Leisure Time Enterprises, Inc. v. Commissioner, 56 T. C. 1180 (1971)

A corporation classified as collapsible under IRC § 341(b) cannot avoid tax recognition on asset sales during liquidation under IRC § 337, regardless of the three-year rule applicable to shareholders.

Summary

Leisure Time Enterprises, Inc. , a corporation formed to construct and sell a swim club, sought nonrecognition of gain under IRC § 337 upon liquidation. The IRS argued it was a collapsible corporation under IRC § 341(b), thus ineligible for § 337 benefits. The Tax Court agreed, holding that the three-year rule in § 341(d)(3), which might benefit shareholders, does not affect the corporation's status under § 337(c)(1)(A). The decision clarifies that the collapsible corporation definition in § 341(b) solely determines § 337 applicability, emphasizing the statutory language and administrative interpretations.

Facts

In 1962, Louis P. Shassian, a residential developer, formed Leisure Time Enterprises, Inc. to construct and lease swim club facilities to a community group, Silverside Swim Club. The corporation leased the land, constructed the facilities through June 1962, and sold them to Silverside in July 1965 at a gain of $61,761. 66. Leisure Time was subsequently liquidated. The IRS determined that Leisure Time was a collapsible corporation under IRC § 341(b) and thus ineligible for nonrecognition of gain under IRC § 337.

Procedural History

The IRS issued a deficiency notice to Leisure Time Enterprises, Inc. for the tax year ended April 30, 1966, asserting that the corporation was a collapsible corporation under IRC § 341 and thus ineligible for nonrecognition under IRC § 337. Leisure Time contested this in the U. S. Tax Court, which upheld the IRS's determination, ruling that the gain must be recognized.

Issue(s)

1. Whether a corporation defined as collapsible under IRC § 341(b) can qualify for nonrecognition of gain under IRC § 337 when selling assets in liquidation, despite the potential applicability of the three-year rule in IRC § 341(d)(3) to its shareholders.

Holding

1. No, because IRC § 337(c)(1)(A) explicitly excludes from its nonrecognition provisions any sale or exchange made by a collapsible corporation as defined in IRC § 341(b), without regard to the three-year rule in IRC § 341(d)(3) applicable to

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shareholders.

Court’s Reasoning

The court’s decision was based on the clear statutory language of IRC § 337(c)(1)(A), which refers solely to the definition of a collapsible corporation under IRC § 341(b), without mention of the three-year rule in § 341(d)(3). The court emphasized that § 341(d)(3) pertains only to shareholders’ gains and does not alter the corporation’s status under § 337. Treasury regulations supported this interpretation, as did prior judicial decisions upholding the regulations’ validity. The court rejected the taxpayer’s argument that the statute’s purpose was to prevent more favorable tax treatment upon corporate asset sales than shareholder stock sales, noting that the legislative history did not support such a reading. The court also observed that a 1968 legislative proposal to amend the law to address this issue was not enacted, further supporting the IRS’s position.

Practical Implications

This decision clarifies that corporations classified as collapsible under IRC § 341(b) must recognize gains on asset sales during liquidation under IRC § 337, regardless of the three-year rule’s potential benefit to shareholders. Legal practitioners must carefully consider a corporation’s collapsible status when planning liquidations, as it directly impacts tax outcomes. The ruling reinforces the importance of precise statutory language and administrative interpretations in tax law, guiding future cases involving similar issues. It also highlights the need for legislative action to change existing tax rules, as subsequent legislative proposals to modify this rule were not enacted.

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