33 T.C. 568 (1959)

The amortization of bond premiums for tax purposes is calculated using the general redemption price, not a special redemption price, if the special price is unlikely to be used.

Summary

The case concerns the deductibility of bond premium amortization under Section 125 of the Internal Revenue Code of 1939. The taxpayer, Goldfarb, purchased bonds at a premium, and claimed an amortization deduction based on the difference between the purchase price and a special redemption price. The IRS disallowed a portion of the deduction. The Tax Court sided with the IRS, holding that the amortization should be calculated based on the difference between the purchase price and the general redemption price, because the special redemption price was unlikely to be used. The court relied on a prior case, *Estate of A. Gourielli*, which addressed the same issue. The practical implication of this decision is that taxpayers must assess the likelihood of a special redemption price when calculating bond premium amortization.

Facts

In 1953, Jacob A. Goldfarb purchased $500,000 face amount of Arkansas Power and Light Company bonds at a premium. The bonds had both a general redemption price and a special redemption price, the latter being lower. The special redemption price could be invoked only if funds were available in certain special funds, and Arkansas had not been placing cash into these funds. The taxpayer calculated a deduction for the amortization of the bond premium, using the special redemption price. The IRS disagreed, permitting a smaller deduction. The bonds were subsequently redeemed at the general call price in 1955.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Goldfarbs' income tax for 1953, disallowing a portion of the bond premium amortization claimed by the taxpayers. The Goldfarbs petitioned the United States Tax Court. The Tax Court ruled in favor of the Commissioner.

Issue(s)

Whether the taxpayer could calculate the amortization of a bond premium based on the special redemption price of the bonds, rather than the general redemption price?

Holding

No, because the special redemption price was unlikely to be used based on the facts of the case, amortization should be calculated using the general redemption price.

Court’s Reasoning

The court relied heavily on the precedent established in *Estate of A. Gourielli*. The court reasoned that the special redemption price was unrealistic because it was highly improbable that the bonds would be redeemed at the special price. The funds required for the special redemption were not being funded. The business of the bond issuer was expanding, and it was using its available cash for its construction program. The court pointed out that the bonds were, in fact, redeemed at the general call price. Therefore, the court sustained the IRS’s determination that the deduction should be limited based on the general redemption price.

Practical Implications

This case provides guidance on calculating the amortization of bond premiums for tax purposes. Taxpayers should carefully evaluate the terms of the bonds, especially the likelihood of redemption at any special redemption price, when determining their amortization deduction. The decision reinforces that the general redemption price is the appropriate basis for amortization unless a special redemption is reasonably anticipated. This impacts bond investors, tax advisors, and businesses issuing bonds, especially in determining the tax implications of bond investments and bond issuance. The holding discourages attempts to use an unlikely special redemption price to increase amortization deductions. It also underscores the importance of economic reality in tax analysis – the court looked beyond the mere existence of a special redemption provision and considered the practical realities of the situation.

