T.C. Memo. 1954-96

The timing of a sale of a business interest, relative to the dissolution of a corporation, is critical in determining whether the corporation or its shareholders are liable for the resulting tax obligations.

Summary

Roxbury Corporation dissolved on December 30, 1942, distributing its assets to its shareholders, Gilman and Hornstein, on December 31, 1942. The Commissioner argued that Roxbury sold its joint venture interest to Keller-Block *before* dissolution, making Roxbury liable for taxes. Alternatively, the Commissioner claimed Gilman and Hornstein received ordinary income from a continuing joint venture interest. The Tax Court held that the sale occurred *after* Roxbury's dissolution, making Gilman and Hornstein liable for capital gains on liquidation in 1942, but not for additional income in 1943 because their basis equaled the sale price.

Facts

1. Roxbury Corporation owned a one-half interest in the Roxbury Heights joint venture.
2. Roxbury dissolved on December 30, 1942, distributing its assets to Gilman and Hornstein on December 31, 1942.
3. The Commissioner asserted that Roxbury sold its joint venture interest to Keller-Block prior to dissolution.
4. A preliminary agreement between Gilman, Hornstein, and Keller-Block, initially dated January 1943, was altered to December 31, 1942, with the changes initialed.
5. Keller-Block's testimony regarding the timing of negotiations was initially vague but later clarified by documents indicating uncertainty about the sale date even on December 30, 1942.

Procedural History

The Commissioner determined tax deficiencies against Gilman and Hornstein as transferees of Roxbury and also for income realized in 1943. Gilman and Hornstein contested these deficiencies in the Tax Court. The Tax Court reviewed the evidence and arguments presented by both parties.

Issue(s)

1. Whether the sale of the joint venture interest was made by Roxbury in 1942 or by Gilman and Hornstein in 1943 after Roxbury's liquidation.
2. Whether Gilman and Hornstein realized ordinary income from their interests in the Roxbury Heights project in 1943.

Holding

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1. No, because the sale was not consummated or agreed upon until 1943, after Roxbury's dissolution.
2. No, because Gilman and Hornstein sold a capital asset (their interest in the joint venture) in 1943, and since their basis equaled the sale price, no additional gain was realized.

Court's Reasoning

The court emphasized that the direct evidence supported the petitioners' contention that the sale occurred in 1943, after Roxbury's dissolution. The court found Keller-Block's initial testimony conflicting and gave greater weight to the documentary evidence showing uncertainty about the sale even on December 30, 1942. The court distinguished *Commissioner v. Court Holding Co.* and *Fairfield Steamship Corporation* because those cases involved sales agreed upon before liquidation. Citing *United States v. Cumberland Public Service Co.*, the court respected the taxpayer's choice to structure the transaction to minimize taxes, as long as the sale genuinely occurred after dissolution. The court reasoned that Roxbury was completely liquidated in 1942 and its assets distributed. Therefore, Gilman and Hornstein properly reported capital gains in 1942. The sale to Keller-Block in 1943 was of a capital asset with a basis equal to the sale price, resulting in no additional gain.

Practical Implications

This case underscores the importance of clearly documenting the timing of asset sales in relation to corporate dissolutions to establish tax liability. It confirms that taxpayers can structure transactions to minimize taxes, but the substance of the transaction must align with its form. It illustrates that absent a pre-existing agreement for sale before liquidation, the shareholders, not the corporation, are liable for taxes on the sale of assets distributed during liquidation. Later cases will examine the specific facts to determine if a sale was, in substance, agreed upon before liquidation, regardless of formal timing. This affects tax planning strategies for closely held corporations undergoing liquidation.

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