Hollywood Baseball Association v. Commissioner, 42 B.T.A. 1211 (1940)

When property is acquired by a corporation after December 31, 1920, through the issuance of stock in a tax-free exchange under Section 112(b)(5) of the Revenue Act, the basis of the property for determining loss upon sale or exchange is the same as it would be in the hands of the transferor.

Summary

Hollywood Baseball Association sought to increase its excess profits credit by including the value of a lease acquired in exchange for stock in its equity invested capital. The Board of Tax Appeals ruled against the Association, holding that under Section 113(a)(8) of the Revenue Act, the basis of the lease was the same as it would be in the hands of the transferors because the acquisition occurred after December 31, 1920, in a tax-free exchange. Furthermore, the Association failed to prove that the lease was worth the claimed value of $128,800 even if the acquisition was deemed to have occurred prior to the specified date.

Facts

- Five associates owned a lease and transferred it to the Hollywood Baseball Association in exchange for stock.
- Each associate received one-fifth of the stock, proportional to their interest in the lease.
- The Association claimed the lease had a value of $128,800 at the time of the transfer, based on a board of directors' resolution.
- The Association sought to include this value in its equity invested capital for excess profits tax purposes.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the petitioner's excess profits tax. The Hollywood Baseball Association petitioned the Board of Tax Appeals for a redetermination, arguing that it was entitled to a larger excess profits credit based on its invested capital.

Issue(s)

1. Whether the basis of the lease acquired by the petitioner in exchange for stock after December 31, 1920, in a tax-free exchange, should be determined by reference to the transferor's basis, according to Section 113(a)(8) of the Revenue Act.
2. If the acquisition occurred before December 31, 1920, whether the petitioner adequately proved the lease's fair market value at the time of the exchange to be $128,800.

Holding

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1. Yes, because Section 113(a)(8) dictates that the basis of property acquired after December 31, 1920, in a tax-free exchange is the transferor's basis.
2. No, because the evidence presented did not support the claimed valuation of $128,800.

Court's Reasoning

The Board of Tax Appeals reasoned that Section 113(a)(8) of the Revenue Act governed the basis of the lease. The acquisition occurred when the stock was issued, which was after December 31, 1920. Because the exchange qualified under Section 112(b)(5) as a tax-free exchange (property transferred to a corporation by persons in control, solely for stock, with proportional interests), the basis of the lease to the corporation was the same as it would be in the hands of the transferors. The court stated, "Thus, the transaction whereby the petitioner acquired this lease comes precisely within those provisions and no gain or loss was recognizable on that transaction. The basis of the lease to the petitioner for loss is thus the transferor's basis."

Even if the acquisition was considered to have occurred before December 31, 1920, the petitioner's claim would still fail because the Association did not provide sufficient evidence to prove that the lease was worth $128,800 at the time of the transfer. The Board noted that the only evidence supporting this valuation was a board resolution, which the court found unconvincing, stating: "However, the evidence as a whole shows that the value of the lease was not more than a small part of that amount."

Practical Implications

This case highlights the importance of understanding the basis rules for property acquired in tax-free exchanges, especially under Section 351 (formerly Section 112(b)(5)) of the Internal Revenue Code. It demonstrates that a corporation's basis in property received in such a transaction is generally the same as the transferor's basis, even if the fair market value of the property at the time of the exchange is different. Taxpayers must maintain accurate records of the transferor's basis to properly calculate depreciation, amortization, and gain or loss upon a later sale. This ruling emphasizes the need for contemporaneous valuation appraisals when claiming a different basis, especially when dealing with related parties. This case is frequently cited in tax law courses when discussing the intricacies of corporate formations and the carryover basis rules.

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