***Wool Distributing Corp. v. Commissioner*, 341 F.2d 33 (2d Cir. 1965)**

Currency futures contracts used to hedge against the risk of loss from potential currency devaluation of foreign wool inventory are considered ordinary assets, and losses incurred are fully deductible, not capital losses.

Summary

Wool Distributing Corporation, a wool importer, sought to deduct losses from its currency futures transactions as ordinary losses, arguing the futures were hedges against potential devaluation of its foreign wool inventory. The IRS classified these losses as capital losses, limiting deductibility. The Second Circuit reversed the Tax Court, holding that the currency futures were integral to Wool Distributing's business and served as price insurance, thus qualifying as hedging transactions. This ruling allowed Wool Distributing to deduct the losses in full, distinguishing the transactions from typical speculative investments in currency futures and highlighting the close connection to the company's core business of importing and selling wool.

Facts

Wool Distributing Corporation held a large inventory of sterling area and French wools. The company anticipated the potential devaluation of the pound sterling and French franc, which would decrease the dollar value of its inventory. To protect against this risk, Wool Distributing sold pound sterling and French franc futures contracts. The company's currency futures holdings approximated its wool inventory. Wool Distributing incurred losses on these futures contracts. The IRS contended the losses should be treated as capital losses.

Procedural History

The Tax Court held that the losses from currency futures were capital losses. Wool Distributing appealed this decision to the Second Circuit Court of Appeals.

Issue(s)

1. Whether the currency futures contracts were capital assets or ordinary assets.

2. Whether losses from the currency futures transactions were ordinary losses deductible in full or capital losses subject to limitations.

Holding

1. Yes, the currency futures contracts were ordinary assets because they were integral to the company's business of importing and selling wool.

2. Yes, losses from currency futures were ordinary losses and fully deductible.

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Court’s Reasoning

The court determined that the currency futures contracts constituted hedging transactions, which are an integral part of the business. The court referenced the *Corn Products Refining Co. v. Commissioner* case, which held that transactions that are an integral part of a company’s business should be treated as ordinary income and losses. The court reasoned that Wool Distributing’s hedging operations were designed to provide price insurance against the specific risk of currency devaluation. The court emphasized that Wool Distributing was not speculating in currency futures, but rather mitigating the risk associated with its inventory. The court noted that Wool Distributing’s currency future positions were closely related to the company’s inventory of foreign wools. The court distinguished this situation from a more typical investment scenario. The court explained that the company had a

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