338 U.S. 451 (1950)

A corporation is not taxed on a sale of assets by its shareholders after a genuine liquidation, even if a major motivation for the liquidation was to avoid corporate-level tax on the sale.

Summary

Cumberland Public Service Co. involved a dispute over whether a sale of assets was made by the corporation (taxable) or by its shareholders after liquidation (not taxable at the corporate level). The Supreme Court held that because the shareholders genuinely negotiated and completed the sale after a bona fide liquidation, the sale was attributed to them, not the corporation. The key factor was that the corporation itself did not participate in negotiations or agreements before liquidation. This case distinguishes itself from *Commissioner v. Court Holding Co.*, which involved a corporation that had essentially completed a sale before liquidation.

Facts

The shareholders of Cumberland Public Service Co. wanted to sell certain assets. The potential buyer initially wanted to purchase the stock, but the shareholders refused. The buyer then offered to purchase the assets directly from the shareholders after a corporate liquidation. The corporation then liquidated, distributing the assets to its shareholders, who subsequently sold the assets to the buyer.

Procedural History

The Commissioner of Internal Revenue argued that the sale was in substance a sale by the corporation, and thus taxable to the corporation. The Tax Court ruled in favor of the taxpayer (Cumberland Public Service Co.), finding that the sale was made by the shareholders after liquidation. The Court of Appeals affirmed. The Supreme Court granted certiorari and affirmed the Court of Appeals' decision.

Issue(s)

Whether the sale of assets was in substance a sale by the corporation, thus taxable to the corporation, or a sale by the shareholders after a genuine liquidation, and thus not taxable to the corporation?

Holding

No, because the sale was made by the shareholders after a genuine liquidation, and the corporation did not participate in the sale negotiations before liquidation.

Court's Reasoning

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The Supreme Court emphasized that the question of whether a sale is attributable to the corporation or the shareholders is a question of fact. The Court distinguished this case from *Commissioner v. Court Holding Co.*, where the corporation had negotiated and substantially completed the sale before liquidation. Here, the corporation refused to sell the assets initially. The shareholders negotiated the sale terms and only then liquidated the corporation. The Court stated, “The Court Holding Co. case does not mean that a corporation can be taxed even when the sale has been made by its stockholders following a genuine liquidation and dissolution.” The critical factor was that the corporation never agreed to the sale before liquidation. The Court deferred to the Tax Court’s finding that the shareholders, not the corporation, conducted the sale.

Practical Implications

This case provides a roadmap for structuring corporate liquidations to avoid corporate-level tax on asset sales. It emphasizes the importance of ensuring that the corporation does not engage in significant sale negotiations or agreements before liquidation. It highlights the factual nature of these inquiries and gives significant deference to the Tax Court’s factual findings. Attorneys advising on corporate liquidations must carefully document the sequence of events and ensure that the shareholders, not the corporation, are the true sellers of the assets following liquidation. Subsequent cases distinguish *Cumberland* when the corporation is too involved in pre-liquidation sale activities. The case clarifies that tax avoidance, in itself, does not invalidate a transaction if the proper legal form is followed.

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