Michigan Law Review

Volume 48 | Issue 8

1950

TAXATION-INCOME TAX-CORPORATION NOT TAXABLE ON A SALE OF PROPERTY BY STOCKHOLDERS FOLLOWING GENUINE LIQUIDATION DISTRIBUTION

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TAXATION—INCOME TAX—CORPORATION NOT TAXABLE ON A SALE OF PROPERTY BY STOCKHOLDERS FOLLOWING GENUINE LIQUIDATION DISTRIBUTION—The stockholders of a closely held electric utility corporation offered to sell all the corporate stock to a cooperative competitor. The cooperative countered with an offer to buy a part of the corporation's physical assets. Hoping to avoid a heavy corporate capital gains tax, the stockholders caused the corporation to distribute to them in partial liquidation the property in question, and then executed the previously contemplated sale themselves. The commissioner assessed and collected a capital gains tax from the corporation which then sued and recovered the amount of the tax in the court of claims. On appeal, *held*, affirmed. *United States v. Cumberland Public Service Co.*, 338 U.S. 451, 70 S.Ct. 280 (1950).

The decision in the principal case limits the doctrine of the *Court Holding Co.* case,[1] and affords a basis upon which stockholders can reasonably expect to arrange a sale of corporate assets without having a gain imputed to the corporation.[2] Following the *Court Holding Co.* case, it was generally assumed that a

[1] In Court Holding Co. v. Commissioner, 324 U.S. 331, 65 S.Ct. 707 (1945), the corporation began negotiations for a sale of assets, but withdrew after realizing the sale would result in "double taxation." The corporation distributed its assets to the stockholders who then sold them in accordance with the previous plan. The Supreme Court affirmed the findings of the tax court that the stockholders were mere "agents" for the sale, and said that taxation cannot be avoided by mere "formalisms" or by using stockholders "as a conduit through which to pass title."

[2] A corporation selling its physical properties is taxed on capital gains resulting from the sale, Treas. Reg. 111, §29.22(a)-18 (1943). And the stockholders may also be subject to a tax on the distribution of the proceeds of the sale, Int. Rev. Code, 26 U.S.C.A. (1945) §115(a), 115(c). On the other hand, a distribution in kind of appreciated property as a liquidation dividend is not taxed as a realization of gain by the corporation, Treas. Reg. 111, §29.22(a)-20 (1943), but is taxed to each stockholder when the value of the property he receives exceeds his stock investment, Int. Rev. Code, 26 U.S.C.A. §115(c). Thus a "double tax" can be eliminated in many situations (if the Court Holding Co. rule can be avoided) by

corporation would be taxed if it had title to assets at the time negotiations for their sale were commenced,[3] although there seemed to be no particular unanimity between the various courts of appeals and the tax court as to which of the many possible fact situations should be controlled by the *Court Holding Co.* rule.[4] Other factors which have added to the conflicting results in this area of taxation are the difficulty of merely ascertaining the facts, the tax philosophy of particular judges and the presence of at least three theories on which the bureau can orginally proceed.[5] Certain facts present in the principal case should be emphasized because they have previously been considered as as least indications of "corporate" sales. These facts are that tax avoidance was the admitted purpose of the entire series of transactions; plans were completed and an agreement signed before any steps were taken toward liquidation; and the corporation continued in existence after the sale in order to dispose of other assets.[6] The principal case rules that "even though a primary motive" is tax avoidance, "sales of physical properties by shareholders following a genuine liquidation distribution cannot be attributed to the corporation for tax purposes."[7] But in view of the reaffirmance in the principal case of the principle that the trial court can look beyond written instruments and consider motives, intent, and conduct in determining "who" has made the sale, and that such findings if supported by evidence will not be upset,[8] it is necessarily uncertain just how much of a retreat from the *Court Holding Co.* doctrine is to be expected. It is interesting that the unanimous opinion in the principal case was written by Justice Black who also wrote the opinion in the *Court Holding Co.* case itself, and who has never before appeared particularly solicitous of taxpayers.[9] The particular problem would seem to call for specific legislation similar to section 129 of the Revenue Revision Bill which was proposed in 1948.[10]

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having the stockholders sell the assets after liquidation. It should be noted, however, that there are situations where it is advantageous tax-wise to have the corporation make the sale.

[3] Fairfield Steamship Corp. v. Comr., (C.C.A. 2d, 1946) 157 F. (2d) 321; Kaufmann v. Comr., (3d Cir. 1949) 175 F. (2d) 28. But see Howell Turpentine Co. v. Comr., (C.C.A. 5th, 1947) 162 F. (2d) 319.

[4] For a description of the many cases and for a fuller treatment of the whole problem see: Perlstein, "Corporation or Stockholders—Who Makes the Sale?" 23 TAXES 526 (1945); Perlstein, "Sale of Stock Followed by Distribution of Assets," 23 TAXES 992 (1945); Magill, "Sales of Corporate Stock or Assets," 47 COL. L. REV. 707 (1947); Ayers, "Stockholder or Corporate Sale of Assets in Liquidation as affected by Court Holding Company and Howell Turpentine," 6 INST. FED. TAX. 364 (1948); Freeland, "Recent Trends in the Court Holding Co. Principle," 7 INST. FED. TAX. 369 (1949). Decision notes include: 56 YALE L. J. 379 (1947); 1 UNIV. FLA. L. REV. 106 (1948); 98 UNIV. PA. L. REV. 262 (1949); 44 ILL. L. REV. 406 (1949); 35 VA. L. REV. 270 (1949); 22 So. CAL. L. REV. 216 (1949); 63 HARV. L. REV. 484 (1950).

[5] Freeland, "Recent Trends in the Court Holding Co. Principle," 7 INST. FED. TAX. 369 (1949) contains an excellent discussion of these theories.

[6] C.C.H. Fed. Tax Guide §8718 (1950).

[7] Principal case at 455.

[8] Principal case at 454-456.

[9] See his opinion in Comr. v. Church, 335 U.S. 632, 69 S.Ct. 332 (1949) for instance.

[10] H.R. 6712, 80th Cong., 2d sess. (1948). Had this section been adopted, taxpayers would be assured of avoiding the "double" tax by scrupulously following the provisions. H.Rep. No. 2087, 80th Cong., 2d sess. 15 (1948).