## *Dean v. Commissioner, 9 T.C. 256 (1947)*

A distribution in kind of appreciated property by a corporation to its shareholders is taxable as a dividend only to the extent of the corporation's accumulated earnings and profits, without including the unrealized appreciation in the value of the distributed assets.

### Summary

The Tax Court addressed whether a corporation's distribution of appreciated securities to shareholders constituted a taxable dividend to the extent of the securities' appreciated value, or only to the extent of the corporation's accumulated earnings and profits. The court held that the distribution was taxable only to the extent of the corporation's earnings and profits. It also addressed the taxability of the rental value of a residence provided to a shareholder and expenses related to "hunter horses." The court found the residential benefit was taxable as compensation and disallowed adding horse-related expenses to the shareholders' incomes.

### Facts

Nemours Corporation distributed securities to its shareholders, the Deans, which had appreciated in value. The Commissioner argued the appreciated value should be included in calculating the corporation's earnings and profits for determining the taxable dividend amount. Additionally, Nemours provided a residence to J. Simpson Dean, and the Commissioner sought to tax the rental value as income to the shareholders. Nemours also incurred expenses related to "hunter horses," which the Commissioner sought to attribute as income to the Deans.

### Procedural History

The Commissioner determined deficiencies in the petitioners' income tax returns, arguing that the distribution of appreciated securities, the residential benefit, and horse-related expenses were taxable income. The Deans petitioned the Tax Court for a redetermination of these deficiencies.

### Issue(s)

1. Whether the distribution in kind of appreciated securities by Nemours to its shareholders resulted in a taxable dividend to the extent of the securities' appreciated value, in addition to the corporation's accumulated earnings and profits.
2. Whether the rental value of the residence provided to J. Simpson Dean should be taxed as income to the shareholders.
3. Whether the expenses incurred by Nemours in connection with raising and maintaining "hunter horses" should be added to the respective petitioners' incomes.

 

## Holding

1. No, because a distribution in kind is taxable as a dividend only to the extent of the corporation's accumulated earnings and profits, determined without including any increment in the value of the distributed assets.
2. Yes, but only to J. Simpson Dean as additional compensation because he rendered services to Nemours, and only to the extent the rental value exceeds amounts paid by Nemours to maintain the residence.
3. No, because Paulina duPont Dean made no use of the horses, and J. Simpson Dean's use was incidental to the main purpose of maintaining the horses for the benefit of Nemours.

## Court's Reasoning

The court reasoned that to constitute a dividend there must be a distribution of earnings and profits. Referencing prior case law such as *Estate of H.H. Timken*, the court stated that a distribution in kind of stock which had appreciated in value did not result in taxable income to the corporation. The court rejected the Commissioner's argument that the Gary Theatre Co. realized an additional profit from the distribution of stock, stating, "The transaction itself did not give rise to any earnings or profits on the part of Gary Theatre Co."

Regarding the residential benefit, the court distinguished between the shareholders, noting that J. Simpson Dean rendered services to Nemours, thus the benefit was taxable to him as compensation. Referring to *Chandler v. Commissioner*, the court determined the rental value of the residence should be treated as additional compensation to J. Simpson Dean but allowed a deduction for expenditures made by Nemours toward maintaining the property.

Finally, regarding the horse-related expenses, the court found that Paulina duPont Dean did not use the horses at all, and J. Simpson Dean's use was merely incidental to the main purpose of training and developing the horses for Nemours' benefit. The court concluded the expenses should not be attributed to the shareholders' incomes.

## Practical Implications

This case clarifies that when a corporation distributes property in kind, the taxable dividend is limited to the corporation's accumulated earnings and profits, preventing taxation on unrealized appreciation. It also highlights the importance of distinguishing between shareholders when determining the taxability of benefits, particularly whether the benefit is related to services provided. The case provides a precedent for analyzing whether expenses incurred by a corporation should be attributed as income to shareholders based on their personal use or benefit. This informs tax planning and litigation strategies related to corporate distributions and shareholder benefits, particularly in closely held corporations. Subsequent cases have cited *Dean* to support the principle that economic benefits conferred on shareholders can be treated as constructive dividends or compensation, depending on the nature of the benefit and the shareholder’s relationship with the corporation.

 