Byrum v. Commissioner, 58 T. C. 731 (1972)

A taxpayer can claim a capital loss deduction for stock that becomes worthless if they establish that the stock had no liquidation or potential value in the year claimed.

Summary

In Byrum v. Commissioner, the Tax Court ruled that Paul J. Byrum's stock in Chappell Securities Corp. became worthless in 1967, allowing him to claim a capital loss deduction for that year under Section 165 of the Internal Revenue Code. The court found that Chappell ceased operations in 1967 after SEC actions and fraud indictments against its officers, leaving the stock with no liquidation or potential value. This case sets a precedent for taxpayers to establish stock worthlessness based on the absence of both current and future value.

Facts

Paul J. Byrum purchased 4,486 shares of Chappell Securities Corp. (Chappell), a brokerage firm, between 1964 and 1965. In 1965, the SEC ordered Chappell to stop selling stock in Investment Corp. of America (ICA), its main business, and seized its records. Chappell ceased operations in early 1967 and its officers were indicted for fraud later that year. Byrum attempted to sell his Chappell stock in 1967, 1970, and 1971 but found no market. Chappell's assets included shares in ICA, which had uncertain value, and other negligible assets. Byrum claimed a capital loss deduction for 1967, asserting the stock became worthless that year.

Procedural History

The Commissioner of Internal Revenue disallowed Byrum's claimed capital loss deduction for 1967, asserting the stock was not worthless in that year. Byrum petitioned the U. S. Tax Court for a redetermination of the deficiency. The Tax Court held a trial on February 23, 1972, and issued its decision on August 1, 1972, ruling in favor of Byrum.

Issue(s)

1. Whether Byrum's stock in Chappell Securities Corp. became worthless in 1967, allowing him to claim a capital loss deduction for that year under Section 165 of the Internal Revenue Code.

Holding

1. Yes, because Byrum established that the Chappell stock had no liquidation or potential value in 1967 due to the company's cessation of operations and the fraud indictments against its officers.

Court’s Reasoning

The Tax Court applied the standard from Sterling Morton, which states that stock becomes worthless when both its current liquidating value and future potential value are wiped out. The court found that Chappell’s closure in 1967 and the fraud indictments against its officers eliminated any potential value as a brokerage firm. Regarding liquidation value, the court noted Chappell’s assets were negligible, with the ICA stock having uncertain value. The absence of action by Chappell’s creditors to liquidate assets further supported the conclusion that the stock had no liquidation value in 1967. The court emphasized that Byrum, as a minority shareholder, faced challenges in establishing the stock’s value but met the burden of proof. The Commissioner failed to present contrary evidence, leading the court to rule in Byrum’s favor.

Practical Implications

This decision provides guidance for taxpayers seeking to claim capital loss deductions for worthless stock. It emphasizes the importance of establishing both the absence of current liquidation value and future potential value. Practitioners should advise clients to document the factors leading to stock worthlessness, such as cessation of business operations, regulatory actions, and criminal charges against corporate officers. The case also highlights the challenges minority shareholders face in proving worthlessness and the need for thorough documentation. Subsequent cases, such as Boehm v. Commissioner, have cited Byrum in discussing the burden of proof for establishing stock worthlessness.

