17 T.C. 1030 (1951)

Section 24(b) of the Internal Revenue Code disallows losses from sales or exchanges of property between an individual and a corporation where the individual owns more than 50% of the corporation's stock, directly or indirectly, to prevent tax avoidance through artificial losses.

Summary

Prentiss and John Moore, brothers, sought to deduct losses from their 1943 income taxes stemming from an exchange of royalty interests with Moore Exploration Company, a corporation in which they became sole stockholders upon completing the exchange. The Tax Court upheld the Commissioner's disallowance of the loss under Section 24(b)(1)(B) of the Internal Revenue Code. The court reasoned that allowing the loss would create a loophole enabling taxpayers to artificially generate losses through transactions with controlled entities, which the statute aimed to prevent.

Facts

The Moore brothers owned 527 shares of Moore Exploration Company. Hadley Case and others (the Case Group) owned the remaining 673 shares and a $51,000 oil payment. In November 1942, an agreement was made for John Moore to purchase the Case Group's stock and oil payment. Part of the consideration involved the transfer of certain oil lease interests (Noelke leases), which were initially owned by the corporation and then assigned to the Moores. The Moores, in turn, assigned these leases to the Case Group. Simultaneously, the Moores assigned a producing royalty interest (Crane County overrides) to the corporation. The final cash payment and stock transfer occurred on March 23, 1943, making the Moores sole stockholders. The Moores claimed a loss based on the difference between their cost basis in the Crane County overrides and the fair market value of the Noelke lease interests.

Procedural History

The Commissioner of Internal Revenue disallowed the losses claimed by the Moores on their 1943 income tax returns. The Moores petitioned the Tax Court for a redetermination of the deficiencies. The Tax Court consolidated the cases for hearing and ultimately ruled in favor of the Commissioner, upholding the disallowance.

Issue(s)

Whether the petitioners are entitled to deduct from gross income in 1943 losses incurred on an exchange of a royalty interest for other royalty interests with a corporation in which they became sole stockholders simultaneously with the exchange, under Section 23(e)(1) of the Internal Revenue Code?

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Holding

No, because Section 24(b) of the Internal Revenue Code disallows losses from sales or exchanges of property between an individual and a corporation when the individual owns more than 50% of the corporation's stock, and the transaction, structured as it was, fell within the ambit of that section.

Court's Reasoning

The Tax Court reasoned that if the transfer of the Crane overrides to the corporation was held in abeyance until the completion of the escrow (which included the stock transfer), then the transfer was effectively to a wholly-owned corporation. Section 24(b) explicitly disallows losses from such transactions. The court distinguished *W.A. Drake, Inc. v. Commissioner*, noting that in *Drake*, control was relinquished simultaneously with the contract, whereas here, the Moores were assured of control once the initial contract was signed, enabling them to assign property to the corporation at a loss without a genuine disposition. The court emphasized that Section 24(b) aimed to prevent taxpayers from creating artificial losses through transactions with controlled entities, stating that the congressional intent was to cover "this kind of transaction and that, if necessary to accomplish this purpose, the acquisition or relinquishment of control simultaneously with the prohibited transaction should be viewed as 'ownership' within the plain meaning of the legislation." The court quoted legislative history, noting, "Experience shows that the practice of creating losses through transactions between members of a family and close corporations has been frequently utilized for avoiding income tax. It is believed that the proposed change will operate to close this loophole of tax avoidance."

Practical Implications

Moore v. Commissioner reinforces the application of Section 24(b) to disallow losses in transactions where control of a corporation is acquired contemporaneously with the transfer of property. This decision emphasizes that the timing of control is crucial; even simultaneous acquisition of control will trigger the disallowance if the transaction, in substance, allows for artificial loss creation. Legal practitioners must carefully analyze the timing and substance of transactions between individuals and corporations they control to avoid the disallowance of losses. The case serves as a reminder that the IRS and courts will look to the overall purpose of tax code provisions to prevent tax avoidance, even if a taxpayer attempts to structure a transaction to technically fall outside the strict wording of the statute. Later cases have cited *Moore* to support the principle that the substance of a transaction, rather than its form, governs its tax treatment when dealing with related parties and loss disallowance provisions.

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