Imler v. Commissioner, 11 T.C. 836 (1948)

A stock redemption resulting from a genuine contraction of business operations is considered a partial liquidation, taxable as a capital gain, rather than a dividend distribution, taxable as ordinary income.

Summary

Imler Supply Co. redeemed a portion of its stock after a fire significantly reduced its business operations. The Tax Court had to determine whether this redemption was essentially equivalent to a dividend, taxable as ordinary income, or a partial liquidation, taxable at the lower capital gains rate. The court held that because the redemption resulted from a genuine contraction of the company's business due to unforeseen circumstances (the fire and resulting business changes), it qualified as a partial liquidation under Section 115(c) of the Internal Revenue Code, and was not equivalent to a dividend under Section 115(g).

Facts

Imler Supply Co.'s principal building was damaged by fire in 1941. Due to wartime shortages and high costs, the company decided to reduce the building from seven to five stories. This reduction made it impossible to continue retinning and soldering operations, which were already unprofitable due to war conditions and material shortages. Consequently, the company discontinued these operations, leading to a reduction in the capital needed for its remaining business activities. As a result, Imler used insurance proceeds to redeem a portion of its outstanding stock.

Procedural History

The Commissioner of Internal Revenue determined that the stock redemption was essentially equivalent to a dividend and assessed a deficiency. Imler Supply Co. petitioned the Tax Court for a redetermination. The Tax Court reviewed the case and rendered a decision in favor of the petitioner, Imler.

Issue(s)

Whether the acquisition and cancellation by Imler Supply Co. of certain shares of its capital stock in 1942 was made at such time and in such manner as to be essentially equivalent to a distribution of a taxable dividend under section 115 (g) of the Internal Revenue Code, or whether the transaction constituted a partial liquidation under section 115 (c).

Holding

No, the redemption was not essentially equivalent to a taxable dividend because the transaction constituted a partial liquidation under Section 115(c) due to a bona fide contraction of the company's business operations.

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Court’s Reasoning

The court reasoned that the redemption was a consequence of a genuine contraction of the company’s business, triggered by the fire and subsequent decision to downsize the building. This reduction in operations led to a decrease in the capital needed to run the business. The court emphasized the presence of a

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