Cobb v. Commissioner, 13 T.C. 495 (1949)

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A distribution is considered a partial liquidation if it completely cancels or redeems part of a corporation’s stock, while a complete liquidation involves a bona fide plan to cancel or redeem all of its stock within a specified timeframe.

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Summary

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Cobb involved a dispute over whether proceeds from the sale of preferred stock back to the issuing corporation, Gremoco, should be taxed as short-term capital gains (partial liquidation) or long-term capital gains (complete liquidation). The Tax Court distinguished between 1,256 shares and 2,000 shares based on the timing of Gremoco’s decision for immediate dissolution. Amounts received for the first block of shares were deemed partial liquidation because a firm plan for complete liquidation did not exist when those shares were acquired, while the second block qualified as complete liquidation. This case illustrates the importance of a defined liquidation plan for favorable tax treatment.

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Facts

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Gremoco, facing difficulties, granted Cobb an option to sell his preferred stock back to the company. From May to October 1939, Gremoco purchased 1,256 shares, intending to eventually acquire all preferred stock and dissolve after selling off marketable securities. However, in mid-October 1939, the common stockholders decided on immediate liquidation. On November 10, 1939, Gremoco purchased the remaining 2,000 shares. The directors voted for immediate dissolution on November 20, 1939, and the corporation dissolved on November 30, 1939.

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Procedural History

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The Commissioner determined that Cobb had a short-term capital gain due to partial liquidation. Cobb challenged this, arguing the transactions were either a stock purchase by Gremoco or distributions in complete liquidation. The Tax Court reviewed the Commissioner's determination.

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Issue(s)

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1. Whether the amounts received by Cobb for the 1,256 shares of preferred stock constituted distributions in partial liquidation under Section 115(c) of the Internal Revenue Code?

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2. Whether the amounts received by Cobb for the 2,000 shares of preferred stock constituted distributions in complete liquidation under Section 115(c) of the Internal Revenue Code?

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Holding

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1. Yes, because at the time Gremoco acquired the first 1,256 shares, there was no defined plan for complete liquidation with a specified timeframe.

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2. Yes, because Gremoco decided to liquidate immediately before acquiring the final 2,000 shares, and the company dissolved shortly thereafter.

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Court's Reasoning

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The court emphasized the distinction between partial and complete liquidation, citing Section 115(i) of the Internal Revenue Code, which defines

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