13 T.C. 1079 (1949)

When a personal holding company files a claim for relief from surtax due to a distribution to its sole stockholder, and the stockholder consents to include the full distribution amount in their gross income as a taxable dividend, the full amount is includible in their income, regardless of whether a lesser amount would have sufficed for the company's relief.

Summary

This case concerns income tax deficiencies for Adolph B. Spreckels, Dorothy C. Spreckels, John N. Rosekrans and Alma Spreckels Rosekrans, and Spreckels-Rosekrans Investment Co. The Tax Court addressed whether distributions by J. D. & A. B. Spreckels Co. were fully taxable dividends and whether Alma Spreckels Rosekrans was taxable on the full distribution she received from Spreckels-Rosekrans Investment Co., a personal holding company, after consenting to include it as income. The court held that the extent of taxable dividends from J. D. & A. B. Spreckels Co. would be determined by a related case and that Alma Spreckels Rosekrans was indeed taxable on the full amount she received, as per her consent.

Facts

The J. D. & A. B. Spreckels Co. made distributions to its stockholders during 1938-1940. Alma Spreckels Rosekrans owned all the stock of Spreckels-Rosekrans Investment Co. (Investment Co.), a personal holding company, and received distributions from it. In 1938, the Investment Co. distributed $32,500 to Rosekrans from paid-in surplus because it had no earnings or profits due to capital losses. The Investment Co. filed a claim for relief from personal holding company surtax under Section 186 of the Revenue Act of 1942. As a condition, the IRS required Rosekrans to consent to include the full $32,500 distribution in her 1938 income, even though a lesser amount would have relieved the Investment Co. from the surtax.

Procedural History

The Commissioner determined income tax deficiencies against the petitioners for the years 1938-1940. The petitioners contested these deficiencies in the Tax Court. The cases were consolidated. The Tax Court addressed the issues of the taxability of the distributions and the amount includible in Alma Spreckels Rosekrans' income.

Issue(s)

1. Whether distributions by the J. D. & A. B. Spreckels Co. to its stockholders in 1938, 1939, and 1940 constituted taxable dividends to the extent of 100% thereof.
2. Whether petitioner Alma Spreckels Rosekrans was taxable on the entire amount of a distribution of $32,500 received by her in 1938 from Spreckels-Rosekrans Investment Co., a personal holding company, upon her consent to

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include such amount in her gross income.

Holding

1. The court did not make a holding. By stipulation of the parties, the extent to which the Spreckels Co.'s distributions to petitioners in the taxable years constituted taxable dividends will be determined, under Rule 50, in accordance with the Court's opinion in the case of *Grace H. Kelham*.
2. Yes, because under Section 115(a) of the Revenue Act of 1938 as amended by Section 186(a)(2) of the Revenue Act of 1942, and Section 186(g) of the Revenue Act of 1942, compliance with the requirements to file a claim for relief and consent to include the distribution as a taxable dividend made the entire distribution taxable, regardless of whether a smaller amount would have relieved the Investment Co. from surtax.

Court's Reasoning

The court reasoned that prior to the 1942 amendment, the $32,500 distribution, having been made from paid-in surplus, was not a taxable dividend under Section 115(a) of the Revenue Act of 1938. However, Section 186(a)(2) of the Revenue Act of 1942 amended Section 115(a) to include distributions by personal holding companies as dividends, regardless of the source of the distribution. The court emphasized that Section 186(g) made the retroactive application of this amendment contingent upon the corporation filing a claim for relief and the shareholder consenting to include the distribution in their gross income. Because Alma Spreckels Rosekrans consented to include the full amount, the court found that the entire $32,500 distribution was taxable to her as a dividend. The court stated, "Such term [dividend] *also* means *any distribution* to its shareholders * * * made by a corporation which, under the law applicable to the taxable year in which the distribution is made, is a personal holding company."

Practical Implications

This case clarifies the tax implications of distributions made by personal holding companies seeking relief from surtax under Section 186 of the Revenue Act of 1942. It emphasizes that when a shareholder consents to include a distribution in their gross income to enable the corporation to obtain relief, the full amount of the distribution is taxable, even if a lesser amount would have sufficed to eliminate the surtax. This decision highlights the importance of understanding the conditions and consequences associated with claiming such relief and obtaining proper tax advice. It informs how similar cases involving personal holding company distributions and shareholder consents should be analyzed. Later cases would cite this ruling to reinforce the binding effect of shareholder consents in similar tax relief claims made by personal holding companies.

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