17 T.C. 797 (1951)

Collections made on loans, mortgages, and other claims received by a stockholder during a corporate liquidation under Section 112(b)(7) of the Internal Revenue Code are taxed as ordinary income, not capital gains, unless there is a subsequent sale or exchange of the assets.

Summary

Mace Osenbach, a stockholder in Federal Service Bureau, Inc., received assets in kind (loans, mortgages, etc.) during the corporation's liquidation under Section 112(b)(7) of the Internal Revenue Code. Osenbach later collected on these assets and reported the income as capital gains. The Commissioner of Internal Revenue determined that the collections constituted ordinary income. The Tax Court agreed with the Commissioner, holding that absent a sale or exchange of the distributed properties, the collections were ordinary income, not capital gains. The court reasoned that the liquidation was a closed transaction and the subsequent collections did not constitute a sale or exchange.

Facts

Federal Service Bureau, Inc. was formed to purchase and collect the assets of a closed bank. Osenbach and another individual each owned 40 shares of the corporation. In 1944, the corporation adopted a plan of liquidation under Section 112(b)(7) of the Internal Revenue Code, distributing its assets (loans, mortgages, securities, etc.) to its stockholders in December 1944. Osenbach and the other stockholder filed elections under Section 112(b)(7). In 1944, collections were made on various distributed assets. Osenbach reported a portion of these collections as long-term capital gains on his individual income tax return.

Procedural History

The Commissioner determined a deficiency in Osenbach's income tax for 1944, arguing that the collections should be taxed as ordinary income, not capital gains. Osenbach petitioned the Tax Court for a redetermination of the deficiency. The case was submitted to the Tax Court based on stipulated facts without a hearing.

Issue(s)

Whether collections made on assets (loans, mortgages, etc.) distributed to a stockholder during a corporate liquidation under Section 112(b)(7) of the Internal Revenue Code constitute ordinary income or capital gains.

Holding

No, because in the absence of a sale or exchange of the distributed properties, the amounts received on collections are ordinary income and not capital gain. The

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exchange of stock for assets in liquidation is a closed transaction, and subsequent collections do not constitute a sale or exchange of capital assets.

Court's Reasoning

The court reasoned that for taxation at capital gains rates, there must be a sale or exchange of capital assets. Osenbach argued that the exchange of corporate stock for the assets distributed in liquidation constituted the necessary sale or exchange. The court acknowledged that such an exchange is a capital transaction. However, the court emphasized that the liquidation was a "complete liquidation" under Section 112(b)(7), indicating a closed transaction. The court distinguished cases like *Commissioner v. Carter*, 170 F.2d 911, and *Westover v. Smith*, 173 F.2d 90, where distributions were considered open transactions because the assets received had no ascertainable value at the time of distribution. The court found that Section 112(b)(7) merely postpones recognition of gain on liquidation to a limited extent and does not guarantee that future collections will be taxed at capital gains rates absent a sale or exchange. The court stated: "Section 112 (b) (7) when analyzed is found simply to provide that in case of a complete liquidation, complete within one month in 1944, a shareholder electing may have his gain upon the shares recognized only to the extent provided in subparagraph (E)."

Practical Implications

This decision clarifies that receiving assets during a Section 112(b)(7) corporate liquidation and subsequently collecting on those assets does not automatically qualify the income for capital gains treatment. Taxpayers must engage in a sale or exchange of the assets to receive capital gains treatment. This ruling affects how tax advisors counsel clients considering corporate liquidations and the tax consequences of collecting on distributed assets. It highlights the importance of structuring transactions to achieve desired tax outcomes, such as by selling the assets rather than merely collecting on them. The concurring opinion argued the *Carter* and *Westover* cases were wrongly decided.

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