4 T.C. 401 (1944)

A corporate distribution in complete cancellation or redemption of a portion of its stock is treated as a partial liquidation under Section 115(i) of the Internal Revenue Code, resulting in short-term capital gain for the shareholder, regardless of the shareholder's holding period of the stock.

Summary

Hamilton Allport sold shares of preferred stock back to the issuing corporation, which then retired those shares. The Commissioner of Internal Revenue determined that this transaction constituted a partial liquidation under Section 115(i) of the Internal Revenue Code, resulting in the gain being taxed as a short-term capital gain. Allport argued that the gain should be taxed as a long-term capital gain because he held the shares for more than 24 months. The Tax Court upheld the Commissioner's determination, holding that the distribution was a partial liquidation regardless of the shareholder's holding period or knowledge of the corporation's intent to retire the stock.

Facts

Hamilton Allport owned 400 preferred shares of Western Light & Telephone Co. with a basis of $5,750.

The corporation's articles of incorporation authorized it to redeem or purchase its preferred shares for retirement at $27.50 per share, plus accumulated unpaid dividends.

The corporation's board of directors passed resolutions authorizing the purchase and retirement of preferred shares.

In 1940, the corporation acquired Allport's 400 shares for $10,900 and retired them, reducing the authorized preferred capital stock and filing a certificate of retirement with the secretary of state.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Allport's income tax for 1940, asserting that the gain from the sale of the stock was taxable as a short-term capital gain because it was received in partial liquidation.

Allport challenged this determination in the United States Tax Court.

Issue(s)

Whether the distribution received by Allport from the corporation for his shares constituted a distribution in partial liquidation under Section 115(i) of the Internal

Revenue Code, thereby resulting in the gain being taxed as a short-term capital gain.

Holding

Yes, because the distribution was made by the corporation in complete cancellation or redemption of a part of its stock, which falls squarely within the statutory definition of partial liquidation under Section 115(i).

Court's Reasoning

The court relied on Section 115(i) of the Internal Revenue Code, which defines amounts distributed in partial liquidation as a distribution by a corporation in complete cancellation or redemption of a part of its stock.

The court emphasized that the statutory definition is absolute and not qualified by the actual or constructive intent of either the corporation or the shareholder. The court stated, "It would not matter if the shareholder were entirely without information as to the plan or the authorization or requirement of the corporation in respect of the acquisition of such shares."

The court noted that Allport was, in fact, aware of the provision allowing the corporation to purchase and retire shares, as it was stated on the stock certificates.

The court distinguished between a distribution in liquidation of the corporation or its business and a distribution in cancellation or redemption of a part of its stock, stating that the statute applies to the latter.

The court cited several cases supporting its holding, including *Dodd v. Commissioner*, 131 F.2d 382; *Hill v. Commissioner*, 126 F.2d 570; *Alpers v. Commissioner*, 126 F.2d 58; *Cohen Trust v. Commissioner*, 121 F.2d 689; *Hammans v. Commissioner*, 121 F.2d 4; and *L.B. Coley*, 45 B.T.A. 405.

Practical Implications

This case clarifies that any distribution made by a corporation to a shareholder in exchange for the shareholder's stock is a partial liquidation under Section 115(i) if the corporation cancels or retires those shares. The length of time the shareholder has held the stock is irrelevant for tax purposes.

This decision highlights the importance of understanding the tax implications of stock redemptions, particularly when the corporation intends to retire the acquired shares.

Legal practitioners should advise clients to carefully consider the potential tax consequences of stock redemptions and to structure such transactions accordingly to minimize adverse tax implications. For example, if long-term capital gain treatment is desired, consider having the corporation hold the repurchased shares as treasury stock rather than retiring them.

This ruling has been cited in subsequent cases to support the proposition that the characterization of a distribution as a partial liquidation depends on the corporation’s actions, specifically whether the acquired shares are canceled or retired.

