Pastene v. Commissioner, 52 T. C. 647 (1969)

Liquidation distributions are considered timely under Section 337 if made within 12 months of adopting the liquidation plan, even if checks are not paid until after the year.

Summary

Norwich Fur Farm, Inc. adopted a liquidation plan on November 1, 1963, and sold its mink and assets within the year. The issue was whether the final distribution of checks on October 28, 1964, qualified as timely under Section 337 when the checks were not paid until after the year. The Tax Court held that the distribution was timely because the checks were issued within the 12-month period, and the corporation had taken steps to ensure sufficient funds were available, even if the checks were not cashed until later. The court also ruled that gains from selling live mink qualified for nonrecognition under Section 337, but gains from selling mink pelts did not because they were inventory sold in the ordinary course of business.

Facts

Norwich Fur Farm, Inc. , a Vermont corporation, was engaged in the business of raising and selling mink pelts. On November 1, 1963, the corporation adopted a plan of complete liquidation, intending to sell all its assets and distribute the proceeds to shareholders within 12 months. By January 1964, all live mink were sold, and mink pelts were shipped for auction in December 1963. The corporation sold its real estate in July 1964. On October 28, 1964, checks were issued to shareholders as a liquidating distribution, although the Windsor bank account had insufficient funds at the time. Funds from other accounts were transferred to cover the checks, which were paid after the 12-month period.

Procedural History

The Commissioner asserted transferee liability against Richard W. Pastene and Eugene Stefanazzi, shareholders of Norwich Fur Farm, Inc. , for a corporate tax deficiency related to the fiscal year ending February 28, 1965. The case was consolidated and heard by the U. S. Tax Court, which issued its decision on July 22, 1969.

Issue(s)

1. Whether the liquidation of Norwich Fur Farm, Inc. qualified for nonrecognition of gain under Section 337(a) when the final checks were distributed within the 12-month period but not paid until after the year.
2. Whether the gain realized on the sale of live mink and mink pelts was eligible for nonrecognition under Section 337.

Holding

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1. Yes, because the checks were issued within the 12-month period following the adoption of the liquidation plan, and the corporation took steps to ensure sufficient funds were available, even if the checks were not cashed until after the year.
2. Yes, for live mink, because they were not considered inventory; No, for mink pelts, because they were inventory sold in the ordinary course of business and not in bulk to one person in one transaction.

Court's Reasoning

The court reasoned that Section 337 requires a corporation to adopt a plan of complete liquidation and distribute all assets within 12 months, less assets retained to meet claims. The court found that Norwich Fur Farm, Inc. adopted a plan on November 1, 1963, and completed its liquidation within the year. The court held that issuing checks to shareholders on October 28, 1964, constituted a timely distribution because the checks were issued within the 12-month period, and the corporation acted in good faith to transfer funds to cover them. For the sale of live mink, the court found they were not inventory, so gains were eligible for nonrecognition. However, mink pelts were considered inventory sold in the ordinary course of business, and thus gains were taxable. The court emphasized that the mink pelts were sold through an auction company, which was the corporation's selling agent, and not in bulk to one person in one transaction, disqualifying them from the Section 337(b)(2) exception.

Practical Implications

This decision clarifies that for Section 337 purposes, issuing checks within the 12-month liquidation period is sufficient, even if they are not paid until later, as long as the corporation acts in good faith to ensure funds are available. Attorneys should advise clients that gains from selling inventory in the ordinary course of business during liquidation are taxable, unless sold in bulk to one person in one transaction. This ruling impacts how businesses structure their liquidation plans to minimize tax liability, particularly regarding the timing and nature of asset sales. Subsequent cases have cited Pastene when addressing the timing and nature of liquidation distributions under Section 337.

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