining contract for Thompson natural seedless raisins was sold in 1938, resulting in a loss of $3,689.92.

Procedural History

Modesto Dry Yard, Inc. contested the Commissioner’s determination that the 1938 loss should not be excluded when calculating the excess profits credit. The Tax Court reviewed the Commissioner’s decision.

Issue(s)

Whether the loss incurred by Modesto Dry Yard, Inc. in 1938 from the sale of raisin futures contracts constitutes a loss from the sale or exchange of capital assets held for more than six months, and therefore excludable from the computation of excess profits net income under Section 711(b)(1)(B) of the Internal Revenue Code.

Holding

Yes, because the contracts to purchase packed raisins to be delivered at some future time (futures contracts) acquired in 1937 and held by petitioner until disposed of in 1938, do not fall within any of the exceptions set forth in section 117 (a) (1) and hence are capital assets as defined in that section. Since the 1938 loss resulted from the sale of capital assets held for more than six months, such amount is excludable in the computation of excess profits net income under section 711 (b) (1) (B) of the

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Internal Revenue Code.

Court's Reasoning

The court reasoned that the contracts for future delivery of packed dried fruits were "futures contracts," and the petitioner never took actual delivery of the packed dried fruits. Citing "Future Trading" by Hoffman, the court stated that in dealing in futures, one deals "not in the actual commodity but in claims on or contracts for the commodity." The court also cited *Commissioner v. Covington*, stating that transactions in commodity futures involve acquiring rights to the specific commodity rather than the commodity itself, and these rights are intangible property and capital assets.

The court rejected the Commissioner's argument that the raisins were includible in the petitioner's inventory. It emphasized that title to the packed dried raisins had not passed to the petitioner, referencing California Civil Code sections 1738, 1739, and 1796 (4), which state that title passes when the parties intend it to pass. Because the raisins were never segregated and delivery was not completed, title remained with the seller. The contracts expressly stated that "Goods are at the risk of Buyer * * * from and after delivery to initial carrier or such carrier's agent," and risk generally follows title. Thus, the court concluded the contracts were capital assets held for more than six months, and the loss from their sale was excludable under Section 711(b)(1)(B).

Practical Implications

This case clarifies the treatment of commodity futures contracts as capital assets for excess profits tax purposes. It highlights that losses from the sale of such contracts, when held for more than six months, can be excluded from the calculation of excess profits net income. This decision provides guidance for businesses engaged in trading commodity futures by emphasizing that such contracts are not includable in inventory if title has not passed. The case is important for understanding the nuances of determining whether an asset qualifies as a capital asset, particularly concerning transactions involving future delivery of goods. The ruling impacts how companies compute their excess profits tax credit and manage their tax liabilities when dealing with commodity futures contracts. Later cases would cite this in determining if similar transactions could be excluded.

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