Clayton v. Commissioner, 52 T. C. 911 (1969); 1969 U. S. Tax Ct. LEXIS 65

Section 1245 of the Internal Revenue Code overrides Section 337, requiring recognition of gain from the sale of Section 1245 property during corporate liquidation.

Summary

In Clayton v. Commissioner, the U. S. Tax Court ruled that the gain realized from the sale of Section 1245 property during a corporate liquidation must be recognized as ordinary income under Section 1245, despite the nonrecognition provision of Section 337. The case involved Clawson Transit Mix, Inc. , which sold its assets, including Section 1245 property, in a complete liquidation plan. The court held that the plain language of Section 1245, supported by regulations and legislative history, mandated the recognition of the gain, overriding the nonrecognition typically allowed under Section 337. This decision highlights the priority of Section 1245 in ensuring that gains from depreciable property are taxed as ordinary income in liquidation scenarios.

Facts

Clawson Transit Mix, Inc. sold all its assets, including certain Section 1245 property, on August 14, 1964, pursuant to a plan of complete liquidation to J. S. L. , Inc. The sale resulted in a Section 1245 gain of $179,996. 30. Clawson did not report this gain on its final income tax return for the period from April 1, 1964, to August 31, 1964. The Commissioner determined that this gain should be taxed as ordinary income and assessed a deficiency of $91,607. 65 against Clawson's transferees, Franklin Clayton and Milan Uzelac, who conceded their liability as transferees for any deficiency determined.

Procedural History

The case was heard by the U. S. Tax Court, which consolidated the proceedings of Franklin Clayton and Milan Uzelac, transferees of Clawson Transit Mix, Inc. The petitioners challenged the Commissioner's determination that the Section 1245 gain should be recognized as ordinary income despite the nonrecognition provision under Section 337. The Tax Court ruled in favor of the Commissioner, holding that Section 1245 overrides Section 337 in this context.

Issue(s)

1. Whether the recognition provision of Section 1245 overrides the nonrecognition provision of Section 337 in the context of a corporate liquidation involving the sale of Section 1245 property.

Holding

1. Yes, because the plain language of Section 1245, supported by regulations and legislative history, mandates the recognition of the gain from the sale of Section 1245 property as ordinary income, overriding the nonrecognition typically allowed under Section 337.

Court’s Reasoning

The Tax Court’s decision was based on the clear statutory language of Section 1245, which states that “such gain shall be recognized notwithstanding any other provision of this subtitle. ” The court found this language unambiguous and supported by Income Tax Regulations, which explicitly state that Section 1245 overrides Section 337. The court also considered the legislative history, including House and Senate reports accompanying the enactment of Section 1245, which emphasized the need to recognize ordinary income in situations where the transferee receives a different basis for the property than the transferor. The court rejected the petitioners’ argument that recognizing the gain would nullify the benefits of Section 337, as the statutory language and legislative intent clearly favored the application of Section 1245 in this context.

Practical Implications

This decision has significant implications for tax planning in corporate liquidations involving Section 1245 property. Attorneys and tax professionals must ensure that gains from such property are reported as ordinary income, even when the transaction might otherwise qualify for nonrecognition under Section 337. The ruling clarifies that Section 1245 takes precedence over Section 337, affecting how similar cases are analyzed and reported. Businesses planning liquidations must account for the potential tax liabilities arising from Section 1245 gains, which could impact their financial planning and decision-making processes. Subsequent cases have followed this precedent, reinforcing the priority of Section 1245 in liquidation scenarios.

