***Bienenstok v. Commissioner*, 12 T.C. 857 (1949)**

Corporate distributions made from current year earnings, even if the corporation has an accumulated deficit, are considered dividends under the Internal Revenue Code of 1939.

Summary

The case involves the tax treatment of distributions from Waldheim & Company to its shareholders, Stanley and Helen Bienenstok. The primary issue is whether these distributions constituted taxable dividends, especially in light of the company's accumulated deficit. The Tax Court held that distributions made from the company's current earnings were taxable dividends, irrespective of prior deficits. Additionally, the court addressed whether a stock redemption and subsequent purchase of stock by Stanley resulted in a taxable dividend, concluding that Stanley's acquisition of stock at a discounted price represented a taxable dividend to the extent of the company's 1945 earnings. Furthermore, the court addressed whether a stock redemption and subsequent purchase of stock by Helen that satisfied debt resulted in taxable gain and found no such gain, as well as several other minor tax deduction issues relating to Stanley's use of his personal car and related legal fees.

Facts

Waldheim & Company made cash distributions to its stockholders in 1945 and 1946. The company had a deficit at the end of 1944 but generated substantial net earnings in 1945. Stanley and Helen Bienenstok were shareholders of the company. Stanley was also the company's employee, and was discharged from his employment by the company early in 1945, but the situation was resolved via a settlement agreement on November 13, 1945. In 1945, Stanley surrendered 155 shares of stock to cancel his debt to the company, and later he purchased 666 2/3 shares of stock at a price significantly below its fair market value. Helen also acquired shares, and later surrendered them to cancel a debt owed to the company. The IRS determined that the distributions to the Bienenstoks were taxable dividends and that Stanley realized taxable income from the stock redemption.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the income tax of Stanley and Helen Bienenstok. Stanley and Helen challenged the determinations in the Tax Court. The Tax Court consolidated the cases and heard the issues presented by the parties. The Tax Court issued its ruling, upholding the Commissioner's findings on the dividend issue for Stanley and Helen, but making adjustments to the Commissioner's findings related to some of Stanley's deductions.

Issue(s)

1. Whether the cash distributions made by Waldheim & Company to its stockholders

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in 1945 and 1946 constituted dividends under Section 115(a) of the Internal Revenue Code of 1939.

2. Whether Helen Bienenstok realized a taxable gain in 1945 from the cancellation of her indebtedness to Waldheim & Company.

3. Whether Stanley Bienenstok received a taxable dividend from the redemption of his stock and/or the purchase of stock at a price below fair market value under Section 115(g) and Section 115(a)(2), respectively.

4. Whether Stanley Bienenstok could deduct automobile expenses.

5. Whether Stanley Bienenstok could deduct attorney's fees.

Holding

1. Yes, because the distributions were made out of the company's earnings or profits for the taxable year, as defined in section 115(a)(2) of the Internal Revenue Code.

2. No, because the surrender of the stock was at full value, equivalent to the stock's fair market value and basis, and thus not a cancellation of indebtedness resulting in taxable gain.

3. Yes, in part. Stanley received a taxable dividend under section 115 (a)(2) because he received the stock at a price significantly below market value, and in an amount equal to the 1945 earnings of the company. The redemption of stock did not result in a taxable dividend.

4. Yes, to a limited extent. Stanley could deduct a portion of the claimed expenses, based on an estimation of reasonable expenses.

5. Yes, Stanley could deduct the attorney's fees.

Court's Reasoning

The court applied Section 115(a) of the Internal Revenue Code of 1939, which defines dividends as distributions from earnings or profits. The court focused on the fact that the company had substantial net earnings in 1945, and therefore, under Section 115(a)(2), the distributions were dividends, even if the company had a prior deficit. The court referenced the fact that a prior case had established that a corporate distribution could be considered a dividend if the company had enough net earnings to cover the distribution.

The court also examined whether Stanley's stock acquisition constituted a dividend. It found that he received a substantial benefit by acquiring the stock well below its fair market value. Citing *Elizabeth Susan Strake Trust*, 1 T.C. 1131, the court found that to the extent of the company's 1945 earnings, the distribution was a dividend.

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The court did not find that Stanley's surrender of stock was a taxable dividend.

Regarding Helen, the court found that her surrender of stock was a satisfaction of a debt at fair market value, and not a cancellation of indebtedness; thus, it did not result in taxable income. Regarding Stanley's deductions for automobile use and attorneys' fees, the court used the Cohan rule to determine the allowable deduction. It allowed a portion of the automobile expenses and the full amount of attorney's fees, based on the nature of the fees.

Practical Implications

This case highlights the importance of the timing of earnings and profits relative to corporate distributions. It demonstrates that even if a company has an accumulated deficit, distributions from current earnings can be treated as taxable dividends. This has significant implications for corporate tax planning. The case also illustrates that transactions that enrich shareholders, such as the purchase of stock below fair market value, can be treated as dividends, even if they are not formally declared as such. Attorneys advising clients on corporate transactions must carefully analyze the substance of those transactions to determine their tax consequences, not merely their form.

The court's use of the Cohan rule, to allow certain deductions based on an estimate of reasonable expenses, shows the court's willingness to find solutions for a taxpayer when it is reasonably clear the taxpayer had expenses but cannot prove their exact amounts. The Bienenstok case has been cited in numerous tax cases for its analysis of the definition of dividends and its approach to the application of the Cohan rule.

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