7 T.C. 1384 (1946)

A distribution is considered a complete liquidation, taxable as a long-term capital gain, when a plan for complete liquidation is adopted and executed after the fulfillment of prior contractual obligations, separate from earlier partial liquidations.

Summary

The Tax Court addressed whether distributions to Harriman in 1940 were in partial or complete liquidation of Harriman Thirty Corporation. Harriman Thirty was formed in 1930 to manage assets not desired by a merging company and had made partial liquidations in 1934, 1937, and 1939. In 1940, a key guaranty held by Harriman Fifteen Corporation was fulfilled, and Harriman Thirty immediately adopted and completed a plan for complete liquidation. The court held the 1940 distribution was a complete liquidation, taxable as a long-term capital gain, because it occurred after the fulfillment of the guaranty, marking a distinct event from the prior partial liquidations.

Facts

W.A. Harriman & Co. (Harriman, Inc.) reorganized in 1930, transferring certain assets to Harriman Fifteen Corporation in exchange for stock. Harriman Fifteen guaranteed certain collections and indemnified Harriman, Inc., against losses. Later, Harriman, Inc. transferred other assets, including its rights under the Harriman Fifteen guaranty, to Harriman Thirty Corporation. Harriman Thirty made distributions in partial liquidation in 1934, 1937, and 1939. In 1940, Harriman Fifteen fulfilled its guaranty obligations, and Harriman Thirty adopted a plan of complete liquidation, distributing its remaining assets to shareholders.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Harriman’s 1940 income tax, arguing the distributions were in partial liquidation. Harriman contested this determination in the Tax Court.

Issue(s)

1. Whether the distributions made to the petitioner in 1940 by the Harriman Thirty Corporation were distributions in complete liquidation or distributions in partial liquidation of that corporation under Section 115 of the Internal Revenue Code?

Holding

1. Yes, the distributions made to the petitioner in 1940 were distributions in complete liquidation because a definite plan for complete liquidation was formed and executed only after Harriman Fifteen fulfilled its contractual

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obligations in 1940, distinct from earlier partial liquidations.

Court’s Reasoning

The court reasoned that the key issue was whether the 1940 distribution was part of a series of distributions in complete cancellation of Harriman Thirty’s stock. The court distinguished this case from *Estate of Henry E. Mills*, 4 T.C. 820, where distributions were made according to an original plan. Here, Harriman Thirty could not formulate a plan for complete liquidation until Harriman Fifteen fulfilled its guaranty. The court emphasized that the “*plan* of liquidation was created at that time and the distribution made to the petitioner in 1940 was made pursuant to *that* plan.” The court also noted that there was no evidence suggesting the actions taken were controlled by a single person or group to defeat taxes, and there were cogent business reasons for the various phases of liquidation. Drawing a parallel to *Williams Cochran*, 4 T.C. 942, the court stated the plan to liquidate cannot be given retroactive effect. Therefore, the 1940 distribution, made in conformity with the resolution, was a complete liquidation taxable as a long-term capital gain under Section 115(c).

Practical Implications

This case provides a framework for distinguishing between partial and complete liquidations for tax purposes. The critical factor is the existence of a concrete plan for complete liquidation. A “floating intention” to liquidate eventually is not sufficient. Attorneys and tax advisors should carefully document the timing and circumstances surrounding the adoption of a complete liquidation plan. The case also emphasizes the importance of considering whether prior distributions were part of a pre-existing plan for complete liquidation or separate, independent actions. This ruling impacts how corporations structure liquidations to optimize tax consequences for shareholders. Later cases cite this case to reinforce the principle that a plan of complete liquidation must be definite and cannot be retroactively applied to prior distributions.

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