4 T.C. 820 (1945)

Distributions in complete liquidation of a corporation are taxed as short-term capital gains unless made as part of a bona fide plan of liquidation completed within a specified timeframe.

Summary

The Tax Court addressed whether distributions from a corporation undergoing liquidation should be taxed as short-term or long-term capital gains. The key issue was whether a series of distributions made over several years constituted a single plan of liquidation. The court held that the distributions were part of a continuous liquidation plan that began before the tax years in question and therefore did not qualify for long-term capital gains treatment. The court also held that a subsequent tax payment by the shareholder on behalf of the corporation does not reduce the taxable amount of a prior distribution.

Facts

C.E. Mills Oil Co. sold its business assets in 1930, receiving stock in another company as payment. The company then began distributing the proceeds from the sale to its stockholders. From 1931 to 1938, the company made distributions labeled as “liquidating dividends.” In December 1938, the company adopted a resolution to completely liquidate and dissolve, with further distributions scheduled for 1939 and 1940. The Mills received distributions in 1939 and 1940. In 1942, Henry Mills, as a transferee of the corporation’s assets, paid a deficiency in the corporation’s 1938 income tax.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the Mills’ income tax for 1939 and 1940, treating the distributions as short-term capital gains. The Mills petitioned the Tax Court, arguing the distributions qualified as long-term capital gains from a complete liquidation. The Tax Court upheld the Commissioner’s determination.

Issue(s)

1. Whether the distributions received by the Mills in 1939 and 1940 were part of a new plan of “complete liquidation” initiated in December 1938, or merely a continuation of an older plan initiated after the 1930 sale of assets, thus affecting their tax treatment as either long-term or short-term capital gains.
2. Whether the amount of a liquidating distribution received in 1940 should be reduced by the amount the distributee later paid in 1942 as a transferee of the corporation’s assets, to cover the corporation’s income tax liability for 1938.

Holding

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1. No, because the distributions were part of a continuous plan of liquidation that began well before December 1938. Therefore, they do not qualify for long-term capital gains treatment under the applicable tax code.
2. No, because the distribution was received under a claim of right in 1940, and subsequent payment of the corporation's tax liability in 1942 does not retroactively alter the income tax owed on the 1940 distribution.

Court's Reasoning

The court reasoned that the distributions made prior to December 31, 1938, were part of the overall liquidation plan. The resolution of December 31, 1938, was merely the concluding part of a plan formulated much earlier. The company had sold its assets in 1930 and immediately began distributing the proceeds. The court emphasized that the corporation indicated in various ways that it was in the process of liquidation and dissolution since the 1930s. The court found that the acceleration of the final payments by Pure Oil did not create a new plan of liquidation. Regarding the second issue, the court relied on the principle established in *North American Oil Consolidated v. Burnet*, stating that "[i]f a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money…" The court noted that no claim was made against the distribution until after Mills received it. Therefore, the distribution was taxable income in 1940, irrespective of the subsequent payment.

Practical Implications

This case demonstrates the importance of clearly defining a plan of liquidation and adhering to the timeframe requirements for long-term capital gains treatment. It emphasizes that a series of distributions over an extended period may be viewed as a single, continuous plan, disqualifying the later distributions from favorable tax treatment. The case also reinforces the "claim of right" doctrine, which dictates that income received without restriction is taxable in the year received, regardless of potential future obligations. Later cases have cited *Mills* for the principle that the existence of a liquidation plan is a question of fact, requiring careful analysis of the corporation's actions and intent.

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