3 T.C. 409 (1944)

When a corporation distributes assets to a shareholder in exchange for a portion of their stock, and the corporation remains in existence, the transaction constitutes a partial liquidation, and the gain recognized is treated as a short-term capital gain.

Summary

Goldin and the Austins were shareholders in Girard Realty Co. Following litigation, Goldin surrendered her shares for half of the company's assets while the Austins retained their shares and continued the company's operations. Goldin argued that the distribution was simply a division of assets, not a partial liquidation, and thus should not be taxed as a short-term capital gain. The Tax Court held that the transaction constituted a partial liquidation under Section 115(c) of the Internal Revenue Code, and the gain was taxable as a short-term capital gain because the company continued to exist.

Facts

Girard Realty Co. was a real estate holding company owned equally by Goldin and the Austins.
Litigation arose between Goldin and the Austins.
To settle the litigation, Goldin surrendered her shares to Girard Realty Co. in exchange for one-half of the company's assets (land and money).
The Austins retained their shares, and Girard Realty Co. continued to operate with them as the sole shareholders.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Goldin, arguing the distribution was a partial liquidation subject to short-term capital gains tax.
Goldin petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether the distribution of assets by Girard Realty Co. to Goldin in exchange for her stock constituted a partial liquidation under Section 115(c) of the Internal Revenue Code.

Holding

Yes, because the distribution was in complete cancellation or redemption of a part of the company's stock, fitting the definition of a partial liquidation under Section 115(i), and the company continued in existence after the exchange.

Court's Reasoning

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The court emphasized that Section 115(i) defines partial liquidation as "a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock."
It rejected Goldin's argument that the transaction was merely a division of assets, noting that the Austins' decision to continue the corporation refuted the idea of a complete liquidation.
The court stated, "When it came to the final draft of the settlement agreement, the Austins decided that they did not desire a complete liquidation. They desired to continue the company…but were agreeable to the petitioner surrendering her shares to the company and receiving from it all the property which would come to her in a complete liquidation."
The court found that both parties, particularly the Austins, recognized the separate entity of the corporation. The court cited Moline Properties, Inc. v. Commissioner, 319 U. S. 436, to support the view that the separate entity of a corporation is only disregarded in rare instances, which were not present here.
The court did not give retroactive effect to the amendment of section 115(c).

Practical Implications

This case clarifies that even if a distribution of assets resembles a division of property between shareholders, it will be treated as a partial liquidation if the corporation remains in existence and a portion of the stock is redeemed.
Attorneys should advise clients that settlements involving corporate assets and stock redemption may trigger short-term capital gains tax, depending on the specific circumstances and applicable tax laws.
Tax planners must carefully consider the form of corporate settlements to avoid unintended tax consequences, especially when shareholders seek to divide assets while maintaining the corporate entity.
Later cases would distinguish this case based on specific facts and changes in tax law, but the underlying principle regarding the definition of partial liquidation remains relevant.

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