16 T.C. 572 (1951)

Stockholders of a lessor corporation are liable as transferees for the lessor's unpaid income tax to the extent of rentals received from the lessee when the lessor lacks sufficient assets to cover the tax liability.

Summary

In 1883, New York Mutual Telegraph Company leased its lines to Western Union, with rent paid directly to New York Mutual's shareholders. The IRS assessed income tax against New York Mutual in 1939 for the year 1930. New York Mutual had insufficient assets to pay this tax. The Commissioner then sought to hold the shareholders liable as transferees for the unpaid taxes. The Tax Court held that the stockholders of the lessor corporation were liable as transferees under Section 311 to the extent of the rentals they received. The court reasoned that the payments to shareholders constituted a transfer of assets that prejudiced the government's ability to collect taxes from New York Mutual.

Facts

New York Mutual Telegraph Company leased its properties to Western Union for 99 years (renewable to 999 years) in 1883. The lease stipulated that Western Union would pay annual rent of $150,000 directly to New York Mutual's stockholders. In 1930, Western Union paid the agreed rental amount to the shareholders. In 1939, the Commissioner assessed $17,706.96 in income tax against New York Mutual for the 1930 rental income. Samuel Wilcox and Florence Bosworth, as shareholders of New York Mutual, received $150 and $289.50 respectively from Western Union in 1930.

Procedural History

The Commissioner assessed income tax against New York Mutual on February 27, 1939, and issued a notice and demand for payment on March 2, 1939. New York Mutual did not pay the tax. The Commissioner then assessed a transferee liability against Western Union, who paid $17,053.92 towards the tax. Notices of transferee liability were then issued to individual stockholders, including Wilcox and Bosworth, on January 31, 1940. The Tax Court consolidated the cases of Wilcox and Bosworth.

Issue(s)

Whether the petitioners, as stockholders of New York Mutual, are liable as transferees under Section 311 of the Revenue Act of 1928 for the unpaid income taxes of New York Mutual for the year 1930, to the extent of rentals they received from Western Union during that year.

Holding

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Yes, because the distribution of rental payments directly to the shareholders of New York Mutual constituted a transfer of assets that prejudiced the government's ability to collect taxes from New York Mutual, making the shareholders liable as transferees to the extent of the rentals received.

Court's Reasoning

The court relied on the established principle that rental payments made directly to a lessor's stockholders constitute taxable income to the lessor. Even though the Commissioner collected a significant portion of the tax from Western Union, a balance remained. The court rejected the taxpayers' argument that the Commissioner had to pursue all possible remedies against New York Mutual before seeking to hold the shareholders liable as transferees. The court stated that "the principal purpose of section 311 was to provide the Commissioner with the same summary procedures for collection of the tax from transferees as he previously possessed in respect to the taxpayer." The court found New York Mutual possessed of no tangible property. The Tax Court followed the Second Circuit's decision in *Commissioner v. Western Union Telegraph Co.*, 141 F.2d 774 (2d Cir. 1944), which addressed similar facts, and held Western Union liable as a transferee. The court reasoned that the transfers to shareholders were "in derogation of the rights of the creditors of the lessors under the state law."

Practical Implications

This case clarifies the scope of transferee liability in situations involving lease agreements where rental payments are made directly to shareholders of the lessor. It reinforces the principle that the IRS is not required to exhaust all possible remedies against the primary obligor before pursuing transferees. The case highlights that such direct payments can be considered transfers of assets that prejudice the government's ability to collect taxes. This ruling informs tax planning and litigation strategy in similar contexts, especially where a corporation distributes income directly to its shareholders, potentially hindering its ability to meet its tax obligations. Later cases applying this ruling would likely focus on whether the distribution left the corporation unable to meet its obligations.

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