Winkelman v. Commissioner, 6 T.C. 496 (1946)

A distribution by a corporation in exchange for its stock is considered a sale of stock, taxable as such, rather than a partial liquidation when the stock is retained as treasury stock and not canceled or redeemed.

Summary

Winkelman exchanged his stock in Michigan, along with cash, for all the stock of New York and Delaware corporations. The Tax Court addressed whether this exchange constituted a sale of capital assets or a distribution in partial liquidation. The court held it was a sale because Michigan retained Winkelman's shares as treasury stock rather than canceling or redeeming them, distinguishing it from a partial liquidation under Section 115(i) of the Internal Revenue Code. The court also determined Winkelman's cost basis for computing gain and the tax implications of payments directed to New York and Delaware under the original agreement.

Facts

Winkelman, an owner of Class B stock in Michigan, agreed with Goetz to exchange his 435 shares plus cash for all stock in New York and Delaware. Michigan never canceled Winkelman's shares but held them as treasury stock. The agreement included a provision for Winkelman to receive half of any recovery on doubtful assets, to be paid to Winkelman, New York, or Delaware at his direction. An accounting error led to Winkelman overpaying, resulting in a settlement payment from the accounting firm partially reimbursed by Michigan.

Procedural History

The Commissioner determined the transaction was a distribution in partial liquidation, making the gain fully taxable. Winkelman challenged this determination in Tax Court, arguing it was a sale of capital assets subject to a lower tax rate. The Commissioner amended the answer to adjust Winkelman's basis due to a settlement received relating to an overpayment. The Tax Court ruled in favor of Winkelman, finding the transaction was a sale, not a partial liquidation, and determined the appropriate cost basis.

Issue(s)

1. Whether the exchange of stock and cash for the stock of other corporations constituted a sale or exchange of capital assets versus a distribution in partial liquidation under Section 115(c) of the Internal Revenue Code.
2. What was the correct basis for computing Winkelman's gain on the transaction, considering the settlement received for an overpayment?
3. Whether payments made to New York and Delaware at Winkelman's direction should be included in Winkelman's income for the tax year.

Holding

1. No, the exchange was a sale because the shares were retained as treasury stock, not canceled or redeemed; therefore, it does not meet the definition of a partial liquidation under Section 115(i) of the Internal Revenue Code.
2. The correct basis is the original cost of the stock plus the actual cash paid because the settlement received was the result of a separate tort claim, not a modification of the original sales contract.
3. Yes, these payments are includable in Winkelman's income because Winkelman had the option to receive the funds directly, making them constructively received despite being directed to third parties.

Court's Reasoning

The court reasoned that Section 115(i) defines partial liquidation as a distribution in complete cancellation or redemption of stock. Since Michigan held the shares as treasury stock, there was no cancellation or redemption. The court cited *Alpers v. Commissioner*, 126 F.2d 58, highlighting the distinction between stock acquired for retirement versus holding as treasury stock. Regarding the basis, the court distinguished *Borin Corporation, 39 B.T.A. 712*, because the settlement was a separate tort claim against the accounting firm, not a modification of the original agreement with Goetz. As for the payments to New York and Delaware, the court applied the doctrine of *Helvering v. Horst, 311 U.S. 112*, stating that because Winkelman had control over where the funds were directed, he constructively received them. The court stated, "The statute applies, not to a distribution in liquidation of the corporation or its business, but to a distribution in cancellation or redemption of a part of its stock."

Practical Implications

This case clarifies the distinction between a stock sale and a partial liquidation for tax purposes. The key factor is whether the corporation cancels or redeems the stock, or holds it as treasury stock. Attorneys should carefully examine the corporation's treatment of the stock. Furthermore, it reinforces the principle of constructive receipt, impacting how payments to third parties are treated for tax purposes when the taxpayer has control over the funds' destination. It is a reminder to carefully document the nature of settlements and ensure they are treated consistently with the underlying transactions to avoid unintended tax consequences.

