11 T.C. 914 (1948)

r
r

When a corporation liquidates, distributions to a stockholder who is also a creditor are applied to debt repayment before being considered a distribution in exchange for stock, especially if the corporation is insolvent.

r
r

Summary

r

D.J. Jorden, manager of Bemidji Wood Products Co. (Bemidji), purchased Bemidji's note and stock from Ogden Corp. Later, upon Bemidji's liquidation, Jorden received assets. The IRS argued the note and stock were income in 1941, and the liquidation proceeds were ordinary income in 1942. Jorden claimed the liquidation was a capital gain. The Tax Court held the 1941 transfer wasn't income. However, the 1942 distribution was payment on the note (ordinary income), not a stock liquidation (capital gain), because Bemidji was insolvent, prioritizing creditor claims. The court also addressed Bemidji's net operating loss carry-overs and interest deductions.

r
r

Facts

r

Utilities Power & Light Corporation owned Bemidji's stock and held a $621,000 note. D.J. Jorden managed Bemidji. Ogden Corporation acquired the note and stock. On October 15, 1940, Ogden, Bemidji, and Jorden contracted for Jorden to purchase the note and stock for $145,500, paid by Bemidji. Bemidji mortgaged its inventory to secure bank loans to make payments. In July 1941, Ogden transferred the note and stock to Jorden. In December 1942, Bemidji liquidated. Jorden, as trustee, received $152,515.51 in assets after paying other debts. Bemidji's books showed the distribution as payment on the note. Bemidji was insolvent throughout this period.

r
r

Procedural History

r

© 2025 SCOTUSreports.com. All rights reserved.

The IRS assessed deficiencies against Jorden for 1941 (claiming receipt of the note and stock was income) and 1943 (based on 1942 income, claiming the liquidation proceeds were ordinary income, not capital gains). The IRS also assessed deficiencies against Jorden as fiduciary for Bemidji for 1941 and 1942. Jorden petitioned the Tax Court for redetermination.

r
r

Issue(s)

r

1. Whether the receipt of Bemidji's note and stock by Jorden in 1941 constituted ordinary income.

r

2. Whether the assets received by Jorden upon Bemidji's liquidation in 1942 were taxable as a long-term capital gain (payment for stock) or as ordinary income (payment on the note).

r

3. Whether Bemidji could include certain net operating losses in its carry-overs for 1941 and 1942, and whether interest accrued but not paid in 1941 was deductible.

r
r

Holding

r

1. No, because the transfer of the note and stock was a purchase by Jorden, not compensation for services.

r

2. Ordinary income, because the distribution was a payment on Bemidji's debt to Jorden, not a distribution in exchange for stock, given Bemidji's insolvency and the priority of creditors' claims.

r

3. The court allowed some net operating loss carry-overs but disallowed the interest deduction due to non-payment and related party rules.

© 2025 SCOTUSreports.com. All rights reserved.

r
r

Court’s Reasoning

r

Regarding the 1941 transfer, the court emphasized the substance of the transaction was a sale by Ogden to Jorden, not compensation. Jorden used Bemidji’s assets to make the payment, but he was never an employee of Ogden. Regarding the 1942 distribution, the court cited the general rule that an insolvent corporation’s assets are first used to pay creditors. The court noted Bemidji was insolvent, and Jorden, as trustee, was directed to pay debts before distributing to shareholders. The Court distinguished *T. T. Word Supply Co.*, stating that case didn’t address whether the distribution was for debt or stock. The court found Jorden’s

© 2025 SCOTUSreports.com. All rights reserved.