Transport, Trading & Terminal Corp. v. Commissioner, 9 T.C. 247 (1947)

A corporation that distributes appreciated property as a dividend in kind to its sole stockholder does not realize taxable gain when the stockholder subsequently sells the property, provided the dividend declaration and transfer are genuine, unconditional, and final, and the sale is not, in substance, a sale by the corporation.

Summary

Transport, Trading & Terminal Corp. (petitioner) distributed shares of Pacific-Atlantic stock to its sole stockholder, American-Hawaiian, as a dividend in kind. American-Hawaiian subsequently sold those shares. The Commissioner argued that the gain from the sale should be taxable to the petitioner because the distribution lacked a business purpose, the sale was effectively by the petitioner, and the appreciation in value was taxable to the petitioner regardless. The Tax Court disagreed, holding that the dividend was a genuine distribution, the subsequent sale was not pre-arranged by the petitioner, and the petitioner did not realize taxable gain on the appreciation of the distributed stock.

Facts

Pacific-Atlantic's principal stockholders wanted to sell their interests. The petitioner, Transport, Trading & Terminal Corp., had already sold nine ships. In June 1940, a meeting was called to discuss an offer from the British Ministry of Shipping to purchase the four remaining ships. Dant, a stockholder, assured the others against any loss if the ships were not sold. No plan was agreed upon regarding Pacific-Atlantic at this meeting, and no stockholder, including the petitioner, agreed to sell their shares. On October 21, 1940, the petitioner declared a dividend in kind of Pacific-Atlantic shares to its sole stockholder, American-Hawaiian. Later, on October 31, a meeting was held where Dant's attorney suggested Dant purchase the remaining four ships, which was rejected. A subsequent meeting in San Francisco on November 11 resulted in Dant offering $60 per share for the Pacific-Atlantic stock, provided the stockholders adjusted the price for potential tax liabilities. This offer was accepted, and States Steamship Co. (not controlled by the petitioner or American-Hawaiian) purchased the shares. The petitioner knew that if Pacific-Atlantic were liquidated or its shares purchased, it would have a large taxable gain.

Procedural History

The Commissioner determined a deficiency in the petitioner's tax return, arguing the gain from the sale of Pacific-Atlantic stock was taxable to the petitioner. The petitioner challenged this determination in the Tax Court.

Issue(s)

Whether the gain realized upon the sale of the Pacific-Atlantic stock by American-Hawaiian, the sole stockholder of the petitioner, can be attributed to the petitioner,

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which had previously distributed such shares as a dividend in kind.

Holding

No, because the declaration of a dividend was genuine, the transfer was unconditional and final, and the subsequent sale was not, in substance, a sale by the petitioner.

Court's Reasoning

The court rejected the Commissioner's arguments that the transfer lacked a business purpose and was solely for tax savings, that the sale was effectively a sale by the petitioner, and that the appreciation in value was taxable to the petitioner. The court distinguished cases where the business purpose test was applied, noting that the test is often used in reorganization cases but is not always controlling. The court emphasized that if the dividend declaration is genuine and the transfer is unconditional and final, it is effective. The court found no evidence that the transaction was unreal or a sham. Regarding the argument that the sale was effectively by the petitioner, the court found that negotiations for the sale were not started by the petitioner prior to the distribution. The offer to purchase the stock came after the dividend was declared and the petitioner no longer owned the shares. The court relied on *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935), which held that a corporation does not realize taxable gain when it distributes appreciated property as a dividend.

Practical Implications

This case clarifies that a corporation can distribute appreciated property as a dividend without recognizing gain, as long as the distribution is a genuine dividend and the subsequent sale of the property is not prearranged or, in substance, a sale by the corporation. The decision reinforces the importance of distinguishing between a genuine dividend distribution and a disguised sale. Attorneys advising corporations considering a dividend in kind should carefully document the separation between the dividend declaration and any subsequent sale negotiations to avoid the IRS arguing that the substance of the transaction was a sale by the corporation. This case is important for understanding the limits of the *General Utilities* doctrine, which has since been limited by statute, but the principles regarding the genuineness of dividend distributions remain relevant. Later cases distinguish this ruling by focusing on whether the corporation actively participated in arranging the subsequent sale by the shareholder.

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