East Coal Co. v. Commissioner, 20 T.C. 633 (1953)

A corporation that purchases property at fair market value after a tax sale cannot claim the original owner's higher basis in the property, even if there is a subsequent reorganization involving stockholders of the original owner.

Summary

East Coal Co. sought to use the adjusted basis of its predecessor, LaFayette, in calculating gain or loss from the sale of properties. LaFayette lost the properties in a tax sale before East Coal Co. acquired them. East Coal Co. argued it was entitled to LaFayette's basis under a reorganization exception in Section 113(a)(7) of the Internal Revenue Code. The Tax Court held that because LaFayette lost the properties in a tax sale, any loss was recognized under the applicable revenue laws, wiping out LaFayette's basis. East Coal Co.'s basis was its cost of acquiring the properties, as determined by the Commissioner.

Facts

LaFayette owned certain coal properties. LaFayette lost these properties through a tax sale. Moore purchased the properties at the tax sale. East Coal Co. later purchased the properties from Moore. Stockholders of LaFayette held an interest in East Coal Co. Velma Karkosiak Hudoc served as secretary to Williams, and then secretary to East Coal Company.

Procedural History

The Commissioner determined a deficiency in East Coal Co.'s income tax. East Coal Co. petitioned the Tax Court for a redetermination. The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether East Coal Co. can use LaFayette's adjusted basis in the properties it purchased from Moore, after LaFayette lost the properties in a tax sale, based on the reorganization provisions of Section 113(a)(7) of the Internal Revenue Code.

Holding

No, because LaFayette's loss was recognized when the properties were lost in the tax sale, eliminating any basis to carry over to East Coal Co. East Coal Co.'s basis is its cost of purchasing the properties from Moore.

Court's Reasoning

The court relied on Section 113(a) of the Internal Revenue Code, which states that the basis of property is its cost to the taxpayer. An exception exists in Section

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113(a)(7) for property acquired by a corporation in connection with a reorganization where control remains in the same persons. East Coal Co. argued that this exception applied, allowing it to use LaFayette's basis. However, the court found that the tax sale deprived LaFayette of all of its properties. Because Section 112(a) of the Revenue Act of 1932 states that the entire amount of loss sustained upon the sale of property shall be recognized, LaFayette's loss was recognized at the time of the tax sale. Since none of the nonrecognition provisions applied, LaFayette had no basis left to transfer to East Coal Co. The court emphasized that East Coal Co. purchased the properties from Moore, not from LaFayette or its stockholders in a tax-free exchange or transfer. Thus, East Coal Co.'s basis was its cost of acquiring the properties from Moore. The court stated: "The evidence shows that LaFayette lost its properties completely through the tax sale and thereafter neither LaFayette nor its stockholders had any interest in the coal properties which could be exchanged or transferred."

Practical Implications

This case clarifies that a tax sale is a taxable event that triggers recognition of gain or loss, thereby extinguishing the prior owner's basis in the property for purposes of subsequent transactions. The case reinforces the principle that a purchaser at a fair market value acquires a new basis equal to the purchase price, regardless of any prior connection to the original owner. Attorneys should advise clients that acquiring assets through a tax sale resets the basis, preventing the purchaser from claiming the original owner's basis, even if a reorganization occurs later. The decision highlights the importance of understanding the tax implications of foreclosure sales and the limitations on carrying over basis in such scenarios. Later cases would distinguish this holding based on the nature of the transaction and whether a true "sale" took place.

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