Hendricks v. Commissioner, 51 T. C. 235 (1968)

For tax purposes, a short sale is not considered consummated until the delivery of the property used to close the sale.

Summary

In Hendricks v. Commissioner, the taxpayers sold Syntex Corp. stock short in 1963 and attempted to close their position by purchasing the stock on December 27 and 30, 1963. However, the settlement and delivery of the stock occurred in January 1964. The issue was whether the losses from the short sales were deductible in 1963. The Tax Court held that the losses were not deductible in 1963 because, under the Internal Revenue Code and regulations, a short sale is not consummated until the delivery of the stock, which occurred in 1964. This ruling emphasized the importance of the delivery date in determining the tax year for recognizing short sale losses.

Facts

In 1963, Walter and Dema Hendricks sold short 3,900 shares of Syntex Corp. stock. After a 3-for-1 stock split, their short position increased to 11,700 shares. Facing a margin call due to rising stock prices, they instructed their broker, Bache & Co. , to purchase enough Syntex stock to cover their short position on December 27 and 30, 1963. However, the settlement dates for these purchases were January 3 and January 6, 1964, respectively, and the stock was delivered to Bache on those dates. The Hendricks had sufficient equity in their accounts to cover the purchase price, but the delivery of the stock to close the short position occurred in 1964.

Procedural History

The Hendricks filed their 1963 tax return claiming short-term capital losses from the Syntex stock short sales. The Commissioner of Internal Revenue issued a notice of deficiency, disallowing the losses for 1963 and attributing them to 1964. The Hendricks petitioned the Tax Court for a redetermination of the deficiency. The Tax Court upheld the Commissioner's determination.

Issue(s)

1. Whether the losses sustained by the petitioners from short sales of Syntex stock were deductible for the taxable year 1963, given that the stock purchased to close the short position was not delivered until January 1964.

Holding

1. No, because under Section 1233 of the Internal Revenue Code and the regulations, a short sale is not deemed consummated until delivery of the property to close the short sale, which in this case occurred in 1964.

Court’s Reasoning

The Tax Court relied on Section 1233 of the Internal Revenue Code and Section 1.1233-1 of the regulations, which state that for tax purposes, a short sale is not consummated until delivery of the property used to close the sale. The court emphasized the distinction between short sales and long sales, noting that in short sales, the transaction remains open until the delivery of the stock to replace the borrowed stock. The Hendricks’ argument that the loss was fixed and ascertainable in 1963 was rejected because the tax consequences of a short sale are not finalized until delivery. The court cited previous cases like H. S. Richardson and Betty Klinger, which established that losses from short sales are realized upon delivery of the stock. The court concluded that the Hendricks’ losses were not deductible in 1963 but in 1964, the year of delivery.

Practical Implications

This decision clarifies that for tax purposes, the timing of loss recognition in short sales is tied to the delivery of the stock, not the purchase date. Taxpayers and practitioners must consider this when planning short sale transactions near the end of a tax year. The ruling reinforces the principle that tax consequences of short sales are not fixed until the short position is closed by delivery, affecting the timing of loss deductions. This case has been applied in subsequent rulings to determine the year of loss recognition for short sales, impacting how similar transactions are analyzed and reported on tax returns.

