11 T.C. 365 (1948)

A subsidiary corporation's purchase of its parent corporation's stock is not considered a redemption of "its stock" under Section 115(g) of the Internal Revenue Code, and thus does not automatically result in a taxable dividend to the parent's shareholders.

Summary

The Wanamaker Trustees case addresses whether a subsidiary's purchase of its parent's stock should be treated as a taxable dividend to the parent's shareholders under Section 115(g) of the Internal Revenue Code. The trustees of the Wanamaker estate sold stock in John Wanamaker Philadelphia (parent) to John Wanamaker New York (subsidiary). The Tax Court held that the subsidiary's purchase was not a redemption of "its stock," therefore Section 115(g) did not apply, and the sale proceeds were not taxable dividends. Additionally, the court addressed the deductibility of state inheritance taxes paid by the trustees on behalf of the beneficiaries, finding them deductible.

Facts

Rodman Wanamaker's will established a trust holding all common stock of John Wanamaker Philadelphia. The trustees were directed to distribute income from the stock. To meet obligations, the trustees sold shares of John Wanamaker Philadelphia stock to its wholly-owned subsidiary, John Wanamaker New York. The IRS argued that this transaction was essentially a dividend to the trust beneficiaries, taxable under Section 115(g) of the Internal Revenue Code. An agreement existed between the trustees and beneficiaries dictating how income was to be applied towards state inheritance taxes previously paid by the trustees.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies against the Wanamaker Trustees, arguing that the proceeds from the stock sales were taxable dividends. The Trustees petitioned the Tax Court for a redetermination of these deficiencies. The Tax Court reversed the Commissioner's determination, finding that Section 115(g) did not apply to the stock sale and allowing a deduction for the state inheritance taxes paid.

Issue(s)

1. Whether the sale of stock by the Wanamaker Trustees to John Wanamaker New York, a wholly-owned subsidiary of John Wanamaker Philadelphia, constitutes a redemption of stock under Section 115(g) of the Internal Revenue Code, resulting in a taxable dividend.
2. Whether the income applied by the trustees, pursuant to an agreement with the beneficiaries, to the payment of state inheritance taxes previously paid by

the trustees, entitles the trustees to a deduction from gross income under Section 162(b) of the Internal Revenue Code.

Holding

1. No, because the subsidiary corporation did not cancel or redeem “its stock” when it purchased the stock of its parent corporation. Section 115(g) applies only when a corporation redeems its own stock.
2. Yes, because the income was used to satisfy an obligation of the beneficiaries, thus it is considered distributed to them and deductible by the trust.

Court’s Reasoning

The Tax Court relied heavily on *Mead Corporation v. Commissioner*, which held that the term “its shareholders” in a related tax statute did not include shareholders of a parent corporation when applied to a subsidiary. Applying this logic, the court reasoned that Section 115(g) only applies when a corporation cancels or redeems its own stock. Since John Wanamaker New York purchased stock in its parent company, it was not dealing with “its stock.” The court stated, “To say that the term ‘its shareholders’ means not only the corporation’s actual shareholders but also the shareholders of its shareholders would be to add to the statute something that is not there and to give it an effect which its plain words do not compel.”

Regarding the state inheritance tax deduction, the court found that the agreement between the trustees and beneficiaries created a clear obligation for the beneficiaries to repay the taxes. Under Pennsylvania law, the inheritance tax obligation rested with the beneficiaries. The court concluded that the amounts withheld by the trustees were effectively paid to the beneficiaries and then returned to the trustees to satisfy the tax obligation. This deemed distribution satisfied the requirements for a deduction under Section 162(b).

Practical Implications

This case clarifies the scope of Section 115(g) and its application to transactions between parent and subsidiary corporations. It establishes that a subsidiary’s purchase of its parent’s stock is not a redemption under Section 115(g), protecting shareholders from unexpected dividend tax treatment in such scenarios. The decision underscores the importance of adhering to the literal language of tax statutes. It also highlights the significance of state law in determining the tax consequences of trust distributions, particularly concerning obligations of beneficiaries. The case provides a precedent for distinguishing transactions based on the specific entity whose stock is being redeemed or canceled.

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