19 T.C. 641 (1953)

When ‘buy’ and ‘sell’ contracts for ‘when issued’ securities are settled through a stock clearing corporation on the settlement date, the transaction is treated as a sale and exchange of the underlying securities, resulting in a short-term capital transaction, rather than a sale of the contract rights themselves.

Summary

The Shanis partnership entered into ‘buy’ and ‘sell’ contracts for new securities of the St. Louis-San Francisco Railway Company on a ‘when, as, and if issued’ basis. The Tax Court addressed whether the settlement of these contracts through the Stock Clearing Corporation resulted in a long-term capital gain and a short-term capital loss (as argued by the petitioners) or a net short-term capital gain (as determined by the Commissioner). The court held that the transactions constituted a sale and exchange of the underlying securities on the settlement date, resulting in a short-term capital gain, following the IRS’s established position in I.T. 3721.

Facts

The Shanis partnership entered into 51 contracts to sell new St. Louis-San Francisco Railway Company securities on a ‘when, as, and if issued’ basis around May 1, 1945. On September 20, 1946, the partnership entered into 9 contracts to buy the same type and quantity of securities. The National Association of Securities Dealers announced on January 1, 1947, that these securities would be recognized and issued on January 24, 1947. On the issuance date, all contracts were settled through the Stock Clearing Corporation.

Procedural History

The Commissioner determined that the settlement of the ‘when issued’ contracts resulted in a net short-term capital gain. The Shanis partnership petitioned the Tax Court, arguing for long-term capital gain treatment on the ‘sell’ contracts and short-term capital loss treatment on the ‘buy’ contracts. The Tax Court reviewed the Commissioner’s determination.

Issue(s)

Whether the settlement of ‘buy’ and ‘sell’ contracts for ‘when issued’ securities through the Stock Clearing Corporation constitutes a sale and exchange of the underlying securities, resulting in a short-term capital transaction, or a sale of the contract rights themselves, potentially resulting in long-term capital gain treatment for the ‘sell’ contracts.

Holding

No, because when ‘buy’ and ‘sell’ contracts of ‘when issued’ securities are retained until the settlement date and cleared through the Stock Clearing Corporation, there is a sale and exchange of the securities involved on the settlement date, resulting in a short-term capital transaction.

Court's Reasoning

The court acknowledged that 'buy' and 'sell' contracts for 'when issued' securities are capital assets, and that contract rights can be assigned, leading to long or short-term capital transactions depending on the holding period. However, in this case, the court found that the partnership did not sell or exchange the contract rights prior to maturity. Instead, the contracts were retained until the settlement date and cleared through the Stock Clearing Corporation. The court followed the IRS's position in I.T. 3721, which treats such transactions as a sale and exchange of the underlying securities on the settlement date. The court cited Raymond B. Haynes, 17 T.C. 772, with approval, noting that no actual sale or purchase is effected under a 'when issued' contract until the new securities are issued, and the holding period begins on the settlement date. The court quoted I.T. 3721, stating that the transactions "in effect, have been completed through the New York Stock Exchange, and no further acquisition or disposition of the new stock will be made under the contracts."

Practical Implications

This case clarifies the tax treatment of gains and losses arising from 'when issued' securities transactions. It reinforces the IRS's position that settlement of offsetting 'buy' and 'sell' contracts through a clearing corporation constitutes a sale of the underlying securities, not a sale of the contract rights themselves. This determination is crucial for taxpayers and legal professionals involved in securities trading, particularly when dealing with complex financial instruments like 'when issued' securities. It emphasizes the importance of understanding the mechanics of stock clearing corporations and the timing of acquisition and disposition for capital gains purposes. Later cases and IRS guidance continue to refine the application of these principles in various financial contexts.

