Estate of Ira C. Curry, 14 T.C. 134 (1950)

A redemption of preferred stock is not essentially equivalent to a taxable dividend when the preferred stockholders do not own common stock and the redemption serves a legitimate business purpose of the corporation.

Summary

The Tax Court held that the redemption of preferred stock held by a trust was not equivalent to a taxable dividend under Section 115(g) of the Internal Revenue Code. The trust held only preferred stock and no common stock in the corporation. The court reasoned that if the corporation had declared dividends instead of redeeming the preferred stock, such dividends would have been distributed only to common stockholders. The redemptions were motivated by a desire to reduce the corporation's liability for cumulative preferred dividends. Furthermore, treating the redemption as a dividend would create an absurd situation where the basis of the remaining preferred stock would continuously increase, eventually leading to an unrecoverable loss.

Facts

The petitioner trust held 7,495 shares of preferred stock in a corporation with a basis of $462,741.30. The corporation partially redeemed the trust's preferred stock in 1945 and 1947. The trust did not own any common stock in the corporation. All dividends on the preferred stock, including arrearages, were paid up at the time of the redemptions. The corporation's officers and directors wanted to reduce the liability for 6% cumulative dividends on the preferred stock, which amounted to over $100,000 per year. Attempts to reduce the dividend rate required 75% approval of preferred stockholders, which the trustee refused to give.

Procedural History

The Commissioner of Internal Revenue determined that the money received by the trust in redemption of the preferred stock was essentially equivalent to taxable dividends. The Tax Court was petitioned to review this determination.

Issue(s)

Whether the partial redemptions of the petitioner trust's preferred stock by the corporation in 1945 and 1947 were made at such time and in such manner as to be essentially equivalent to taxable dividends under Section 115(g) of the Internal Revenue Code.

Holding

No, because the distribution was not essentially equivalent to a taxable dividend when viewed in light of the fact that the trust held only preferred stock and the

© 2025 SCOTUSreports.com. All rights reserved.

redemptions were motivated by a valid business purpose.

Court’s Reasoning

The court reasoned that for Section 115(g) to apply, the distribution must be made at a time and in a manner essentially the same as if the corporation had declared and paid a taxable dividend. Since the trust owned only preferred stock, and all preferred dividends were paid up, any dividends declared would have been distributed to common stockholders, not the trust. The court also considered the business purpose behind the redemptions, which was to reduce the corporation’s liability for cumulative preferred dividends. The court found that treating the redemptions as dividends would lead to a “disappearing cost basis,” where the cost basis of the remaining stock would become unrealistically high and unrecoverable. The court distinguished the case from *William H. Grimditch, 37 B. T. A. 402 (1938)*, because in *Grimditch* the preferred stockholders were related to the common stockholders, effectively creating one economic unit. The court stated, “What we have said above is limited to the facts of the instant case, and we have not considered the results of the redemptions here under consideration as they affect taxpayers who might have been both common and preferred stockholders. The results need not be identical in all cases.”

Practical Implications

This case clarifies that the redemption of preferred stock held by a shareholder with no common stock is less likely to be treated as a taxable dividend, especially when the redemption serves a legitimate corporate purpose. It highlights the importance of considering the stockholder’s position and the corporation’s motives in determining whether a stock redemption is equivalent to a dividend. This decision informs tax planning for corporations considering stock redemptions and advises careful structuring to avoid dividend treatment for preferred stockholders who do not own common stock. It also illustrates how seemingly straightforward tax rules can create absurd results if applied without considering the underlying economic reality. Later cases would need to distinguish situations where preferred shareholders also held some common stock, or had close relationships with common shareholders.

© 2025 SCOTUSreports.com. All rights reserved.