20 T.C. 122 (1953)

When a corporation's property is sold for delinquent taxes and later acquired by a different corporation through purchase from the state, the acquiring corporation's basis in the property is its cost, not the prior owner's basis.

Summary

Coon Run Fuel Company (Petitioner) sought to use the historical cost basis of its predecessor, LaFayette Coal & Coke Company, when calculating a capital loss on the sale of coal lands. LaFayette lost the lands due to a tax sale. Petitioner, formed by LaFayette's stockholders, later purchased the land from the state. The Tax Court held that Petitioner's basis was its cost of purchasing the land from the state, not LaFayette's original cost, because the tax sale extinguished LaFayette's ownership and no tax-free reorganization occurred.

Facts

LaFayette Coal & Coke Company owned 2,732.27 acres of coal land, acquired in 1907 and 1908 for $163,965. LaFayette failed to pay property taxes after 1926, and in 1929, the land was sold to the State of West Virginia for delinquent taxes. LaFayette's stockholders formed Coon Run Fuel Company. Coon Run Fuel Company purchased the coal land from the state in 1932 for $700. In 1945, Coon Run Fuel Company sold the coal land for $68,300 and claimed a loss based on LaFayette's original cost basis.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Coon Run Fuel Company's income tax, arguing that the company realized a capital gain on the sale. Coon Run Fuel Company petitioned the Tax Court, contesting the Commissioner's assessment and claiming it sustained a long-term capital loss. The Tax Court ruled in favor of the Commissioner, holding that Coon Run Fuel Company was not entitled to use LaFayette's cost basis.

Issue(s)

1. Whether Coon Run Fuel Company can use the historical cost basis of LaFayette Coal & Coke Company, its predecessor, to calculate gain or loss on the sale of property, where LaFayette lost the property in a tax sale before Coon Run Fuel Company acquired it from the state.

Holding

1. No, because LaFayette lost all rights to the property when it was sold for delinquent taxes, and Coon Run Fuel Company's subsequent purchase from the state was not a tax-free reorganization or transfer that would allow it to inherit

LaFayette’s basis.

Court’s Reasoning

The court reasoned that under Section 113(a) of the Internal Revenue Code, the basis of property is generally its cost to the taxpayer. While Section 113(a)(7) provides an exception for property acquired in a reorganization where control remains in the same persons, this exception didn’t apply. The court stated that “The tax sale deprived LaFayette of all of its properties without any compensation whatsoever and a pertinent inquiry is whether that loss was recognized ‘under the law applicable to the year’ in which the loss occurred. If the loss was recognized it would wipe out LaFayette’s basis on the properties and there would be nothing to carry over to the petitioner.” The court found that the loss was recognized and that there was no transfer of property from LaFayette to Coon Run Fuel Company, as LaFayette had lost its property rights. Thus, Coon Run Fuel Company’s basis was its purchase price from the State.

Practical Implications

This case clarifies that a corporation cannot use the historical cost basis of a predecessor entity if the predecessor lost the property through a tax sale before the successor acquired it. The critical point is that the tax sale extinguishes the original owner’s basis. Attorneys advising clients on property acquisitions must carefully examine the chain of title and how prior ownership interests were terminated. This ruling prevents taxpayers from artificially inflating their basis to create tax losses when they acquire distressed property. It emphasizes that a purchase from a state following a tax sale is a new acquisition, not a continuation of the prior ownership for tax basis purposes. This principle applies to various types of property and influences tax planning related to distressed assets.

