9 T.C. 115 (1947)

Unrealized appreciation in the value of stock held by a corporation, and later distributed as a dividend, does not increase the corporation's earnings and profits for the purpose of determining the taxable amount of dividends received by shareholders.

Summary

Bradley Mining Co. distributed stock it owned in Bunker Hill to its shareholders. The fair market value of the Bunker Hill stock exceeded Bradley Mining's adjusted cost basis. The Commissioner argued that the unrealized appreciation in the Bunker Hill stock increased Bradley Mining's earnings and profits, thereby increasing the amount of the distribution taxable as a dividend to Bradley's shareholders. The Tax Court disagreed, holding that the unrealized appreciation did not constitute earnings and profits to the distributing corporation and, therefore, was not taxable as a dividend to the shareholders to the extent of the increase.

Facts

Jane Easton Bradley owned 4,209 shares of Bradley Mining Co. (Mining) stock. In 1941, Mining distributed cash and shares of Bunker Hill & Sullivan Mining & Concentrating Co. (Bunker Hill) stock to its shareholders. Mining had acquired the Bunker Hill stock prior to 1941, and at the time of acquisition, Mining had sufficient earnings and profits to cover the cost of the Bunker Hill shares. The fair market value of the Bunker Hill stock at the time of distribution exceeded Mining's adjusted cost basis.

Procedural History

The Commissioner determined a deficiency in Bradley's income tax liability, arguing that the distribution of Bunker Hill stock should be taxed based on its fair market value, including the appreciated value over Mining's cost basis. Bradley contested this determination in the Tax Court. The Tax Court found that the Commissioner's determination was erroneous, leading to an overpayment by the petitioner.

Issue(s)

Whether, when a corporation distributes property to its stockholders, the earnings and profits of the distributing corporation increase by the difference between the value and cost of the property distributed, for the purpose of determining the portion of the distribution taxable to the stockholders as dividends under Section 115 of the Internal Revenue Code.

Holding

No, because a mere increase in the value of property is not income until realized; it

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is nothing more than an unrealized increase in value.

Court's Reasoning

The Tax Court relied on precedent, including *Estate of H.H. Timken*, which held that the increase in value of distributed stock does not constitute taxable income to the stockholders of the distributing corporation. The court quoted the Sixth Circuit's opinion in *Timken*, stating, "But the difficulty with the proposition is, that a mere advance in the value of the property is not income. It is nothing more than an unrealized increase in value." The Tax Court also noted that earnings and profits available for dividends do not consist of particular and specific assets. Even if the shares had been acquired out of earnings and profits, the distribution of shares would not automatically be a dividend unless the distributing corporation had earnings or profits at the time of distribution out of which to make the distribution. The court distinguished cases cited by the Commissioner, such as *Binzel v. Commissioner* and *Commissioner v. Wakefield*, finding them either factually distinguishable or superseded by later precedent.

Practical Implications

This case clarifies that unrealized appreciation in the value of property held by a corporation does not increase the corporation's earnings and profits until the appreciation is realized through a sale or exchange. This is important for determining the taxability of distributions to shareholders. When a corporation distributes appreciated property as a dividend, the shareholders are taxed only to the extent of the corporation's accumulated earnings and profits, without including the unrealized appreciation in the calculation. This ruling impacts how corporations structure distributions to shareholders and how shareholders report dividend income. Later cases follow this principle, ensuring that unrealized gains are not prematurely taxed as dividends.

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