5 T.C. 908 (1945)

A taxpayer cannot avoid tax liability on gains from corporate liquidation by gifting stock to family members when the liquidation process is substantially complete and the gift is essentially an assignment of liquidation proceeds.

Summary

Howard Cook gifted stock in a corporation undergoing liquidation to his sons shortly before the final liquidating distribution. The Tax Court determined that Cook's intent was to gift the liquidation proceeds, not the stock itself, because the corporation's assets were already sold and the decision to liquidate was final. Therefore, the gain from the liquidation of the gifted shares was taxable to Cook, not his sons. The Court also held that the value of notes received in liquidation included accrued interest, as the interest was not proven uncollectible.

Facts

Howard Cook owned 300 shares of Midland Printing Co. In October 1941, Midland began selling its assets due to the potential loss of a major contract. By December 15, 1941, Midland had sold most of its assets and its shareholders voted to liquidate and dissolve the corporation before December 31, 1941. On December 23, 1941, Cook gifted 60 shares of Midland stock to each of his two sons. On December 29, 1941, Midland issued liquidation checks to its shareholders. Cook received cash and notes, while his sons received only cash. The sons then loaned the cash they received to Cook in exchange for unsecured notes.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Howard Cook's income tax for 1941. Cook challenged the deficiency in the United States Tax Court, contesting the taxability of the liquidation proceeds from the shares gifted to his sons and the valuation of the notes he received.

Issue(s)

1. Whether Cook made a valid gift of stock to his sons, or whether he merely assigned the proceeds of liquidation, making him liable for the tax on the gain.

2. Whether the value of the notes Cook received as part of the liquidation distribution included accrued interest.

Holding

1. No, because Cook's intent was to make a gift of the liquidation distributions, not a bona fide gift of stock, given the advanced stage of the liquidation process.

2. Yes, because Cook failed to prove that the notes or the accrued interest had a lesser value than that determined by the Commissioner.

Court's Reasoning

The Tax Court focused on the substance of the transaction over its form. Although Cook completed some formalities of gifting stock, the Court found that the gifts occurred when Midland was in the final stages of liquidation. The resolution to liquidate had already been passed, and the corporation's assets had been sold. Cook knew that the only benefit his sons would receive was the liquidation proceeds. The Court emphasized that Cook, acting as his sons' proxy, voted the gifted shares at the December 29th meeting and directed the transfer agent to issue liquidation checks directly to his sons. The Court analogized the situation to, where a taxpayer attempted to avoid tax liability by gifting property that was already under contract for sale. The Tax Court concluded that Cook gifted the proceeds of liquidation, not the stock itself. Regarding the notes, the Court found Cook's self-serving statement about their bank unacceptability insufficient to overcome the Commissioner's determination of value, especially since Cook forgave the accrued interest in exchange for the reissuance of the notes in a more marketable form.

Practical Implications

This case illustrates the "step transaction doctrine," where the IRS and courts can collapse a series of formally separate steps into a single integrated transaction to determine the true tax consequences. It serves as a warning that gifts of assets on the verge of liquidation or sale may be recharacterized as gifts of the proceeds, with adverse tax consequences to the donor. Attorneys advising clients considering such gifts must carefully analyze the timing and substance of the transfer to ensure that the client is not taxed on gains they attempted to shift to another taxpayer. Later cases applying the step transaction doctrine often cite Cook as an example of a taxpayer's failed attempt to avoid tax liability through a series of contrived transactions.

