23 T.C. 962 (1955)

When a trustee distributes assets to satisfy a beneficiary's claim against the trust, the beneficiary's basis in the assets is the value of the claim surrendered, not the trustee's basis in those assets.

Summary

Lindsay C. Howard received shares of stock from a trust in exchange for his claim to a portion of the trust's accumulated earnings. The Commissioner of Internal Revenue argued that Howard's basis in the stock should be the same as the trust's basis. The Tax Court held that Howard's basis was equivalent to the value of the claim he surrendered, not the trust's basis in the stock. This decision established that when a beneficiary exchanges a claim for trust assets, the transaction is treated as a purchase by the beneficiary for tax purposes. This ruling is significant for determining capital gains or losses in similar trust distributions.

Facts

Charles S. Howard created a trust for his wife and sons, including Lindsay C. Howard. The trust held his automobile business. The trust's net income was to be distributed, with one-fifth accumulated for each son until age 21. In 1923, the business was incorporated, and the trust received stock. Upon reaching age 21, Lindsay received shares of the corporation's stock in exchange for his share of the accumulated earnings. The basis of the stock in the hands of the trustee was less than the value of Howard's claim. In 1948, Howard sold some of the stock and claimed a basis equal to the value of his claim. The Commissioner contended that his basis should be the same as the trust's basis.

Procedural History

The Commissioner determined deficiencies in Lindsay Howard's income tax, disagreeing with Howard's calculation of the basis for the stock sale. The issue was brought before the United States Tax Court. The Tax Court considered the arguments of both parties concerning the correct determination of the basis of the shares of stock distributed to the petitioner by the trust.

Issue(s)

1. Whether the basis for gain or loss to petitioner of shares distributed to him by the trustee is the value of the claim which he surrendered in connection with their acquisition.

Holding

1. Yes, because the court determined that the basis for the stock received by the taxpayer was the value of the claim surrendered for the stock, not the trustee's

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basis in the stock.

Court's Reasoning

The court distinguished this case from those involving distributions of property where the beneficiary did not surrender a claim. Here, Howard surrendered a claim to accumulated earnings in exchange for the stock. The court reasoned that the distribution of stock to satisfy Howard’s claim was a “sale or other disposition” of the stock, effectively a purchase by Howard. The claim surrendered represented the purchase price. The court cited several cases that supported the view that the basis of property acquired in exchange for a claim is the value of the claim. The court rejected the Commissioner’s argument that Howard’s basis should be the same as the trustee’s basis because that would be applicable when the stock distribution was made under the terms of the trust without the exchange of a claim.

Practical Implications

This case provides a clear rule for determining the basis of property distributed by a trust when the beneficiary exchanges a claim for the property. Attorneys must understand that such a transaction is treated as a purchase, and the basis will be the value of the claim surrendered. This impacts the calculation of capital gains or losses upon subsequent sales. This decision is crucial when advising clients on the tax consequences of receiving assets from a trust in exchange for a claim against the trust. It informs how similar transactions should be structured and reported for tax purposes. The distinction between surrendering a claim versus receiving a distribution as a beneficiary is key in tax planning and in resolving disputes with the IRS.

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