The H.W. Porter & Co., Inc., 14 T.C. 307 (1950)

A corporation dealing in its own stock as it might in the shares of another corporation can realize taxable gain or deductible loss, depending on the specifics of the transaction.

Summary

The Tax Court addressed whether a corporation realized taxable gain from selling treasury stock to its vice president, Kaiser. The Commissioner argued the corporation was dealing in its own shares as it would with another company's stock. The court agreed with the Commissioner, finding the sale unqualified with no restrictions. Kaiser's later resale to the petitioner at the same price also lacked restrictions. Therefore, the court held the corporation liable for tax on the long-term capital gain, distinguishing the case from situations where stock transactions are tied to employment contracts with resale obligations. The decision turned on whether the stock transactions were genuinely unrestricted sales.

Facts

The petitioner, a Missouri corporation manufacturing shoes, had broad powers in its articles of incorporation to deal in its own stock.
In 1939, to secure the services of McBryan as sales manager, the company purchased 600 shares of its own stock for $3,333.33 and transferred them to him, with the condition that he could not sell the stock and had to return it upon termination of his employment.
McBryan resigned in 1940 and returned the shares, which were then held as treasury stock.
In 1945, the corporation sold these treasury shares to Kaiser, its vice president, at $40.75 per share without any restrictions on resale.
In 1946, Kaiser sold the shares back to the company at the same price.

Procedural History

The Commissioner determined deficiencies in the petitioner's income tax for fiscal years 1945 and 1946, and in excess profits tax for 1946.
The petitioner conceded the deficiencies for 1946 but contested the determination that it realized a taxable gain from the sale of treasury stock in 1945.
The Tax Court sustained the Commissioner's determination, finding the gain taxable.

Issue(s)

Whether the corporation realized a taxable long-term capital gain from the sale of its treasury stock to its vice president, Kaiser, when the sale was not subject to any restrictions or conditions.

Holding

Yes, because the corporation dealt with its own shares as it would with the shares of another corporation, and there were no restrictions on Kaiser's ability to sell or transfer the stock.

Court's Reasoning

The court relied on Section 22(a) of the Internal Revenue Code and Section 29.22(a)-15 of Regulations 111, which state that if a corporation deals in its own shares as it might in the shares of another corporation, the resulting gain or loss is taxable.

The court distinguished this case from others where the sale of stock was connected to an employment contract with an obligation to resell the stock upon termination of employment. Here, there were no such restrictions.

The court noted that there was no change in the petitioner's capital structure because of the sale and repurchase of the shares.

The court likened the facts to those in *Brown Shoe Co., 45 B.T.A. 212, affd. 133 F. 2d 582*, where the taxpayer was held taxable on the profit realized on the sale of its own shares to its president and key employees because there was no alteration of the taxpayer's capital structure and no restriction on the sale of the shares.

Practical Implications

This case emphasizes that the tax treatment of treasury stock transactions hinges on whether the corporation is genuinely dealing in its own stock as it would with the stock of another company, without any hidden conditions or restrictions.

When advising clients on treasury stock transactions, attorneys must carefully document the absence of restrictions on the sale or resale of the stock, especially when dealing with employees.

The presence of restrictions tied to employment or other specific obligations can change the character of the transaction and potentially avoid immediate tax liability.

Later cases will likely scrutinize the substance of such transactions to determine if the corporation truly relinquished control over the shares or if the sale was merely a disguised form of compensation or a temporary transfer subject to mandatory repurchase.

The Third and Seventh Circuit Courts of Appeal have since overturned rulings by the Tax Court that were similar to the petitioner's arguments.