John Randolph Hopkins, et ux., 15 T.C. 160 (1950)

Section 24(b) of the Internal Revenue Code disallows losses from sales or exchanges of property between an individual and a corporation more than 80% of whose stock is owned by that individual, even if the acquisition of control occurs simultaneously with the transaction causing the loss, if the transaction assures that control.

Summary

Hopkins claimed a loss on the transfer of Crane overrides to a corporation. The Tax Court considered whether the transfer was effectively postponed until the completion of an escrow agreement, which also involved the acquisition of the remaining stock of the corporation by Hopkins. The court held that Section 24(b) of the Internal Revenue Code disallows the loss because the transfer was, in effect, to a wholly-owned corporation, which is prohibited under the statute. The court reasoned that the purpose of Section 24(b) was to prevent taxpayers from creating artificial losses through transactions with controlled entities.

Facts

The petitioners, John Randolph Hopkins and his wife, transferred Crane overrides to a corporation. The assignment of the Crane overrides occurred in 1942. An escrow agreement was in effect until March 1943, when the final cash payment and other details were completed. Completion of the escrow agreement resulted in the petitioners acquiring the remaining stock of the corporation.

Procedural History

The Commissioner disallowed the loss claimed by the petitioners on their 1943 tax return. The petitioners appealed the Commissioner’s determination to the Tax Court.

Issue(s)

Whether Section 24(b) of the Internal Revenue Code disallows a loss from the transfer of property between an individual and a corporation when the individual acquires control of the corporation as part of the same transaction.

Holding

Yes, because the congressional intent behind Section 24(b) was to prevent taxpayers from creating artificial losses through transactions with controlled entities, and the acquisition or relinquishment of control simultaneously with the prohibited transaction should be viewed as “ownership” within the meaning of the statute if control is assured by the transaction.

Court’s Reasoning

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The court reasoned that if the effectiveness of the Crane assignment was held in abeyance by the escrow, the result would be a transfer to a wholly-owned corporation, which is disallowed under Section 24(b). The court distinguished *W. A. Drake, Inc. v. Commissioner*, noting that in that case, control existed before the contract of sale. Here, the court emphasized that once the contract was signed, the petitioners were assured of control of the acquiring corporation. Therefore, they could assign the property at a loss, knowing they were not actually disposing of anything, and the loss was purely illusory. The court stated that "One of the purposes of section 24 (b) was to prevent exactly this sort of thing." The court emphasized the legislative history of Section 24(b), noting that Congress intended to close loopholes that allowed taxpayers to create losses through transactions with family members and close corporations. The court concluded that to allow the loss in this case would be opening the very "loophole" Congress intended to close.

Practical Implications

This case clarifies that the timing of control in relation to a loss-generating transaction is critical when applying Section 24(b). Even if control is acquired simultaneously with the transaction, the loss will be disallowed if the transaction itself assures that control. This case serves as a warning to taxpayers attempting to utilize transactions with entities they are about to control to generate tax losses. It emphasizes the importance of considering the substance of a transaction over its form, particularly when the purpose of a transaction appears to be tax avoidance. Later cases have cited *Hopkins* to reinforce the broad application of Section 24(b) and its successor statutes to prevent tax avoidance through related-party transactions.

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