26 T.C. 331 (1956)

A corporation cannot avoid taxation on income it has earned by distributing the right to receive that income to its shareholder as a liquidating dividend before the income is realized, especially when the corporation continues to exist for the purpose of paying its liabilities.

Summary

J. Ungar, Inc., an accrual-basis corporation acting as a sales agent, resolved to liquidate. Before full liquidation, it distributed to its sole shareholder the right to receive commissions on sales orders. These commissions were earned through completed sales transactions but were not yet paid or accrued as income because the goods had not shipped. The IRS argued these commissions were taxable to the corporation under the anticipatory assignment of income doctrine. The Tax Court agreed, holding that the corporation, while in the process of liquidation, remained a taxable entity. Because the corporation had performed all necessary services to earn the commissions, and the remaining steps to receive payment were merely administrative, the assignment of the right to receive the commissions did not shield the corporation from tax liability. The court emphasized the corporation's continued existence for liquidating its liabilities as a key factor.

Facts

J. Ungar, Inc., was a New York corporation that acted as a sales agent, primarily for a Spanish exporter. It used an accrual method of accounting and recognized commissions only upon shipment of goods. On August 29, 1950, the corporation resolved to liquidate and, on September 15, 1950, distributed its assets to its sole shareholder, Jesse Ungar, including the right to receive commissions on unshipped orders. The corporation retained some cash to pay its liabilities. The merchandise associated with these commissions shipped before the end of the corporation's fiscal year (February 28, 1951). The corporation did not report the commissions as income. The shareholder subsequently received the commissions. The IRS determined a deficiency in income and excess profits taxes, claiming the commissions were taxable to the corporation as an anticipatory assignment of income.

Procedural History

The case was heard by the United States Tax Court. The court consolidated the cases of J. Ungar, Inc., and Jesse Ungar, the shareholder and transferee. The Tax Court ruled in favor of the Commissioner of Internal Revenue, finding the corporation liable for the taxes on the commissions. The shareholder conceded transferee liability.

Issue(s)

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1. Whether the corporation, having distributed the right to receive brokerage commissions as a liquidating dividend, must report the commissions as income for its final fiscal period even though, under its accounting method, it had not yet accrued the income.

Holding

1. Yes, because the corporation, in the process of liquidation, was still a taxable entity when the commissions were realized by its stockholder, and the commissions represented an anticipatory assignment of income.

Court's Reasoning

The court found the anticipatory assignment of income doctrine applicable. The court cited precedent that an individual cannot avoid taxation by assigning the right to income earned through services or property. The corporation argued this doctrine did not apply because it was liquidated when the shareholder acquired the right to the commissions. The court disagreed, finding the corporation's taxable status continued throughout the liquidation process. The court emphasized that the corporation retained assets (cash) to satisfy its liabilities, making it a continuing taxable entity, as defined by the regulations in effect at that time. The court reasoned that, since all services necessary to earn the income had been performed, the corporation's assignment of the right to receive payment did not shield it from taxation on income. The fact that the corporation followed a consistent accounting practice of recognizing income only upon shipment was not determinative, given the anticipatory nature of the assignment and the corporation's continued existence. The court stated, "The fact that a corporation is in the process of liquidation does not exempt it from taxation on income which it has earned."

Practical Implications

This case underscores the importance of the anticipatory assignment of income doctrine in corporate liquidations. It serves as a warning that corporations cannot avoid taxation by assigning the right to receive income to shareholders just before it is realized, especially if the corporation continues to exist for winding up its affairs. Attorneys should advise clients that a corporation's liquidation is not a complete tax shield; earned income may still be taxable. Specifically, if the corporation has performed all the acts required to earn the income and only awaits the ministerial act of receipt, an assignment of the right to receive the income may not shield the corporation from tax liability. This decision clarifies that a corporation's tax obligations continue even during liquidation if it retains assets, even cash, until its liabilities are settled. Later cases have cited this ruling to distinguish between the transfer of appreciating assets (which may not be taxed to the corporation) and the assignment of a right to income where the corporation has largely performed the income-producing services. This ruling significantly shapes the timing of income recognition in liquidation scenarios and requires careful planning to avoid

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unexpected tax liabilities.

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