3 T.C. 203 (1944)

When a corporation dissolves and transfers assets to a trust as part of its liquidation plan, the income generated from those assets during the liquidation process is taxable to the corporation, not the trust.

Summary

First National Co. of Wichita Falls, a Texas corporation, dissolved and transferred its assets to two trusts for the benefit of its stockholders. The Commissioner of Internal Revenue determined deficiencies against both the corporation and one of the trusts (Trust No. 2), asserting that the income from the transferred assets was taxable to both. The Tax Court addressed whether it had jurisdiction over the dissolved corporation and whether the income from the assets was taxable to the corporation or the trusts. The court held it lacked jurisdiction over the corporation due to the expiration of the statutory period for winding up its affairs and ruled that the income was taxable to the dissolved corporation, not the trust, because the asset transfer was part of the liquidation plan.

Facts

The First National Co. of Wichita Falls was a Texas corporation chartered in 1927. In 1935, it reduced its capital stock and transferred assets to McGregor, McCutchen, and McGregor as trustees (Trust No. 1) for the benefit of its stockholders. In February 1938, the stockholders resolved to dissolve the company and transfer its remaining assets to First National Bank of Wichita Falls as trustee (Trust No. 2) for the stockholders' benefit. The company transferred its assets to the trusts, and the dissolution documents were filed on February 7, 1938. The trust agreement for Trust No. 2 stated its purpose was to liquidate the properties, not to engage in business.

Procedural History

The Commissioner determined deficiencies against the First National Co., Trust No. 2, and asserted transferee liability against the First National Bank. The three cases were consolidated in the Tax Court. The Commissioner conceded no transferee liability and that Trust No. 2 was not liable for excess profits taxes. The Tax Court then addressed the issues of its jurisdiction over the dissolved corporation and the taxability of the income generated by the assets transferred to the trusts.

Issue(s)

1. Whether the Tax Court has jurisdiction over a dissolved corporation when the deficiency notice was issued more than three years after dissolution, despite the Commissioner having notice of the dissolution within the three-year period.
2. Whether the income from assets transferred to a trust during a corporate liquidation is taxable to the dissolved corporation or the trust.

Holding

1. No, because under Texas law, a corporation's existence continues for only three years after dissolution to settle its affairs, and after that period, the corporation no longer exists for legal proceedings.
2. The income is taxable to the dissolved corporation because the transfer of assets to the trust was part of the plan for the corporation's dissolution and liquidation.

Court's Reasoning

Regarding jurisdiction, the court relied on Texas law, which allows a corporation to exist for three years after dissolution to wind up its affairs. Since no receiver was appointed, and the deficiency notice was issued after this three-year period, the corporation no longer existed, and the court lacked jurisdiction. The court cited *Lincoln Tank Co., 19 B.T.A. 310*. Regarding the income's taxability, the court applied Treasury Regulation 101, Article 22(a)-21, which states that when a corporation is dissolved, and its affairs are wound up by trustees, any sales of property are treated as if made by the corporation. The court emphasized that the transfer of assets to Trust No. 2 was an integral part of the corporation's dissolution plan. The court quoted *First Nat. Bank of Greeley v. United States, 86 Fed. (2d) 938* stating that the trust was carrying out the liquidation precisely as the corporation would have. The court distinguished *Merchants National Building Corporation, 45 B.T.A. 417*, because in that case, the transfer of assets occurred before the dissolution was contemplated. The court determined, based on the authorities cited and the treasury regulation, the income was not the income of the First National Bank of Wichita Falls, trustee of Trust No. 2, but was the income of the corporation in dissolution.

Practical Implications

This case clarifies that the IRS can tax income generated during the liquidation of a corporation to the corporation itself, especially when a trust is used as a vehicle for liquidation shortly before dissolution. Attorneys must carefully structure corporate liquidations, especially when using trusts, to avoid having the income taxed at the corporate level. The timing of the trust creation relative to the formal dissolution decision is critical. If the trust is clearly established as part of the dissolution plan, the IRS is more likely to treat the income as taxable to the corporation, not the trust beneficiaries. Later cases would likely distinguish this case if the trust were formed for legitimate business purposes separate from imminent dissolution or if the distribution of assets to stockholders occurred well in advance of a resolution to dissolve the corporation.