9 T.C. 247 (1947)

A corporation that distributes appreciated property as a dividend to its sole shareholder is not taxable on the subsequent gain realized by the shareholder from the sale of that property, provided the distribution is a genuine dividend and the corporation did not, in substance, make the sale.

Summary

Transport, Trading & Terminal Corporation (petitioner) declared a dividend in kind to its sole shareholder, American-Hawaiian Steamship Co., consisting of shares of Pacific-Atlantic Steamship Co. American-Hawaiian subsequently sold these shares. The Commissioner of Internal Revenue argued that the gain from the sale should be taxed to the petitioner. The Tax Court held that the gain was not taxable to the petitioner because the dividend was genuine, unconditional, and the petitioner did not, in substance, make the sale. The court emphasized that the negotiations for the sale of stock occurred after the dividend distribution.

Facts

Petitioner was a wholly-owned subsidiary of American-Hawaiian. In 1940, petitioner owned 10,000 shares of Pacific-Atlantic. Pacific-Atlantic was considering selling its remaining ships. Charles Dant, a major stockholder in Pacific-Atlantic, assured other stockholders that they would not suffer a loss if the ships were not sold. On October 21, 1940, petitioner declared a dividend in kind of its Pacific-Atlantic shares to American-Hawaiian. Later, American-Hawaiian sold the shares to States Steamship Co., controlled by Dant. The Commissioner sought to tax the gain from this sale to petitioner.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the petitioner’s income tax, declared value excess profits tax, and excess profits tax for the year 1940. The petitioner contested this determination in the United States Tax Court.

Issue(s)

Whether the gain realized upon the sale of shares of Pacific-Atlantic by American-Hawaiian, the sole stockholder of petitioner, can be attributed to petitioner, which had previously distributed such shares as a dividend in kind?

Holding

No, because the dividend was genuine, unconditional and final, and the petitioner did not, in substance, make the sale.

Court’s Reasoning

The court rejected the Commissioner’s arguments that the transfer lacked a business purpose and was solely for tax savings. The court reasoned that the declaration of a dividend is a legitimate corporate action, and if the transfer is unconditional and final, it is effective as such. The court distinguished the case from cases where the corporation had already negotiated a sale before distributing the property. The court found that the negotiations for the sale of stock occurred *after* the dividend distribution and that the purchase was made by States Steamship Co., an entity not controlled by petitioner or its parent. The court followed the precedent set in *General Utilities & Operating Co. v. Helvering*, stating that “The *General Utilities* case has been repeatedly followed… We do so here.”

Practical Implications

This case illustrates the importance of the timing of dividend distributions in relation to sales negotiations. A corporation can distribute appreciated property as a dividend without being taxed on the subsequent gain if the sale is genuinely negotiated and executed by the shareholder after the distribution. This ruling clarifies that a valid dividend in kind shields the distributing corporation from tax liability on the shareholder’s later sale, provided the corporation does not effectively orchestrate the sale itself. This case remains relevant in structuring corporate distributions to minimize tax burdens, emphasizing the need for a clear separation between the corporation’s distribution and the shareholder’s subsequent transaction.

