Blount v. Commissioner, 51 T. C. 1023 (1969)

Stock redemptions under a retirement plan may be treated as dividends if they do not result in a meaningful change in shareholder control and are not motivated by a substantial business purpose.

Summary

Howard Blount, a shareholder in Blount Lumber Co. , had his stock redeemed under a retirement agreement. The Tax Court ruled that these redemptions were essentially equivalent to dividends under IRC § 302(b)(1). The court found no meaningful change in ownership or control, ample earnings and profits, and no substantial business purpose for the redemptions. This case underscores the importance of demonstrating a significant business purpose and a shift in control for redemptions to be treated as sales rather than dividends.

Facts

Howard Blount, along with his brother Floyd and brother-in-law Wallace, owned the majority of Blount Lumber Co. ‘s stock. In 1960, they entered into a retirement agreement allowing each to have up to a certain number of shares redeemed annually at their discretion. Howard retired at the end of 1959 and had shares redeemed from 1960 to 1963. The company had substantial accumulated earnings and profits and had not paid dividends on common stock since the 1940s.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Howard’s income tax, treating the stock redemption payments as dividends. Howard petitioned the U. S. Tax Court, which upheld the Commissioner’s determination, finding that the redemptions were essentially equivalent to dividends.

Issue(s)

1. Whether the stock redemptions under the retirement agreement were essentially equivalent to dividends under IRC § 302(b)(1).

Holding

1. Yes, because the redemptions did not result in a meaningful change in shareholder control, the company had ample earnings and profits, and there was no substantial business purpose for the redemptions.

Court’s Reasoning

The court applied the tests for dividend equivalency, focusing on whether there was a significant shift in ownership and control, sufficient accumulated earnings and

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profits, a history of dividend distributions, and a substantial business purpose for the redemptions. The court found no meaningful change in Howard's relative ownership position, as the retirement plan allowed each principal shareholder to redeem shares at their discretion, maintaining their proportional interests. The company's substantial accumulated earnings and profits and lack of recent dividend payments on common stock supported the dividend treatment. The court rejected the argument that the redemptions served a business purpose, noting that the plan did little to prevent stock sales to outsiders or transfer control to the next generation. The court emphasized that providing cash to retired shareholders could have been achieved more directly through increased pensions, not stock redemptions.

Practical Implications

This decision highlights the importance of demonstrating a significant business purpose and a meaningful change in control when structuring stock redemptions to avoid dividend treatment. Attorneys should advise clients to carefully design redemption plans to ensure they serve a valid business purpose, such as facilitating a change in ownership or preventing stock sales to outsiders. The case also underscores the need to consider the company's earnings and profits and dividend history when planning redemptions. Subsequent cases have continued to apply these principles, often distinguishing situations where redemptions were part of a legitimate business strategy from those resembling disguised dividends.

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