Pacific Affiliate, Inc. v. Commissioner, 18 T.C. 1175 (1952)

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A securities dealer can hold securities as capital assets for investment purposes, distinct from securities held for sale to customers in the ordinary course of business; the primary factor is whether the securities are sold 'to customers' through merchandising functions or through brokers.

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Summary

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Pacific Affiliate, Inc., a securities dealer, disputed deficiencies in income and excess profits taxes. The Tax Court addressed several issues, including whether certain securities were capital assets or held for sale to customers, the treatment of margin account liabilities, and the inclusion of borrowed funds in invested capital. The Court held that a securities dealer can hold securities as capital assets for investment, determined which assets qualified, clarified the amortization of bond premiums, and addressed the includibility of specific debts in invested capital. The core principle established is the recognition that a securities dealer can simultaneously act as an investor, with different tax implications for each activity.

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Facts

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Pacific Affiliate, Inc. was a California corporation engaged in the securities business, operating through retail distribution, government bond operations, and investing/speculating for its own account. The company maintained a margin account with Bear, Stearns & Company. Disputes arose over the tax treatment of various securities transactions, including the classification of Federal Land Bank bonds, United States Treasury bonds, and American Telephone & Telegraph Company bonds, as well as the proper calculation of invested capital.

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Procedural History

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The Commissioner of Internal Revenue assessed deficiencies against Pacific Affiliate, Inc. for income tax and excess profits tax. Pacific Affiliate paid the deficiencies and petitioned the Tax Court for refunds, contesting several aspects of the Commissioner's determinations.

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Issue(s)

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1. Whether the margin account liability to Bear, Stearns & Company is allowable as borrowed invested capital.

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2. Whether certain Federal Land Bank bonds were held primarily for sale to customers or as capital assets.

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3. Whether certain debts incurred by the petitioner are includible as part of invested capital.

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4. Whether certain dividends received by the petitioner are excluded from excess profits net income.

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5. Whether "when, as, and if issued" contracts respecting corporate securities are properly recognizable as individual assets on a "gross basis

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