Kingsley v. Commissioner, 72 T. C. 1095 (1979)

Deferred payments of stock in tax-free reorganizations are subject to imputed interest rules under section 483 of the Internal Revenue Code.

Summary

In Kingsley v. Commissioner, the U. S. Tax Court addressed whether section 483 of the Internal Revenue Code, which imputes interest on deferred payments, applied to stock received by Jerrold L. Kingsley in a tax-free reorganization. Kingsley exchanged all his shares in Household Research Institute for shares in American Home Products Corp. , with some shares reserved and delivered later. The court held that the deferred stock payment was subject to section 483, and the value of the shares received should be determined at the time of receipt due to the indefinite nature of the payment date.

Facts

Jerrold L. Kingsley entered into a stock-for-stock reorganization agreement with American Home Products Corp. (American) in 1966, exchanging all shares of Household Research Institute (HRI) for American's common stock. At closing, Kingsley received 15,070 shares, but an additional 2,775 shares were reserved and to be delivered later, no earlier than three years after closing or upon completion of any IRS audits. These reserved shares were adjusted for a stock split and interim dividends, and Kingsley received 6,153 shares in April 1970. The IRS determined a deficiency in Kingsley's 1970 tax return, arguing that part of the value of the shares received in 1970 constituted interest income under section 483.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Kingsley's 1970 federal income tax and applied section 483 to the deferred stock payment. Kingsley petitioned the U. S. Tax Court to challenge this determination. The court reviewed prior cases and regulations, affirming the applicability of section 483 to deferred stock payments in tax-free reorganizations and ruling that the value of the shares should be determined at the time of receipt.

Issue(s)

1. Whether section 483 of the Internal Revenue Code applies to the deferred stock payment received by Kingsley in a tax-free reorganization.
2. Whether the value of the shares received in 1970 should be determined as of the date of the original agreement in 1966 or the date of receipt in 1970.

Holding

1. Yes, because section 483 applies to any deferred payment in a sale or exchange,

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including stock payments in tax-free reorganizations, as established by prior court decisions.
2. No, because the due date of the deferred payment was indefinite, thus the shares must be valued at their fair market value as of the date of receipt in 1970 under section 483(d).

Court’s Reasoning

The court applied section 483 broadly, noting that the statute’s language covers “any payment” and that prior court decisions (e. g. , Solomon v. Commissioner, Katkin v. Commissioner) consistently applied section 483 to deferred stock payments in tax-free reorganizations. The court rejected Kingsley’s arguments that the reserved shares were his at closing and held that the delivery of shares in 1970 was a deferred payment subject to section 483. Regarding valuation, the court found that the due date of the deferred payment was indefinite due to its dependency on IRS audits, thus requiring valuation at the time of receipt under section 483(d). The court emphasized the literal application of the statute and the need to prevent disguising interest as capital gain.

Practical Implications

This decision clarifies that section 483 applies to deferred stock payments in tax-free reorganizations, requiring taxpayers to account for imputed interest. Practitioners should consider the timing and structuring of deferred payments in reorganizations to avoid unintended tax consequences. The ruling emphasizes the importance of valuing deferred payments at the time of receipt if the due date is indefinite, which may affect planning strategies for mergers and acquisitions. Subsequent cases like Caruth v. United States have followed this principle. This decision underscores the need for careful drafting of reorganization agreements to address potential tax liabilities and the valuation of deferred payments.

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