Pattison v. Commissioner, 9 T.C. 428 (1947)

For amounts received upon retirement of corporate debt to be treated as capital gains under Section 117(f) of the Internal Revenue Code, the debt instrument must have been issued with interest coupons or in registered form by the debtor corporation itself, not merely tracked internally by a subsequent holder or agent.

Summary

The petitioners purchased interests in notes of Lamm Lumber Co. and later arranged for American Trust Co. to collect and distribute payments. They argued that because American Trust Co. kept records of ownership and transfers, the notes were "in registered form" under Section 117(f) of the Internal Revenue Code, entitling them to capital gains treatment upon retirement of the debt. The Tax Court disagreed, holding that the notes had to be put in registered form by the debtor corporation, Lamm Lumber Co., to qualify under Section 117(f), and the petitioners' arrangement with American Trust Co. did not satisfy this requirement.

Facts

- Lamm Lumber Co. issued notes for loans received from Consolidated Securities Co.
- The notes were not in registered form at the time of issuance.
- Petitioners purchased undivided interests in the notes in 1941.
- Petitioners entered into an agreement with American Trust Co. to act as their agent to collect payments on the notes and distribute them to the petitioners.
- American Trust Co. maintained records of the petitioners' ownership interests and any transfers thereof.
- Lamm Lumber Co. was not a party to the agreement with American Trust Co.
- Lamm Lumber Co. did not maintain any register of the notes, their owners, or payments to the owners.

Procedural History

The Commissioner of Internal Revenue determined that the gains realized by the petitioners upon the payment of the notes should not be treated as capital gains. The petitioners challenged this determination in the Tax Court.

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, based on the records maintained by American Trust Co. as agent for the noteholders, such that the gains realized upon payment of the notes should be treated as capital gains.

Holding

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No, because the notes were never put into registered form by the debtor corporation, Lamm Lumber Co., as required by Section 117(f). The actions of the petitioners in hiring an agent to track ownership interests did not constitute registration by the debtor.

Court's Reasoning

The court reasoned that Section 117(f) requires the debtor-corporation to put the evidence of indebtedness into registered form for the retirement of the indebtedness to be recognized as an exchange, thus allowing for capital gains treatment. The court emphasized that Lamm Lumber Co. was not a party to the agreement with American Trust Co. and did not maintain any register of the notes or their owners. The American Trust Co. acted solely as an agent for the petitioners, and its records did not constitute the type of register contemplated by Section 117(f). The court distinguished *Lurie v. Commissioner*, 156 F.2d 436 (1946), noting that in *Lurie*, the debtor-corporation itself took back and reissued the notes in registered form, which was not the case here. The court stated that it would be a "strained construction of the facts to conclude that the agreement between the petitioners and the American Trust Co. operated in some way to effect a registration of the notes by the Lamm Lumber Co."

Practical Implications

This case clarifies that for debt retirement to qualify for capital gains treatment under Section 117(f) (now Section 1271 of the Internal Revenue Code), the debt instrument must be initially issued in registered form or subsequently put in registered form by the debtor corporation itself. Arrangements made solely by the creditor or a third-party agent to track ownership are insufficient. This decision emphasizes the importance of proper documentation and registration procedures at the time of debt issuance or modification. Later cases applying this ruling confirm that the critical factor is the debtor's actions in registering the debt, not merely the creditor's internal record-keeping.

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