Stavisky v. Commissioner, 27 T.C. 147 (1956)

Payments made to assign a "when issued" securities contract are treated as sales or exchanges of capital assets, determining whether resulting losses are capital or ordinary losses.

Summary

The Tax Court addressed whether a payment made by a taxpayer to transfer a portion of a "when issued" stock sale contract resulted in a capital loss or an ordinary loss. The taxpayer entered contracts to buy and sell "when issued" Missouri Pacific Railroad preferred stock. Due to rising prices, he paid a third party to assume part of his selling contract. The court determined that this was a sale or exchange of a capital asset, resulting in a long-term capital loss because the initial contract was entered into before the effective date of the applicable tax code provision. The court rejected the taxpayer's argument that the payment was merely a release from an obligation, emphasizing the bilateral nature of the contract and the transfer of rights and liabilities.

Facts

Meyer J. Stavisky contracted to sell 10,000 shares of "when issued" Missouri Pacific Railroad preferred stock. The following day, he contracted to buy 10,000 shares of the same stock. Due to rising prices, Stavisky was required to deposit substantial cash to meet "mark to market" requirements. In December 1951, he transferred 40% of his selling contract to Sutro Bros. & Co., paying $31,150. In January 1952, he transferred 40% of his purchase contract to Ira Haupt & Co., receiving $29,975. The reorganization plan for Missouri Pacific Railroad failed in December 1954, and the "when issued" contracts were canceled.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the taxpayer's 1951 income tax return, disallowing the deduction claimed for the payment to Sutro as an ordinary loss. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether the payment made by the taxpayer to Sutro for the transfer of a portion of the sales contract constituted a sale or exchange of a capital asset.

2. If the transaction was a sale or exchange, whether the resulting loss was a long-term or short-term capital loss.

Holding

1. Yes, because the transfer of the contract rights and liabilities constituted a sale or

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exchange of a capital asset.

2. Yes, because the initial contract was entered into before the effective date of the relevant provision of the Internal Revenue Code, therefore the loss was long-term.

Court’s Reasoning

The court rejected the argument that the payment was merely a release from an obligation, emphasizing the bilateral nature of the “when issued” contracts. The court pointed out that the taxpayer possessed both rights and obligations under the contract. The court held that the transfer of a portion of the contract’s rights and liabilities to a third party constituted a sale or exchange. The court cited I.T. 3721, a Revenue Ruling holding that transfers of rights under “when issued” contracts constitute sales or exchanges of capital assets. The court distinguished the taxpayer’s situation from a simple release from liability and applied the principle that the taxpayer had sold a portion of their contract rights. The court then analyzed the length of time the asset was held. The court found the relevant date to determine long-term versus short-term treatment was the date the initial contract was made. Since the contract was made before the 1950 Revenue Act, the loss was treated as a long-term capital loss.

Practical Implications

This case clarifies that payments made for the assignment of “when issued” contracts are treated as sales or exchanges. This impacts the tax treatment of such transactions. Lawyers advising clients who engage in these types of securities transactions must understand the implications of Section 117 of the Internal Revenue Code and related regulations. This means carefully analyzing when the original contract was made, and whether the transfer meets the criteria of a sale or exchange. The court’s focus on the bilateral nature of contracts has implications for similar financial instruments. Later cases dealing with assignments or sales of contractual rights would likely cite this case. Business planners and tax advisors need to understand the timing of entering into contracts and the potential tax ramifications of assignments or transfers.

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