Estate of H.O. Wood, Jr. v. Commissioner, 5 T.C. 272 (1945)

When securities are sold and the specific securities sold cannot be identified, the "first-in, first-out" (FIFO) rule is used to determine whether the securities were held for the long-term capital gains holding period, matching the earliest purchases with the earliest sales.

Summary

The Estate of H.O. Wood, Jr., disputed the Commissioner's method of allocating proceeds from "when issued" securities sales to determine capital gains. The partnership, of which H.O. Wood was a member, sold securities obtained through reorganization, some held longer than six months and some not. Because specific securities sold could not be identified, the Commissioner applied a FIFO method, matching earliest acquisitions with earliest sales. The Tax Court upheld the Commissioner's general approach, finding it more accurate than the partnership's averaging method, but modified it to align acquisition dates with those used for holding period calculations.

Facts

A partnership (of which H.O. Wood was a member) held bonds of a corporation. The corporation reorganized. The partnership received new securities in the reorganized corporation in exchange for the old bonds. The partnership had acquired the original bonds at various times and prices. The partnership entered into "when issued" sales contracts for the new securities. On the settlement date, the partnership satisfied these sales contracts partly with "when issued" purchase contracts and partly by delivering the new securities. It was impossible to identify which securities were sold under which sales contracts.

Procedural History

The Commissioner determined a deficiency in the partnership's tax return based on the allocation of sales proceeds. The Estate, succeeding the partnership, challenged the Commissioner's determination in the Tax Court.

Issue(s)

Whether the Commissioner's method of allocating proceeds from the "when issued" securities sales, using a "first-in, first-out" (FIFO) approach, to determine the holding period for capital gains purposes, was a reasonable method.

Holding

Yes, because when specific securities sold cannot be identified, matching the earliest acquired securities with the earliest sales contracts is a reasonable method for determining capital gains holding periods, but the acquisition dates must align with those used for holding period calculations.

Court’s Reasoning

The court reasoned that absent specific identification of securities sold, an arbitrary method of allocation is necessary. The Commissioner’s FIFO method, similar to that used for commingled securities purchases, is generally acceptable. The court noted the “first in, first out” rule has ancient origins, comparing it to allocating payments on an open account to the earliest debts. While acknowledging criticisms of the FIFO rule, the court found it a fair solution when precise facts are unascertainable. The court distinguished cases involving tax-free reorganizations where averaging is permitted, noting that those cases create an exception to the general FIFO rule, justified by specific statutory provisions. The court found the Commissioner’s method more accurate than the partnership’s averaging method because it used actual sales prices. However, the Court corrected the Commissioner’s departure from using consistent acquisition dates for holding period and FIFO purposes, stating, “Ordinarily, the dates of acquisition for the purpose of determining the holding period are the same dates of acquisition for the purpose of applying the ‘first in, first out’ rule.”

Practical Implications

This case reinforces the application of the FIFO rule when identifying specific securities sold is impossible, particularly important for brokers and taxpayers dealing with numerous transactions. It clarifies that even in complex scenarios like “when issued” securities, the FIFO method provides a practical means of determining capital gains. The decision underscores the importance of maintaining consistent acquisition dates for both holding period and cost basis calculations. Later cases will cite this when determining if a taxpayer’s method of accounting is reasonable.

