27 T.C. 82 (1956)

When a corporation distributes its assets to shareholders in liquidation, the gain from a subsequent sale of those assets is taxable to the shareholders, not the corporation, unless the corporation actively negotiated the sale before liquidation.

Summary

Merkra Holding Co. leased property with an option to purchase. Before the option was exercised, Merkra liquidated, distributing the property to its shareholders. The lessee then exercised the purchase option. The Commissioner sought to tax the gain from the sale to the corporation, arguing the shareholders were merely a conduit. The Tax Court held that the gain was taxable to the shareholders, as Merkra did not negotiate the sale before liquidation. The court distinguished this from cases where the corporation conducted sales negotiations before liquidation. The timing of the liquidation to take advantage of the tax laws did not change the holding.

Facts

Merkra Holding Co. (Merkra) owned a parcel of land. In 1929, Merkra leased the parcel to Marex Realty Corporation (Marex) for 21 years, with renewal options and an option for Marex to purchase the property for $1,000,000 before January 31, 1951. In May 1950, Merkra learned that Marex was considering exercising the purchase option. Merkra's stockholders and directors then decided to liquidate Merkra and distribute its assets to the stockholders. On January 30, 1951, Marex exercised the purchase option. The Commissioner of Internal Revenue determined a tax deficiency against Merkra for the gain on the sale, arguing that the sale was made by the corporation.

Procedural History

The Commissioner assessed a deficiency against Merkra. Merkra and its shareholders (as transferees) contested this in the United States Tax Court. The Tax Court consolidated the cases and ruled in favor of the taxpayers, holding that the gain was taxable to the shareholders, not the corporation. The Court's ruling allowed for the use of a Rule 50 computation.

Issue(s)

1. Whether the gain on the sale of real property after corporate liquidation and distribution of the property to shareholders is taxable to the corporation or the shareholders when the sale was pursuant to an option to purchase that was included in the original lease.

Holding

1. No, because the corporation did not negotiate the sale before liquidation, the sale

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was considered to be made by the shareholders.

Court's Reasoning

The court applied the principle established in *Commissioner v. Court Holding Co.*, 324 U.S. 331 (1945), which stated that a sale negotiated by a corporation, but consummated by its shareholders after liquidation, could be attributed to the corporation for tax purposes. The court distinguished *Court Holding Co.* from the current case. The court emphasized that for a sale to be attributed to the corporation, the corporation must have engaged in sale negotiations. In this case, the option to purchase was part of the lease agreement, and the court found that this did not constitute negotiations by Merkra to sell the property. Furthermore, Merkra did not conduct any negotiations for the sale of the property before its liquidation.

Practical Implications

This case emphasizes the importance of carefully structuring corporate liquidations, especially when an asset sale is anticipated. To avoid the corporation being taxed on the gain, the corporation itself cannot engage in the sale negotiations. The shareholders can take over the sale after the liquidation is complete, but there must be a break between the corporate activity and the shareholder's action, and the corporation's action prior to the sale must not constitute "negotiations" for the sale. Also, the fact that a corporation planned its liquidation in the midst of knowing the option would be used and with the goal of lowering its tax burden does not change the result where the corporation did not partake in the sale negotiations.

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