Cohen v. Commissioner, 6 T.C. 200 (1946)

The tax treatment of a corporation's acquisition of its own stock depends on whether the transaction constitutes a distribution in partial liquidation (treated as a sale of stock) or a purchase of stock for resale as treasury stock (potentially taxed differently).

Summary

The petitioner, a shareholder, received payments from a corporation for her preferred stock. The central issue was whether these payments constituted a distribution in partial liquidation under Section 115(c) of the Internal Revenue Code, or a sale of stock to the corporation. If it was a partial liquidation, the full gain would be taxable. If it was a sale, only 50% of the gain would be taxable. The Tax Court held that the payments were distributions in partial liquidation because the stock was acquired for redemption, not for resale as treasury stock, emphasizing the intent behind the corporate action.

Facts

The Cohen family reorganized their company, issuing two classes of preferred stock. The first preferred stock had terms specifying a schedule for redemption. Agnes Cohen and the petitioner owned shares of this first preferred stock. The company redeemed some of the petitioner's shares. The stock certificates were marked as being acquired as "treasury stock" by the secretary-treasurer, but there was no formal resolution authorizing this designation. The key factual element was the predetermined redemption schedule attached to the first preferred stock. The agreement of 1926 guaranteed that Agnes Cohen and the beneficiaries under Robert Cohen's will would receive $252,000, the par value of his shares of old common stock. The company issued the first class of preferred stock to fulfill that requirement.

Procedural History

The Commissioner of Internal Revenue determined that the payments to the petitioner constituted a distribution in partial liquidation and assessed a deficiency. The petitioner challenged this determination in the Tax Court. The Tax Court upheld the Commissioner's determination. No further appeal information is available.

Issue(s)

1. Whether the amounts received by the petitioner from the corporation constituted a distribution in partial liquidation under Section 115(c) of the Internal Revenue Code.

Holding

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1. No, because the first preferred stock was issued with the intention that it was to be redeemed, not purchased for holding in the treasury.

Court’s Reasoning

The Tax Court reasoned that the controlling factor in determining whether a partial liquidation has occurred is the intent of the corporation in reacquiring its stock. If the stock is purchased to be canceled and retired, it is a distribution in partial liquidation. However, if the stock is purchased to be held as treasury stock for resale, it is an ordinary capital transaction. The court found that the first preferred stock was issued with the specific intention of being redeemed according to a set schedule, as evidenced by the terms on the stock certificates. "It is perfectly obvious that a decision was made when the company was reorganized to issue a special class of stock for the sole purpose of taking care of the object of the agreement of February 20, 1926, and that when that object had been fulfilled through the use of the special stock, to wit, the first preferred stock, that special stock could not be used by any new holder acquiring any shares of the first preferred stock after the periods within which the stated amounts of first preferred stock were to be redeemed." The court disregarded the secretary-treasurer’s notation that the stock was acquired as treasury stock because it was not supported by a formal resolution or the terms of the stock issuance. The Court also noted that treasury stock can be sold to the public but the first preferred stock had restrictions that would render it not able to be resold to the public. "It is inherent in the concept of treasury stock that stock which is so held in the treasury of a corporation is of a type which can be sold to the public; otherwise, treasury stock could not possibly be considered as an asset of the corporation." Because the first preferred stock could not be reissued after the original redemption schedule, it did not have the main attribute of treasury stock.

Practical Implications

This case highlights the importance of documenting the intent behind a corporation’s acquisition of its own stock. To achieve the desired tax treatment, corporations must ensure that their actions align with their stated intent. If the intent is to hold the stock as treasury stock for potential resale, corporate records should reflect this intent clearly through resolutions and other documentation. The terms of the stock itself are key. This case serves as a reminder that labels like “treasury stock” are not decisive; the substance of the transaction, including the terms of the stock and the underlying intent, will govern the tax treatment. Later cases would examine the specific facts to decide whether a stock redemption was in fact a partial liquidation, particularly in closely held corporations.

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