33 T.C. 805 (1960)

When a taxpayer claims a loss on the transfer of stock in exchange for consideration, they must establish the value of the consideration received to determine the amount of the loss.

Summary

Leo Sack transferred 200 shares of Hudson Knitting Mills Corporation stock to new managers in exchange for their managerial services and a $12,000 contribution to the corporation. Sack claimed a loss on this transfer, arguing he received less in consideration than the stock's cost. The Tax Court disallowed the deduction because Sack failed to establish the value of the consideration he received. The court held that without evidence of the value of the managerial services and the resulting benefits, Sack could not prove the extent of his loss.

Facts

Leo Sack owned 120 shares of Hudson Knitting Mills Corporation stock. Facing operational losses and disputes with other shareholders, Sack bought out the Pauker interest, purchasing an additional 204 shares. The next day, he transferred 200 shares to new managers in exchange for a $12,000 contribution to the corporation's capital and their promise to manage the company. Sack claimed a loss deduction on his 1955 tax return related to this stock transfer. The corporation experienced losses before the new management took over but showed a profit shortly thereafter.

Procedural History

The Commissioner of Internal Revenue disallowed Sack's claimed loss deduction. Sack contested this decision in the United States Tax Court.

Issue(s)

Whether the taxpayer can establish a deductible loss on a stock transfer when part of the consideration is the managerial services to be provided to the corporation.

Holding

No, because Sack failed to establish the value of the consideration received in exchange for the stock, specifically the value of the managerial services and the resulting benefit.

Court's Reasoning

The court determined that to claim a loss, Sack needed to prove the value of all the consideration he received. This included not just the $12,000 in capital but also the intangible benefit of new management. The court cited prior case law, stating that

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the value of the stock at the time of transfer could represent the price realized in such transactions. However, because there was no evidence to show the value of the Hudson stock at the time of the transfer and the value of the consideration Sack received in the form of the new managerial contract, the court found that Sack had not met his burden of proof. The court emphasized that, as the taxpayer, Sack bore the responsibility for proving the amount of any loss, and he failed to do so by failing to show the value of part of the consideration which he bargained for and received in the transfer of his stock.

Practical Implications

This case underscores the importance of substantiating the value of all components of consideration in transactions involving stock transfers, especially when claiming a loss for tax purposes. It suggests that taxpayers need to carefully document the value of both tangible and intangible assets received in an exchange. For attorneys, this means advising clients to obtain valuations or other evidence to support the value of all consideration received, including management services, to increase the likelihood of a successful tax deduction. Moreover, the decision suggests that when a tax deduction hinges on valuing non-monetary consideration, the taxpayer must demonstrate a reasonable method for that valuation.

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