Paine v. Commissioner, 1948 Tax Ct. Memo LEXIS 76 (1948)

For a corporate note to be considered 'in registered form' under Section 117(f) of the Internal Revenue Code (allowing capital gains treatment upon retirement), the debtor corporation, not a subsequent holder or their agent, must maintain records of ownership and transfers.

Summary

Paine sought capital gains treatment on the retirement of notes purchased at a discount. The notes, originally unregistered, were placed under a trust agreement managed by American Trust Co. after Paine acquired them. Paine argued that the trust's record-keeping constituted registration. The Tax Court held that the notes were not 'in registered form' as required by Section 117(f) because the debtor, Lamm Lumber Co., did not register them. The court emphasized that the debtor corporation itself must establish and maintain the register for the notes to qualify.

Facts

Lamm Lumber Co. issued unregistered notes in exchange for loans from Consolidated Securities Co. After May 6, 1930.
In 1941, Paine purchased undivided interests in these notes.
Paine and other holders entered into an agreement with American Trust Co. to act as their agent.
American Trust Co. was responsible for receiving payments on the notes and distributing them to the holders and tracking transfers of interests among the holders.
Lamm Lumber Co. was not a party to this agreement and did not maintain any register of the notes or their owners.

Procedural History

The Commissioner of Internal Revenue determined that the gains realized by Paine upon payment of the notes should not be treated as capital gains.
Paine petitioned the Tax Court for a redetermination.

Issue(s)

Whether the notes of Lamm Lumber Co. were 'in registered form' within the meaning of Section 117(f) of the Internal Revenue Code, when the debtor corporation did not maintain a register, but the holders' agent did.

Holding

No, because the debtor corporation, Lamm Lumber Co., did not register the notes or maintain any register of owners or payments. The actions of the American Trust Co., acting as an agent for the noteholders, did not constitute registration by the debtor

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as required by Section 117(f).

Court's Reasoning

The court reasoned that Section 117(f) requires the debtor-corporation to put the evidence of indebtedness into registered form if the retirement is to be recognized as an exchange for capital gains purposes.
The court emphasized that the Lamm Lumber Co. never took back the original unregistered notes and reissued them in registered form.
The court distinguished Lurie v. Commissioner, noting that in Lurie, the debtor-corporation itself registered the evidences of indebtedness. In Paine, the American Trust Co. acted as an agent for the petitioners, not for Lamm Lumber Co., and its records did not constitute registration by the debtor.
The court stated, "We understand the wording of section 117 (f) to refer to evidence of indebtedness which is put into registered form by a debtor-corporation, and that one of the requirements of section 117 (f) is that the evidence of indebtedness be put in registered form by the debtor if the retirement of the indebtedness is to be recognized as an exchange so that gain or loss shall be treated as capital gain or loss."

Practical Implications

This case clarifies that for debt instruments to qualify for capital gains treatment upon retirement under Section 117(f) (now codified elsewhere in the IRC), the debtor corporation must actively maintain a register of ownership. It is not sufficient for a subsequent holder, or a trustee acting on their behalf, to create a register. This decision emphasizes the importance of proper documentation and registration procedures at the time of issuance of debt instruments to ensure favorable tax treatment.
The ruling impacts how similar cases are analyzed by requiring scrutiny of who maintained the register and whether it was the debtor corporation.
Tax advisors must ensure that corporations issuing debt instruments understand the registration requirements if they wish for the instruments to qualify for capital gains treatment upon retirement. Subsequent cases will likely continue to focus on whether the debtor itself maintained the register, solidifying this case's precedent.

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