54 T.C. 420

A purported corporate liquidation will be recharacterized as a dividend distribution if it is merely a step in a reincorporation plan, lacking genuine economic substance and primarily intended to bail out earnings at capital gains rates, especially when shareholder continuity exists.

Summary

The Tax Court addressed whether the liquidation of Lammerts (Old) followed by the creation of Lammerts (New), which continued the same business, qualified as a complete liquidation under Section 331 or should be treated as a dividend distribution. Henry Lammerts' will directed the liquidation of Lammerts (Old). His estate liquidated the corporation and then his widow and son, the beneficiaries, formed Lammerts (New) to operate the same business. The court held that because there was no genuine termination of the corporate business and substantial continuity of shareholder interest, the liquidation of Lammerts (Old) was a valid Section 331 liquidation, not a reincorporation or reorganization that would trigger dividend treatment. However, a subsequent redemption of preferred stock was deemed essentially equivalent to a dividend.

Facts

Lammerts (Old) was a family-owned Buick dealership. Henry P. Lammerts Sr., the primary shareholder, died and his will directed his executors to liquidate the corporation and distribute its assets. Following Henry's death, his executors, his wife Hildred and son Henry Jr. (Parkinson), liquidated Lammerts (Old). Shortly after, Lammerts (New) was incorporated by Hildred and Parkinson, and it continued the same Buick dealership business using essentially the same assets, employees, and location, except for the real property (Ramp Garage) and some liquid assets which remained with Lammerts (Old), renamed Lammerts Associates, Inc.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' income and estate taxes, arguing the liquidation was not a genuine liquidation under Section 331 and should be treated as a dividend or reorganization. The Tax Court heard the case to determine the tax consequences of the liquidation, a preferred stock redemption, and a penalty for late filing of a fiduciary income tax return.

Issue(s)

1. Whether the liquidation of Lammerts (Old) was a valid complete liquidation under Section 331, or should be recharacterized as a reorganization or a dividend distribution under Section 301.
2. Whether the redemption of preferred stock by Lammerts (New) from Hildred Lammerts was essentially equivalent to a dividend under Section 302(b)(1).

3. Whether the late filing of the fiduciary income tax return by the Estate of Henry P. Lammerts was due to reasonable cause, thus avoiding penalties under Section 6651(a).

Holding

1. No. The liquidation of Lammerts (Old) was a valid complete liquidation under Section 331 because it was not a continuation of Lammerts (Old) in a reorganized form, primarily due to a sufficient change in shareholder proprietary interest and capital structure between Lammerts (Old) and Lammerts (New).
2. Yes. The redemption of preferred stock was essentially equivalent to a dividend because Hildred Lammerts' constructive stock ownership under Section 318 meant the redemption did not result in a meaningful reduction of her interest in the corporation.
3. No. The late filing was not due to reasonable cause because the executors failed to exercise ordinary business care and prudence in ascertaining their fiduciary duties.

Court's Reasoning

The court reasoned that the liquidation of Lammerts (Old) met the requirements of Section 331 because it was a genuine liquidation, not a mere reincorporation. The court distinguished this case from scenarios where liquidation-reincorporation transactions are disregarded, emphasizing that in this case, there was not a complete identity of shareholder interests between the old and new corporations. The change in stock ownership and capital structure was significant enough to prevent recharacterization as a reorganization, specifically rejecting the application of an (F) reorganization. The court relied on precedent like *Berghash*, emphasizing that a radical shift in stock ownership prevents (F) reorganization classification. Regarding the stock redemption, the court applied constructive ownership rules under Section 318, finding that Hildred's ownership remained effectively unchanged before and after the redemption, thus failing the "not essentially equivalent to a dividend" test of Section 302(b)(1). Finally, the court found no reasonable cause for the late filing penalty, as the executors' ignorance of fiduciary tax obligations did not constitute ordinary business care and prudence, quoting regulation Sec. 301.6651-1(a)(3).

Practical Implications

Estate of Lammerts clarifies the boundaries of the liquidation-reincorporation doctrine, emphasizing that a genuine liquidation under Section 331 can occur even when the business continues under new corporate form, provided there are sufficient changes in shareholder ownership and capital structure. It highlights that for Section 331 to apply, the liquidation must represent a real change in the shareholder's investment, not just a formalistic restructuring. For stock redemptions, the case reinforces the importance of attribution rules under Section 318 when determining dividend equivalency, particularly in family-controlled corporations. It also serves as a reminder to executors and fiduciaries of their duty to ascertain and fulfill all tax obligations, as ignorance of these duties is not a valid defense against penalties for late filing.

