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When identical securities are acquired at different times and prices, and subsequently sold without identifying the specific lots sold, the "first-in, first-out" (FIFO) rule applies to determine the holding period and cost basis for capital gains purposes.

Summary

The case addresses the allocation of sales proceeds between securities held for different periods (long-term vs. short-term capital gains) when specific identification of the sold securities is impossible. The Board of Tax Appeals upheld the Commissioner's use of the FIFO rule to match sales prices with the costs of securities in chronological order of acquisition. This case clarifies the application of the FIFO rule, particularly when securities are sold simultaneously and specific identification is lacking, emphasizing that using actual sales prices more closely reflects reality than averaging methods.

Facts

The partnership satisfied its "when issued" sales contracts partly through "when issued" purchase contracts and partly by delivering securities of the reorganized corporation, obtained in exchange for bonds of the old corporation previously purchased at various times and prices. It was impossible to identify particular securities or "when issued" purchase contracts with specific "when issued" sales contracts.

Procedural History

The Commissioner determined a deficiency in the partnership's income tax. The partnership appealed to the Board of Tax Appeals, contesting the Commissioner's method of allocating sales proceeds between long-term and short-term capital gains.

Issue(s)

Whether, when securities are sold without specific identification and have been acquired at different times, the Commissioner can use the "first in, first out" rule to allocate sales proceeds for capital gains purposes.

Holding

Yes, because when specific identification is impossible, matching sales contracts with securities chronologically is a reasonable method for determining capital gains, and the Commissioner's approach of using actual sales prices is more accurate than using an average sales price.

Court's Reasoning

The court reasoned that the “first in, first out” rule is a long-standing principle rooted in the analogy of payments on an open account, where earlier payments are allocated to earlier debts. While acknowledging criticisms of the rule, the court found it provides a satisfactory and fair solution when precise facts are unascertainable. The court cited Treasury Regulations providing that stock sales should be charged against the earliest purchases if identity cannot be determined. The court rejected the taxpayer’s argument that averaging should be used as it introduces a fictional sales price. The court stated that matching sales contracts with securities chronologically is “as reasonable as any other method that has been suggested” and is not “contrary to fact.” The court quoted Judge Learned Hand from *Towne v. McElligott*, stating, “The most natural analogy is with payment upon an open account, where the law has always allocated the earlier payments to the earlier debts, in the absence of a contrary intention.”

Practical Implications

This decision reinforces the use of the FIFO rule in situations where specific identification of securities sold is impossible. Legal practitioners must advise clients to keep accurate records of security purchases to enable specific identification upon sale. If records are incomplete, the FIFO rule will likely be applied, potentially impacting the tax consequences of the sale. This case is relevant for tax planning and compliance, emphasizing the importance of documentation. This case has been cited in subsequent cases to support the application of the FIFO rule in various contexts involving the sale of commingled assets.

