SUPREME COURT OF THE UNITED STATES

Commissioner v. National Alfalfa Dehydrating & Milling Co.

417 U.S. 134 (1974) · No. No. 73-9 · Decided May 28, 1974

SUMMARY

The Supreme Court held that a corporation did not incur amortizable bond discount when it issued debentures in exchange for its own outstanding preferred stock. Because the transaction merely replaced one form of previously contributed capital with another and did not involve new capital or an additional borrowing cost, the corporation could not deduct the difference between the debentures' face amount and the preferred stock's market value. The Court reversed the Tenth Circuit.

CASE DETAILS

COURT	Supreme Court of the United States
WRITING FOR THE COURT	Justice Blackmun; Chief Justice Burger; Justice Douglas; Justice Brennan; Justice Stewart; Justice White
JURISDICTION	Federal
DECIDED	May 28, 1974
DOCKET	No. 73-9
DISPOSITION	reversed
PROCEDURAL POSTURE	The Commissioner sought Supreme Court review by certiorari of a divided decision of the United States Court of Appeals for the Tenth Circuit reversing the Tax Court's decision upholding the Commissioner's disallowance of debt-discount deductions.
PRECEDENTIAL VALUE	binding Supreme Court precedent
PARTIES	Commissioner of Internal Revenue v. National Alfalfa Dehydrating & Milling Co.

TOPICS

income tax · tax deductions · corporate tax · tax · statutory interpretation

PRACTICE AREAS

federal income taxation · corporate taxation · tax deductions · corporate finance

QUESTIONS PRESENTED

1. Whether a corporate taxpayer incurs amortizable bond discount under Internal Revenue Code § 163(a) when it issues debt obligations in exchange for its own outstanding preferred stock.
2. Whether the preferred stock's market value may be used to determine a deductible debt discount in an intracorporate exchange that does not involve new capital or a market borrowing transaction.

HOLDINGS

1. A corporation does not incur amortizable bond discount when it issues its own debt obligations in exchange for its previously outstanding preferred stock, without more.
2. The tax consequences of the actual exchange cannot be determined by reconstructing a hypothetical transaction that the taxpayer could have undertaken but did not.

KEY QUOTATIONS

> *"a transaction is to be given its tax effect in accord with what actually occurred and not in accord with what might have occurred."* (417 U.S. at 148)

> *"We hold, accordingly, that NAD did not incur amortizable bond discount upon the issuance of its $50 face value 5% debentures in exchange for its outstanding $50 par cumulative preferred stock."* (417 U.S. at 155)

FACTUAL BACKGROUND

In 1957, National Alfalfa Dehydrating and Milling Co. exchanged $50 face-value, 5% sinking-fund debentures for its outstanding $50 par cumulative preferred shares. The preferred shares had an over-the-counter market value of approximately $33 per share, while the debentures were issued at face value. The corporation treated the difference between the preferred shares' market value and the debentures' face amount as amortizable debt discount and claimed deductions under § 163(a) of the Internal Revenue Code. The exchange did not bring new capital into the corporation; it replaced the preferred-stock portion of existing capital with debenture obligations.

PROCEDURAL HISTORY

The Tax Court upheld the Commissioner and denied the claimed debt-discount deductions. The Tenth Circuit reversed, concluding that the difference between the preferred stock's market value and the debentures' face amount represented deductible borrowing cost. The Supreme Court granted certiorari and reversed the Tenth Circuit.

DISPOSITION

reversed

CASES CITED

- Erie Lackawanna R. Co. v. United States, 190 Ct. Cl. 682, 422 F.2d 425 (1970)
- Missouri Pacific R. Co. v. United States, 192 Ct. Cl. 318, 427 F.2d 727 (1970), modified on rehearing, 193 Ct. Cl. 257, 433 F.2d 1324 (1970), cert. denied, 402 U.S. 944 (1971)

- American Smelting & Refining Co. v. United States, 130 F.2d 883 (3d Cir. 1942)
- Atchison, T. & S. F. R. Co. v. United States, 443 F.2d 147 (10th Cir. 1971)
- Helvering v. Union Pacific R. Co., 293 U.S. 282, 286 (1934)
- United States v. Midland-Ross Corp., 381 U.S. 54, 57, 66 (1965)
- Deputy v. Du Pont, 308 U.S. 488, 493, 498 (1940)
- New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934)
- Higgins v. Smith, 308 U.S. 473, 477 (1940)
- Old Mission Portland Cement Co. v. Helvering, 293 U.S. 289, 293 (1934)
- Gregory v. Helvering, 293 U.S. 465, 469 (1935)
- Founders General Corp. v. Hoey, 300 U.S. 268, 275 (1937)
- Television Industries, Inc. v. Commissioner, 284 F.2d 322, 325 (2d Cir. 1960)
- Interlochen Co. v. Commissioner, 232 F.2d 873, 877 (4th Cir. 1956)
- Gray v. Powell, 314 U.S. 402, 414 (1941)
- Gulf, M. & O. R. Co. v. United States, 339 F. Supp. 489 (S.D. Ala. 1972)
- Cities Service Co. v. United States, 316 F. Supp. 61 (S.D.N.Y. 1970), 362 F. Supp. 830 (S.D.N.Y. 1973)
- San Joaquin Light & Power Corp. v. McLaughlin, 65 F.2d 677, 679 (9th Cir. 1933)
- Helvering v. Southwest Consolidated Corp., 315 U.S. 194, 202 (1942)
- St. Louis-S.F. R. Co. v. United States, 195 Ct. Cl. 343, 350, 444 F.2d 1102, 1106 (1971), cert. denied, 404 U.S. 1017 (1972)
- Claussen's, Inc. v. United States, 469 F.2d 340, 344 n. 11 (5th Cir. 1972)
- John Kelley Co. v. Commissioner, 326 U.S. 521 (1946)
- Nassau Lens Co. v. Commissioner, 308 F.2d 39 (2d Cir. 1962)
- Southern Fertilizer & Chemical Co. v. Edwards, 167 F. Supp. 879, 881 (M.D. Ga. 1955)
- Southern Natural Gas Co. v. United States, 188 Ct. Cl. 302, 412 F.2d 1222, 1235-1239 (1969)
- Montana Power Co. v. United States, 141 Ct. Cl. 620, 159 F. Supp. 593 (1958), cert. denied, 358 U.S. 842 (1958)
- Montana Power Co. v. United States, 232 F.2d 541 (3d Cir. 1956) (en banc), cert. denied, 352 U.S. 843 (1956)
- Penfield v. Davis, 105 F. Supp. 292, 311 (N.D. Ala. 1952), aff'd, 205 F.2d 798 (5th Cir. 1953)