6 T.C. 884 (1946)

Distributions from a corporation reorganized from a transferor corporation are not taxable dividends under the *Sansome* doctrine when the stock distribution in the reorganization was already taxed as an ordinary dividend, preventing double taxation of the same earnings.

Summary

In *Slover v. Commissioner*, the Tax Court addressed whether distributions from Fayver Realty Corporation were taxable dividends. Fayver was formed through a reorganization of S.L. Slover Corporation. Crucially, the stock distribution to Samuel Slover, the sole shareholder of S.L. Slover Corp., during the reorganization was taxed as an ordinary dividend. The Commissioner argued that Fayver inherited the earnings and profits of S.L. Slover Corp. under the *Sansome* doctrine, making subsequent distributions taxable dividends. The Tax Court disagreed, holding that since the initial stock distribution was already taxed as a dividend, applying *Sansome* would result in double taxation of the same corporate earnings, which was not the intent of the *Sansome* rule. The court determined that the distributions were a return of capital, not taxable dividends.

Facts

S.L. Slover Corporation transferred real properties to Fayver Realty Corporation in a tax-free reorganization in exchange for all of Fayver's stock.

Samuel L. Slover was the sole shareholder of S.L. Slover Corporation and received all of Fayver's stock in the reorganization.

This receipt of Fayver stock by Samuel L. Slover was treated as an ordinary taxable dividend in 1935, and taxes were paid on it.

Fayver made distributions to its shareholders (including Samuel Slover and his donees) in 1940 and 1941.

Fayver's own earnings and profits after its formation were insufficient to cover these distributions.

The Commissioner argued that Fayver inherited the earnings and profits of S.L. Slover Corporation under the *Sansome* doctrine, making Fayver's distributions taxable dividends.

Procedural History

The Commissioner determined deficiencies in the petitioners' federal income taxes for 1940 and 1941, including distributions from Fayver as taxable income.

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The petitioners contested this determination in the United States Tax Court.

Issue(s)

1. Whether distributions made by Fayver Realty Corporation to its stockholders in 1940 and 1941 were taxable dividends, or non-taxable returns of capital.
2. Whether Fayver Realty Corporation "inherited" the earnings and profits of its transferor, S.L. Slover Corporation, under the doctrine of *Commissioner v. Sansome*, despite the initial stock distribution in reorganization being taxed as a dividend.

Holding

1. No, the distributions by Fayver were not taxable dividends; they were a return of capital because Fayver's own earnings were exhausted and the *Sansome* doctrine was inapplicable in this case.
2. No, Fayver did not "inherit" the earnings and profits of S.L. Slover Corporation for the purpose of dividend taxation in this specific reorganization context because the initial stock distribution was already taxed as a dividend.

Court's Reasoning

The court reasoned that the *Sansome* doctrine, which generally holds that a successor corporation in a reorganization inherits the earnings and profits of the predecessor, should not apply in this case.

The purpose of the *Sansome* rule is to prevent the tax-free distribution of accumulated earnings. However, in this case, the distribution of Fayver stock to Slover during the reorganization was already taxed as an ordinary dividend. As the court noted, "Under the present facts no comparable possibility exists. Since the Revenue Act of 1934 distributions of stock even in reorganizations have been taxable to recipients to the full extent of their fair market value under the circumstances existing here."

The court emphasized that the earnings of the S.L. Slover Corporation had already been effectively taxed when the Fayver stock was distributed and taxed as a dividend. To apply the *Sansome* doctrine and tax the subsequent distributions from Fayver would be to tax the same earnings again.

The court cited Treasury Regulations which indicated that distributions in reorganizations where no gain was recognized do not diminish earnings and profits, implying the opposite should be true when gain *is* recognized. "The general rule provided in section 115 (b) that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, does not apply to: (1) The distribution, in pursuance of a plan of reorganization * * * if no gain to the distributees from the receipt of such stock or securities was recognized by law."

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The court concluded that because the initial stock distribution was fully taxable, it constituted a diminution of the earnings and profits of the distributing corporation, making the *Sansome* doctrine inapplicable to subsequent distributions from the newly formed corporation.

Practical Implications

Slover v. Commissioner clarifies the limits of the *Sansome* doctrine in corporate reorganizations, particularly when the initial stock distribution is taxed as a dividend. It establishes that the *Sansome* doctrine should not be applied to create double taxation of corporate earnings.

This case is important for tax practitioners advising on corporate reorganizations and dividend distributions. It highlights that the tax treatment of the initial reorganization distribution is crucial in determining the taxability of subsequent distributions from the successor corporation.

The decision suggests that when a stock distribution in a reorganization is properly taxed as a dividend, the earnings and profits of the transferor corporation, to the extent they are represented by the taxed dividend, are considered to have been effectively distributed and should not be treated as inherited earnings and profits by the transferee corporation under *Sansome* for future distribution purposes.

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