Simmons v. Commissioner, 72 T. C. 1204 (1979)

Stock received in exchange for other stock does not qualify as section 1244 stock, even if the stock was used as collateral for a corporate obligation.

Summary

In Simmons v. Commissioner, the Tax Court held that stock received in exchange for other stock does not qualify as section 1244 stock, which allows for ordinary loss treatment. Donald Simmons transferred Exxon stock to a landlord as collateral for his corporation's lease, receiving Murteza stock in return. The court found that this transaction was an exchange of stock for stock, disqualifying the Murteza stock from section 1244 status. The ruling underscores the importance of the nature of the transaction in determining eligibility for section 1244 treatment, impacting how similar future transactions should be structured for tax purposes.

Facts

Donald Simmons, a vice president and director at Murteza Restaurants, Inc. , transferred 250 shares of Exxon stock to Antonio Reale, Murteza's landlord, as collateral for the corporation's lease obligation. In exchange, Simmons received 242 shares of Murteza common stock. Later, Simmons sold his Murteza stock at a significant loss and claimed an ordinary loss deduction under section 1244 of the Internal Revenue Code. The Commissioner of Internal Revenue challenged the deduction, asserting that the Murteza stock was not section 1244 stock because it was received in exchange for other stock.

Procedural History

The case was initially assigned to Judge Cynthia H. Hall but was reassigned to Judge Samuel B. Sterrett. The Tax Court heard the case and ruled on the issue of whether the Murteza stock qualified as section 1244 stock, ultimately deciding in favor of the Commissioner.

Issue(s)

1. Whether the 242 shares of Murteza common stock acquired by Simmons on July 28, 1973, qualified as section 1244 stock, entitling him to an ordinary loss deduction upon their disposition.

Holding

1. No, because the Murteza stock was received in exchange for Simmons' Exxon stock, which does not meet the requirements of section 1244(c)(1)(D) as it stood during the taxable year in question.

Court's Reasoning

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The court focused on the nature of the transaction, determining that Simmons received the Murteza stock in direct exchange for his Exxon stock. The court rejected Simmons' argument that he received the stock in discharge of a debt owed by Murteza, finding this to be an artificial distinction. The court emphasized that the substance of the transaction was an exchange of stock for stock, not a payment for a debt. The court also noted that Simmons' own tax return calculations suggested he recognized the exchange nature of the transaction. The court concluded that the Murteza stock did not qualify as section 1244 stock because it was issued in exchange for other stock, as prohibited by section 1244(c)(1)(D). The court's decision was influenced by the statutory language and the intent to limit section 1244 treatment to stock issued for money or other property, excluding stock or securities.

Practical Implications

This decision clarifies that for stock to qualify for section 1244 treatment, it must be issued for money or property other than stock or securities. Legal practitioners must carefully structure transactions to ensure eligibility for section 1244 benefits, particularly when using stock as collateral. The ruling may influence business planning, as corporations and investors will need to consider alternative methods of securing obligations to maintain tax advantages. This case has been cited in subsequent rulings to distinguish between stock exchanges and other forms of stock issuance, impacting how similar cases are analyzed and decided.

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