***Stolz v. Commissioner*, 25 T.C. 545 (1956)**

A stock redemption is considered a taxable dividend if it is essentially equivalent to a dividend, even if the redemption is pro rata and there is no contraction of the corporation's business.

Summary

The case concerned whether a corporation's redemption of preferred stock was essentially equivalent to a dividend. The Tax Court held that the redemption was, in fact, a dividend, because it was pro rata among the shareholders, and there was no valid corporate business purpose for the redemption. The court focused on the "net effect" of the transaction, considering the distribution of corporate earnings and profits. The taxpayers argued that the redemption was a return of capital, not a dividend, and that they did not personally benefit from the transaction. However, the court found the redemption to be taxable as a dividend because the taxpayers' proportional interest in the corporation remained unchanged.

Facts

E.H. Stolz and Alvin V. Graff agreed to obtain a Ford franchise and form a corporation, Stolz-Graff Motors, Inc. Graff provided the capital, receiving preferred stock, while Stolz received common stock and was to manage the dealership. The corporation later redeemed the preferred stock in two distributions. The Ford Motor Company required Stolz to own a half-interest in the business. To comply, Graff sold half of his preferred stock to Stolz, who financed the purchase with a note payable from dividends and redemption proceeds. The corporation had significant earnings and profits at the time of the redemptions. After the redemptions, the corporation increased its common stock to meet Ford's minimum capitalization requirements.

Procedural History

The Commissioner of Internal Revenue determined deficiencies against Stolz for underpayment of income taxes, treating the redemption proceeds as taxable dividends. Stolz challenged this in the Tax Court.

Issue(s)

1. Whether the redemption of the preferred stock was essentially equivalent to a distribution of a taxable dividend under Section 115(g) of the Internal Revenue Code of 1939.

Holding

1. Yes, because the redemptions were essentially equivalent to dividends. The Tax Court held that the redemption proceeds should be treated as a taxable dividend.

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Court’s Reasoning

The court considered whether the stock redemption was

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