9 T.C. 364 (1947)

When a corporation liquidates and distributes assets of indeterminable value to its shareholders, subsequent collections on those assets are treated as capital gains, not ordinary income, provided no further services are required from the shareholder to realize that income.

Summary

Oil Trading Co., an oil brokerage firm, dissolved and distributed its assets, including brokerage commission contracts with unascertainable fair market value, to its sole shareholder, Susan Carter. Carter collected on these contracts in the following year. The Tax Court addressed whether these collections constituted ordinary income or capital gains and whether the Commissioner properly allocated certain amounts to the corporation's income for the prior year. The court held that the collections, except for amounts already earned by the corporation, were capital gains because they arose from the liquidation, a capital transaction, and no further services were required of Carter.

Facts

Oil Trading Co., an oil brokerage business, dissolved on December 31, 1942, and distributed its assets to its sole shareholder, Susan J. Carter. Among the assets were 32 brokerage commission contracts with no ascertainable fair market value. These contracts entitled the corporation to commissions on oil sales it had brokered. The contracts generally required no further services from the corporation after the initial brokerage. Susan Carter's basis in her stock was $1,000. In 1943, Carter collected $43,640.24 on these contracts and paid $5,018.60 in corporate debts.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Susan Carter's 1943 income tax, treating collections on the brokerage contracts as ordinary income rather than capital gains. The Commissioner also assessed a deficiency against Oil Trading Co. for its 1942 income, allocating a portion of the 1943 collections to the corporation's 1942 income. The cases were consolidated in the Tax Court.

Issue(s)

1. Whether amounts received in 1943 by Susan J. Carter under commission contracts distributed to her in the liquidation of Oil Trading Co. constitute ordinary income or capital gain?

2. Whether certain amounts received by Carter in 1943 were properly included by the Commissioner in the gross income of Oil Trading Co. in 1942, under Section 41 of the Internal Revenue Code?

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Holding

1. No, because the collections arose from the liquidation, a capital transaction, and generally no further services were required of Carter to earn the commissions. The subsequent payments are treated as part of the purchase price for the stock.

2. Yes, because $8,648.04 of the collections represented income fully earned by the corporation in 1942, and the Commissioner properly allocated it to the corporation's income to clearly reflect its earnings under Section 41.

Court's Reasoning

Regarding the capital gain issue, the court relied heavily on *Burnet v. Logan*, which held that when a sale involves consideration with no ascertainable fair market value, taxation is deferred until payments are received. The Tax Court reasoned that the corporate liquidation was an exchange of stock for assets (including the commission contracts). Since these contracts had no ascertainable fair market value at the time of distribution, the later collections should be treated as capital gains under Section 115(c) of the Internal Revenue Code.

The Court distinguished between contracts requiring further services (which would generate ordinary income) and those that did not. Because the brokerage contracts generally required no substantial future services, the payments were considered part of the purchase price for the stock. The court stated, "The corporation, a broker, was paid in every realistic sense for the usual function of a broker — bringing seller and purchaser into agreement."

As for the allocation of $8,648.04 to the corporation's 1942 income, the court cited Section 41 of the Internal Revenue Code, which allows the Commissioner to compute income in a way that clearly reflects it. Because the corporation had fully earned this income before dissolution (i.e., the brokerage services were complete, and the bills had been sent), it was proper to allocate the income to the corporation, despite its cash basis accounting.

Practical Implications

Carter v. Commissioner provides guidance on the tax treatment of assets distributed during corporate liquidations. It clarifies that collections on assets with unascertainable fair market value are generally taxed as capital gains when no further services are required. This ruling impacts how liquidating distributions are structured and how shareholders report income received post-liquidation. This case highlights the importance of assessing whether future services are required to realize income from distributed assets. It also reinforces the Commissioner's authority under Section 41 to allocate income to clearly reflect a taxpayer's earnings, even for cash-basis taxpayers. Later cases have cited *Carter* for the principle that the tax character of income from the sale of property is determined at

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the time of the sale, and subsequent events do not change that character.

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