Schmidt v. Commissioner, 55 T. C. 335 (1970)

Losses from corporate liquidation are recognized only after the corporation has made its final distribution.

Summary

Ethel M. Schmidt sought to claim a capital loss on her shares in Highland Co. during its liquidation process in 1965. The IRS denied this deduction. The Tax Court ruled that because the liquidation was not complete by the end of 1965, and further distributions were expected, Schmidt's loss could not be recognized in that year. The court applied the general rule that losses in a corporate liquidation can only be recognized after the final distribution, emphasizing that the timing of loss recognition is tied to the completion of the liquidation process.

Facts

In 1965, Highland Co. adopted a plan for complete liquidation, selling its tangible assets and distributing $44,000 pro rata to shareholders. Ethel M. Schmidt, owning 812 of the 1,353 shares, received $26,406. 51, leaving her with an unrecovered basis of $36,033. 49. The remaining assets included cash, street warrants, and accounts receivable. Schmidt claimed a long-term capital loss of $10,440. 36 on her 1965 tax return, offsetting a gain from selling real property she owned separately. The IRS disallowed this deduction.

Procedural History

Schmidt filed a petition in the U. S. Tax Court challenging the IRS's disallowance of her claimed capital loss. The Tax Court, after reviewing the evidence and applicable law, ruled in favor of the Commissioner, denying Schmidt's claimed deduction for the 1965 tax year.

Issue(s)

1. Whether Schmidt is entitled to a capital loss deduction on her Highland Co. stock in 1965 under sections 302, 317(b), and 331(a)(1) of the Internal Revenue Code.
2. Whether Schmidt is entitled to claim a portion of her loss in 1965 due to the partial liquidation of Highland Co. under sections 331(a)(2) and 346.
3. Whether Schmidt is entitled to a capital loss deduction on her Highland Co. stock in 1965 under section 165 of the Internal Revenue Code.

Holding

1. No, because the transaction did not constitute a redemption within the meaning of sections 302 and 317(b), and the liquidation was not complete by the end of 1965, making the final amount of loss uncertain.
2. No, because the amount that would ultimately be distributed in complete payment

for the shares was indefinite and uncertain as of the end of 1965.
3. No, because the loss was not actual and present, but merely contemplated as sure to occur in the future, and the stock was not worthless nor had there been a completed sale or exchange by the end of 1965.

Court's Reasoning

The court applied the general rule that losses in a corporate liquidation can only be recognized after the final distribution, citing cases like *Dresser v. United States* and *Turner Construction Co. v. United States*. It emphasized that Schmidt's potential loss was uncertain because the liquidation process was not complete by the end of 1965, and further distributions were expected. The court also noted that the distribution Schmidt received was part of a plan for complete liquidation, not a partial liquidation that would allow for immediate recognition of loss. The court distinguished cases like *Commissioner v. Winthrop* and *Palmer v. United States*, which allowed loss recognition in partial liquidations where the amount of the loss was reasonably ascertainable. Furthermore, the court rejected Schmidt's arguments under sections 302 and 317(b), stating that the Highland Co. did not acquire beneficial ownership of the stock in exchange for property, a requirement for redemption treatment. The court also found that Schmidt's claim under section 165 failed because her loss was not actual and present, and her stock was not worthless at the end of 1965.

Practical Implications

This decision underscores the importance of the timing of loss recognition in corporate liquidations. Taxpayers cannot recognize losses until the liquidation process is complete and all distributions have been made. This impacts how attorneys should advise clients on the timing of tax reporting in liquidation scenarios, emphasizing the need to wait until the final distribution. Practically, it means that shareholders in a liquidating corporation must plan their tax strategy around the uncertain timing of final distributions. This ruling also affects how similar cases are analyzed, reinforcing that only after final distribution can losses be recognized, which may influence business decisions on the timing of liquidation and dissolution. Subsequent cases and IRS rulings have continued to apply this principle, such as *Rev. Rul. 68-348*, which further clarifies the treatment of losses in complete liquidations.

