Maher v. Commissioner, 56 T. C. 763 (1971)

A corporation's assumption of a shareholder's personal liability constitutes a constructive dividend to the shareholder.

Summary

In Maher v. Commissioner, the U. S. Tax Court ruled that when Selectivend Corp. assumed payments on Ray Maher's personal promissory notes, it constituted a constructive dividend to Maher. The court rejected Maher's argument that Section 301(b)(2) of the Internal Revenue Code should reduce the taxable amount of the distribution due to his secondary liability on the notes. The court clarified that Section 301(b)(2) applies only when a shareholder assumes a corporate liability, not when the corporation assumes a shareholder's liability. This decision underscores the tax implications of corporate actions involving shareholders' personal liabilities.

Facts

In 1963, Ray Maher assigned a contract to Selectivend Corp. , which in turn assumed payments on Maher's personal promissory notes. Maher argued that he had an agreement with the IRS to concede the absence of a constructive dividend for 1963, but the court found no such agreement existed. Maher then contended that under Section 301(b)(2) of the Internal Revenue Code, the taxable value of the distribution should be reduced to zero because he remained secondarily liable on the notes.

Procedural History

The case was initially set for trial on February 17, 1969, but was continued to allow for the consolidation of transactions from later years. On December 10, 1970, the Tax Court issued its initial opinion, holding that Maher received a constructive dividend in 1963. Following Maher's motion for reconsideration on January 12, 1971, the court held a hearing on March 3, 1971, to address the alleged agreement and Maher's additional arguments on the constructive dividend issue. The court ultimately denied the motion on July 12, 1971.

Issue(s)

1. Whether the assumption of payments on Ray Maher's personal promissory notes by Selectivend Corp. constituted a constructive dividend to Maher in 1963?
2. Whether Section 301(b)(2) of the Internal Revenue Code reduced the taxable amount of the distribution to Maher because he remained secondarily liable on the notes?

Holding

1. Yes, because the assumption of Maher's personal liability by Selectivend Corp.

was considered a distribution of property under Section 317(a) of the Internal Revenue Code.
2. No, because Section 301(b)(2) applies only when a shareholder assumes a corporate liability, not when the corporation assumes a shareholder's liability.

Court's Reasoning

The court reasoned that the assumption of Maher's personal promissory notes by Selectivend Corp. was tantamount to a distribution of property as defined by Section 317(a), which includes "money, securities, and any other property. " The court rejected Maher's argument regarding Section 301(b)(2), stating that this section applies only when a shareholder assumes a corporate liability, not the reverse scenario where the corporation assumes the shareholder's liability. The court emphasized that Maher's secondary liability on the notes did not equate to an assumption of corporate liability or receiving property subject to a liability under Section 301(b)(2)(B). The court also clarified that no agreement existed between Maher and the IRS to concede the absence of a constructive dividend for 1963.

Practical Implications

This ruling clarifies that when a corporation assumes a shareholder's personal liability, it is treated as a constructive dividend to the shareholder, subject to taxation. Legal practitioners advising clients on corporate transactions must consider the tax consequences of such actions. This decision also underscores the importance of understanding the specific language and application of tax code sections like 301(b)(2), which does not apply to reduce the taxable value of distributions when the corporation, rather than the shareholder, assumes liability. Businesses should be cautious of the tax implications of assuming shareholder liabilities, and subsequent cases have referenced Maher when addressing similar issues of constructive dividends and corporate liability assumptions.