Bolles v. Commissioner, 69 T. C. 346 (1977)

Securities subject to resale restrictions under the Securities Act of 1933 must be valued at a discounted rate due to their limited marketability.

Summary

In Bolles v. Commissioner, the court addressed the valuation of securities received in an exchange offer, which were subject to resale restrictions under the Securities Act of 1933. The petitioners, who exchanged Piper Aircraft Corp. stock for Bangor Punta Corp. (BPC) securities, argued for a significant discount due to these restrictions. The court agreed, finding that the BPC securities should be discounted by 38% for common stock, 22% for convertible debentures, and 67% for warrants, reflecting the impact of resale restrictions on their marketability. Additionally, the court determined that certain contract rights received by the petitioners had no ascertainable value in 1969 due to their contingent nature.

Facts

John S. and Mary P. Bolles exchanged their Piper Aircraft Corp. shares for a package of Bangor Punta Corp. (BPC) securities on August 7, 1969. This package included BPC common stock, warrants, and convertible debentures. The exchange was part of a larger agreement between BPC and the Piper family to acquire a controlling interest in Piper. The Bolleses sought to value these securities at a discounted rate due to resale restrictions under the Securities Act of 1933. Additionally, they received rights to potential additional consideration under the agreement, contingent on BPC acquiring more than 50% of Piper’s outstanding shares.

Procedural History

The IRS determined a deficiency in the Bolleses’ federal income tax for 1969, valuing the BPC securities without considering the resale restrictions. The Bolleses petitioned the Tax Court to challenge this valuation. The court heard arguments on the valuation of the BPC securities and the ascertainable value of the contract rights under the May 8, 1969, agreement.

Issue(s)

1. Whether the BPC securities received by the Bolleses should be valued at a discounted rate due to resale restrictions under the Securities Act of 1933.
2. Whether the contract rights under section 2(E) of the May 8, 1969, agreement had an ascertainable fair market value during 1969.

Holding

1. Yes, because the resale restrictions under the Securities Act of 1933 significantly decreased the marketability of the BPC securities, justifying a discount of 38% for

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common stock, 22% for convertible debentures, and 67% for warrants.
2. No, because the contract rights were contingent upon BPC acquiring more than 50% of Piper's shares, an event shrouded in uncertainty during 1969, rendering the rights without ascertainable value.

Court's Reasoning

The court applied the principle from Hirsch v. Commissioner that securities subject to resale restrictions under the Securities Act of 1933 must be valued at a discounted rate. The Bolleses were deemed part of a control group of BPC, limiting their ability to sell the securities without violating the Act. The court rejected the IRS's valuation, which did not account for these restrictions, and found the Bolleses' expert testimony on average discounts for restricted securities credible. For the contract rights, the court followed Burnet v. Logan, ruling that rights contingent on uncertain future events have no ascertainable value. The court emphasized that the BPC securities' market prices were not indicative of their fair market value due to the resale restrictions and the volatile market conditions for conglomerates at the time.

Practical Implications

This decision informs how securities subject to resale restrictions should be valued for tax purposes, emphasizing the need to consider marketability restrictions. Tax practitioners must account for such discounts when advising clients on similar transactions. The ruling also affects how contingent contract rights are treated for tax purposes, reinforcing that rights dependent on uncertain future events may not be recognized as having a value until those events occur. Subsequent cases, such as Le Vant v. Commissioner, have applied similar principles in valuing restricted securities. This case highlights the importance of considering all relevant factors, including securities law restrictions, in tax valuation disputes.

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