***5 T.C. 1130 (1945)***

The determination of taxable income from corporate reorganizations and sales hinges on establishing the true nature of transactions (sale vs. agency) and the timing of property transfers.

**Summary**

This case concerns the tax implications for McAbee, Zimmerman, and other Hemingray Glass Co. stockholders following its merger with Owens-Illinois. The central issue is whether McAbee and Zimmerman received taxable income as compensation for services or as liquidating dividends with a zero basis when they received Owens stock. The court determined that McAbee acted as an agent for the stockholders, not a purchaser of their stock. Further issues involved the taxability of stock received in 1937 and whether payments related to a patented process should be treated as ordinary income or capital gains. The Tax Court ultimately sided with the Commissioner on most points.

**Facts**

McAbee, president of Hemingray, acquired most of Hemingray's shares, except those of Zimmerman, to facilitate a merger with Owens. The merger plan involved Owens giving 17,827 shares of Owens stock and some cash for Hemingray's assets. Hemingray was obligated to pay its debts. McAbee and Zimmerman received cash (approximately $45,000) and Owens stock. The Commissioner included the value of cash and stock in their gross incomes. The Hemingray stockholders were supposed to receive 4 shares of Owens stock for each share of Hemingray stock they owned.

**Procedural History**

The Commissioner determined deficiencies in the petitioners' income tax for the years 1935 and 1937. McAbee, Zimmerman, and other stockholders of Hemingray Glass Co. challenged these determinations in the Tax Court. The Tax Court consolidated the cases for hearing and opinion.

**Issue(s)**

1. Whether the amounts received by McAbee and Zimmerman in 1935 and 1937 were properly included in their gross incomes as compensation for services or liquidating dividends on stock with a zero basis.
2. Whether Zimmerman, Mrs. McAbee, Holmes, and the Hemingray estate trustees must include in their 1937 gross incomes the fair market value of Owens stock received in that year as liquidating dividends.
3. Whether the amount Zimmerman received in 1937 from Owens under contracts related to a glass treatment process constitutes ordinary income or capital gain.

## Holding

1. No, as to liquidating dividends; Yes, as to compensation for services, because McAbee acted as an agent for the other stockholders, and the profits he received were compensation for his services.
2. No, because the Hemingray stockholders acquired equitable title to the Owens stock in 1933 when it was placed in escrow for their benefit.
3. Yes, because the amount received was part of the sale price of property other than a capital asset.

## Court's Reasoning

The court reasoned that McAbee's letter to the stockholders indicated an agency relationship, not a sale. The letter stated that if the deal fell through, the stock would be returned. The court emphasized that McAbee acted to facilitate the merger and would receive a "substantial personal profit" for his services. The court determined the Owens stock was acquired as compensation and was taxable as income. The court emphasized that the intent of the parties, as evidenced by the written agreements, was critical. Regarding the second issue, the court found the stockholders gained equitable title to the Owens stock in 1933 when it was placed in escrow; the 1937 distribution was merely the release of the stock. For the third issue, the court determined the amount received by Zimmerman was a commutation of the specified sale price for the patent rights. "Upon execution of the contract the title to the patent rights passed to Hemingray, with the power to assign them or to grant licenses under them. Clearly this was a sale and not a licensing agreement."

## Practical Implications

This case underscores the importance of carefully documenting the intent of parties in corporate reorganizations and sales. The distinction between an agency relationship and a sale is crucial for determining tax liabilities. Specifically, it is critical to clarify who owns the stock when a transaction occurs. This case also provides guidance on how escrow arrangements impact the timing of income recognition. Parties must ensure that agreements accurately reflect the intended tax consequences. Later cases would cite this ruling for the principle that courts will look to the substance of a transaction over its form when determining tax liability and also when assessing whether payments are ordinary income or capital gains. The case stresses the necessity of demonstrating a clear intent to sell an asset for capital gains treatment.

 