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Rev. Rul. 76-377

The purpose of this Revenue Ruling is to update and restate, under the current statute and regulations, the position set forth in I.T. 3334, 1939-2 C.B. 180.

The question presented concerns the Federal income tax treatment of gains realized and losses sustained when an individual taxpayer who is a majority stockholder in a family corporation transfers stock in another corporation to the family corporation in partial satisfaction of the taxpayer's indebtedness to the family corporation.

In 1975, the taxpayer was president of X corporation and owned more than 50 percent of its stock, the remainder of stock being owned by members of the taxpayer's family. As of December 31, 1974, the taxpayer owed 71x dollars to X. During 1975, the taxpayer transferred to X, in partial satisfaction of the debt, shares of stock in Y corporation, a publicly held corporation, with a fair market value of 65x dollars. The transaction resulted in gain with respect to some of the shares of the stock and loss with respect to other shares. Computing the gain or loss on the sale of each block of stock separately, it was found that losses aggregated 10x dollars and gains aggregated 9x dollars; and that, considering the transfers as a whole, a net loss of 1x dollars was sustained.

Section 267(a) of the Internal Revenue Code of 1954 provides, in part, that no deduction shall be allowed in respect of losses from sales or exchanges of property (other than losses in case of distributions in corporate liquidations), directly or indirectly, between persons specified within any one of the paragraphs of subsection (b).

Subsection (b) of section 267 of the Code provides at paragraph (2) that among the persons referred to in subsection (a) is an individual and a corporation more than 50 percent in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual.

In *Morris Investment Corporation v. Commissioner*, 156 F. 2d 748 (3rd Cir. 1946), aff'g 5 T.C. 583 (1945), cert. denied, 329 U.S. 788 (1946), a corporation sold certain securities to its controlling stockholder at a lump sum and claimed a net loss on the transaction by using the losses on some of the securities to offset the gain on others. The United States Circuit Court of Appeals held that the transaction must be construed as a number of distinct sales of the various securities, and since the purchaser owned more than 50 percent of the corporation's stock, losses were not deductible. However, the corporation was held taxable on any gains from the sales.

The question has been raised whether all of the Y stock transferred to X should be considered as a unit resulting in a net loss of 1x dollars or whether each block of stock should be considered as a separate transaction and the gains and losses treated separately.

In view of the decision in *Morris Investment Corporation* and the specific provisions of section 267 of the Code to the effect that no deduction shall be allowed in respect of losses from the sales or exchanges of property between an individual and a corporation more than 50 percent in

value of the outstanding stock of which is owned by such individual, the losses sustained by the taxpayer by virtue of the transfer of stock to the corporation may not be offset against the gains derived from such transfer. To allow an offset would permit the deduction of losses specifically prohibited by statute and frustrate the legislative purpose of section 267. Thus, each block of stock transferred should be considered as a separate transaction and the gains and losses treated separately.

Accordingly, in the instant case, the aggregate gain of 9x dollars must be reported in gross income by the taxpayer. No deduction from gross income is allowed with respect to the losses of 10x dollars pursuant to section 267 of the Code.

I.T. 3334 is superseded, since the position set forth therein is restated under current law in this Revenue Ruling.

1 ¶ Prepared pursuant to Rev. Proc. 67-6, 1967-1 C.B. 576.