19 T.C. 382 (1952)

When taxpayers receive capital gains from a corporate liquidation and, in a later year, pay corporate tax deficiencies as transferees, those subsequent payments are treated as capital losses, not ordinary losses.

Summary

Arnold and Irma Heiderich, and Henry and T. Lucille Ramey, previously received liquidating dividends from a corporation, U-Drive-It Co. of Newark, which they solely owned, and properly paid capital gains taxes on those distributions. Later, the IRS assessed tax deficiencies against the dissolved corporation for prior tax years. As transferees of the corporate assets, the Heiderichs and Rameys paid these deficiencies. The Tax Court addressed whether these payments should be treated as ordinary losses or capital losses. Relying on the Supreme Court's decision in *Arrowsmith v. Commissioner*, the Tax Court held that the payments constituted capital losses.

Facts

Prior to September 30, 1943, the Heiderichs and Rameys owned all the stock of U-Drive-It Co. of Newark. On September 30, 1943, the corporation was liquidated and dissolved, and its assets were distributed to the Heiderichs and Rameys as tenants in common. They reported and paid capital gains taxes on these liquidating distributions in 1943. In 1946, the IRS determined tax deficiencies against the corporation for the years 1937-1943 and notified the Heiderichs and Rameys of their liability as transferees. The Heiderichs and Rameys contested the deficiencies, and in 1947, a stipulated decision was entered determining a reduced deficiency amount. The Heiderichs and Rameys then paid this amount, plus interest.

Procedural History

The Commissioner of Internal Revenue assessed deficiencies against Arnold and Irma Heiderich, and Henry and T. Lucille Ramey for the 1947 tax year. The Heiderichs and Rameys petitioned the Tax Court, contesting the Commissioner's determination that their payments of the corporation's tax deficiencies constituted ordinary losses. The cases were consolidated. The Tax Court reviewed the issue of whether the payments were ordinary or capital losses.

Issue(s)

Whether payments made by taxpayers, as transferees of assets from a liquidated corporation, to satisfy the corporation's tax deficiencies, should be characterized as ordinary losses or capital losses for income tax purposes.

Holding

No, because under the precedent set by *Arrowsmith v. Commissioner*, such payments are considered capital losses in the year the payments are made.

Court's Reasoning

The Tax Court relied on the Supreme Court's decision in *Arrowsmith v. Commissioner*, which established that payments made to satisfy transferee liability stemming from a prior capital gains transaction should be treated as capital losses. The court stated, "The Supreme Court in *Arrowsmith v. Commissioner*…held that any such loss resulting from satisfaction of transferee liability is a capital loss in the year of payment." The Tax Court found no basis to distinguish the facts of the case from those in *Arrowsmith*. The court emphasized that the payments were directly related to the prior corporate liquidation, which had been treated as a capital gains transaction. Therefore, the subsequent payments to satisfy the corporation's tax liabilities retained the same character as the original transaction, resulting in a capital loss for the Heiderichs and Rameys in the year of payment.

Practical Implications

This case, following the Supreme Court's ruling in *Arrowsmith*, clarifies the tax treatment of payments made to satisfy transferee liability after a corporate liquidation. It establishes that such payments are generally treated as capital losses, not ordinary losses. This is significant for taxpayers who receive liquidating distributions from corporations and subsequently become liable for the corporation's debts or taxes. Legal practitioners must analyze the origin of the liability and its connection to a prior capital transaction to determine the appropriate tax treatment of the subsequent payment. This ruling impacts tax planning and litigation strategies in situations involving corporate liquidations and transferee liability, especially when determining the deductibility of losses. It reinforces the principle that the character of a subsequent payment is determined by the character of the original transaction that gave rise to the liability.

