Glisson, Johnson, and Godwin v. Commissioner, 21 T.C. 470 (1954)

Payments made by stockholder-transferees to satisfy the tax liabilities of a dissolved corporation are treated as capital losses in the year of payment, and interest accruing on those liabilities after the corporation's dissolution is deductible as interest expense.

Summary

The Tax Court addressed whether payments made by stockholders to cover the tax liabilities of their dissolved corporation should be treated as ordinary or capital losses. The court, citing *Arrowsmith v. Commissioner*, held that such payments constitute capital losses. Further, the court determined that interest accruing after the corporation's dissolution and paid by the stockholders is deductible as interest expense. Finally, the court ruled that the capital loss and interest deduction should be allocated among the stockholders based on their ownership percentage in the corporation, absent special circumstances.

Facts

Three individuals, Glisson, Johnson, and Godwin, were stockholders of a corporation that was liquidated in 1945. In 1946, the former stockholders, as transferees, paid taxes owed by the dissolved corporation. The amounts paid included both the tax deficiencies and interest. On their individual tax returns, the stockholders each deducted the same amount as an ordinary loss, despite having paid different amounts to settle the corporation's liabilities.

Procedural History

The Commissioner of Internal Revenue challenged the taxpayers' treatment of the payments as ordinary losses. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether payments made by stockholder-transferees to satisfy the tax liabilities of a dissolved corporation constitute ordinary losses or capital losses?
2. Whether interest accruing on those tax liabilities after the corporation's dissolution is deductible as interest expense?
3. How should the capital loss and interest deduction be allocated among the stockholder-transferees?

Holding

1. Yes, because consistent with *Arrowsmith v. Commissioner*, satisfying transferee liability arising from a corporate liquidation results in a capital loss, not an ordinary loss.

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2. Yes, because interest that accrued after the corporation's dissolution is considered interest paid for the stockholders' own account and is deductible as interest expense under Section 23(b) of the Internal Revenue Code.
3. The capital loss and interest deduction are to be apportioned among the stockholders based on their ownership percentage in the corporation, because there were no special circumstances presented to justify another allocation method.

Court's Reasoning

The court relied on the Supreme Court's decision in *Arrowsmith v. Commissioner*, which established that payments made to satisfy transferee liability are capital losses. The court found no basis to distinguish the case from *Arrowsmith*. As to the interest, the court cited *Arnold F. Heiderich, 19 T.C. 382*, stating that "this portion of the interest was fully deductible as interest by the transferees of the corporation in the amounts so paid by them." Regarding allocation, the court determined that absent special circumstances, the loss should be allocated based on stock ownership. The court noted that while creditors could recover from any of the petitioners up to the value of assets received, the petitioner would then be entitled to contribution from the other stockholders. The court rejected the taxpayers' equal allocation of the losses, stating, "Certainly the parties could not by agreement apportion the losses equally as they apparently have done by each taking a deduction of $1,252.22."

Practical Implications

This case reinforces the principle that payments made by former shareholders to settle corporate liabilities post-liquidation are generally treated as capital losses, not ordinary losses, impacting the tax treatment of these payments. It clarifies that interest accruing after dissolution is deductible as interest expense, offering a potential benefit to the shareholders. The case also highlights the importance of proper allocation of losses among shareholders based on ownership percentages, unless specific agreements or circumstances justify an alternative approach. This decision influences how tax advisors counsel clients involved in corporate liquidations and subsequent transferee liability situations, emphasizing the need for accurate record-keeping and a clear understanding of ownership percentages. Later cases applying this ruling would likely focus on whether 'special circumstances' exist to justify non-proportional allocation of liabilities among former shareholders.

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