9 T.C. 556 (1947)

A distribution qualifies as a complete liquidation, taxable as a capital gain, only if made pursuant to a bona fide plan of liquidation with specific time limits, formally adopted by the corporation.

Summary

The taxpayers, shareholders of Inland Bond & Share Co., sought to treat distributions received in 1941 and 1942 as part of a complete liquidation to take advantage of capital gains tax rates. The Tax Court held that the 1941 distributions did not qualify as part of a complete liquidation because Inland had not formally adopted a bona fide plan of liquidation at that time. The absence of formal corporate action and documentation, such as IRS Form 966, until 1942, indicated that the 1941 distributions were taxable as distributions in partial liquidation, leading to a higher tax liability for the shareholders.

Facts

Clyde and Joseph Porter were shareholders in Inland Bond & Share Co., a personal holding company. In 1941, Inland made two distributions to its shareholders in exchange for a portion of their stock, reducing the outstanding shares. Corporate resolutions were passed to amend the certificate of incorporation to reduce the amount of capital stock. On June 27, 1941, a liquidating dividend was paid to stockholders. A similar distribution occurred in September 1941. In April 1942, the directors resolved to liquidate and dissolve the company, distributing remaining assets to the stockholders. IRS Form 966 was filed in June 1942.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the taxpayers' income tax for 1941, arguing that the distributions were taxable in full as short-term capital gains because they were distributions in partial liquidation and no bona fide plan of liquidation existed in 1941. The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether the distributions made to the petitioners by Inland in 1941 were distributions in partial liquidation or were part of a series of distributions in complete liquidation of the corporation pursuant to a bona fide plan of liquidation.

Holding

No, because the distributions made in 1941 were not made pursuant to a bona fide plan of liquidation adopted by the corporation at that time. The court found no formal corporate action or documentation to support the existence of a liquidation

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plan until 1942.

Court’s Reasoning

The court emphasized that to qualify as a complete liquidation under Section 115(c) of the Internal Revenue Code, the distributions must be made “in accordance with a bona fide plan of liquidation.” The court found no evidence of such a plan in 1941. The absence of formal corporate resolutions indicating a plan of dissolution or complete liquidation, the failure to file Form 966 in 1941, and the explicit reference to “a final liquidation and distribution” in the 1942 resolutions all pointed to the absence of a plan in 1941. The court stated, “The case is to be decided by what was actually done by the corporation, not by the unconvincing or nebulous intention of some of the interested stockholders.” Testimony by the taxpayers about their intent was insufficient to overcome the lack of formal documentation. The court concluded that the deficiencies in the formal record were “so pronounced and so vital that we are compelled to the conclusion that the statute has not been complied with.”

Practical Implications

This case highlights the importance of formal documentation and corporate action in establishing a valid plan of liquidation for tax purposes. Taxpayers seeking to treat distributions as part of a complete liquidation must ensure that the corporation formally adopts a plan of liquidation, documents that plan in its corporate records, and complies with all relevant IRS requirements, including timely filing Form 966. The absence of such formalities can result in distributions being treated as partial liquidations, leading to adverse tax consequences. Later cases cite Porter for its emphasis on objective evidence of a liquidation plan over subjective intent. This case serves as a cautionary tale for tax planners, emphasizing the need for meticulous adherence to procedural requirements to achieve desired tax outcomes in corporate liquidations.

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