Continental Illinois National Bank & Trust Co. of Chicago v. Commissioner, 72 T. C. 378 (1979)

The tax benefit rule does not apply to gains from securities acquired in satisfaction of a debt in bankruptcy, and stock acquired for both business and investment motives can qualify as a capital asset.

Summary

Continental Illinois National Bank & Trust Co. of Chicago purchased a two-thirds interest in conditional sales contracts from LaSalle National Bank, which were guaranteed by Tastee Freez and its subsidiaries. After these entities filed for bankruptcy, Continental received securities in partial satisfaction of the debt, which it later donated to a charitable foundation. The court held that the tax benefit rule did not apply to the appreciated value of the donated securities, as the original debt transaction was closed upon receiving the securities. Additionally, the court ruled that Continental's purchase of Credit Bureau of Cook County (CBCC) stock, motivated by both business and investment purposes, resulted in capital gain upon sale, not ordinary income.

Facts

Continental Illinois National Bank & Trust Co. of Chicago purchased a two-thirds interest in $8 million worth of conditional sales contracts and chattel mortgages from LaSalle National Bank, which were originally financed by Tastee Freez and its subsidiary, Allied Business Credit Corp. These contracts were guaranteed by Tastee Freez, Allied, and Carrols, Inc. When these entities filed for bankruptcy under Chapter XI, Continental filed claims and received securities in partial satisfaction of the debt, including Tastee Freez common stock and debentures. In 1968, Continental exchanged these debentures for more Tastee Freez stock and donated all the stock to a charitable foundation, claiming a charitable deduction. Additionally, Continental purchased stock in Credit Bureau of Cook County (CBCC) in 1967, which it sold in 1968 at a profit, intending to treat the gain as capital gain.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Continental's 1968 federal income tax, asserting that the appreciated value of the donated Tastee Freez stock should be included in income under the tax benefit rule, and the gain from the sale of CBCC stock should be treated as ordinary income. Continental petitioned the Tax Court for a redetermination of the deficiency. The Tax Court ruled in favor of Continental on both issues.

Issue(s)

1. Whether the donation of appreciated Tastee Freez common stock to a charitable foundation resulted in the recovery of a previously deducted item which must be

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returned to income under the tax benefit rule.
2. Whether, under the Corn Products doctrine, the gain realized by Continental on the sale of its stock in the Credit Bureau of Cook County, Inc. , is reportable as ordinary income or capital gain.

Holding

1. No, because the transaction was closed when Continental received the securities in the bankruptcy proceedings, and the appreciated value of the donated securities did not relate back to the original debt.
2. No, because the CBCC stock was held as a capital asset, given the substantial investment motive alongside the business motive for its acquisition.

Court’s Reasoning

The court relied on precedents like Allen v. Trust Co. of Georgia and Waynesboro Knitting Co. v. Commissioner, which established that receiving securities in satisfaction of a debt closes the original transaction. The securities acquired by Continental were treated as a new and separate investment, with their own basis for future gain or loss. The court emphasized that the tax benefit rule applies only when a recovery is directly attributable to a previously deducted loss, which was not the case here. For the CBCC stock, the court applied the principle from Corn Products Refining Co. v. Commissioner, noting that the stock was not merely a business necessity but also an investment. The court cited W. W. Windle Co. v. Commissioner, which held that where a substantial investment motive exists in a predominantly business-motivated acquisition of corporate stock, such stock is a capital asset. Continental’s acquisition of CBCC stock was motivated by both the desire to improve its credit card operations and the investment potential of the credit bureau industry, leading to the conclusion that the stock was a capital asset and the gain from its sale was capital gain.

Practical Implications

This decision clarifies that when a creditor receives securities in satisfaction of a debt in bankruptcy proceedings, the transaction is considered closed for tax purposes, and any subsequent gain or loss from those securities is not subject to the tax benefit rule. This ruling affects how creditors handle debts in bankruptcy and subsequent donations of appreciated securities. For the treatment of stock as a capital asset, the decision emphasizes that a substantial investment motive can outweigh a business motive, impacting how businesses classify their stock holdings for tax purposes. This ruling may encourage companies to consider the investment potential of their stock acquisitions, even when motivated by business needs. Subsequent cases, such as Agway, Inc. v. United States, have continued to apply and refine these principles.

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