***Herbert Enoch and Naomi Enoch, et al. , Petitioners v. Commissioner of Internal Revenue, Respondent, 57 T. C. 781 (1972)***

A corporate redemption of stock does not result in a constructive dividend to the buyer unless the buyer had a personal, unconditional obligation to purchase the redeemed shares.

**Summary**

Herbert Enoch purchased Gloria Homes through R. R. R. , Inc. , using a complex financial arrangement involving corporate refinancing and stock redemption. The IRS claimed Enoch received a constructive dividend from the redemption of 19 shares, but the court disagreed, ruling that Enoch was not personally obligated to buy all shares. However, the court found that R. R. R. ‘s repayment of Enoch’s personal loan constituted a constructive dividend. The case also addressed various deductions claimed by R. R. R. , such as prepayment penalties, interest, and loan fees, resulting in disallowances for certain expenses not directly related to the corporation’s business.

**Facts**

Herbert Enoch sought to purchase Gloria Homes, an apartment complex owned by R. R. R. , Inc. The corporation’s stock was owned by A. Pollard Simons and Sunrise Mining Corp. Enoch financed the purchase by investing personal capital, refinancing the property, and borrowing from Union Bank. R. R. R. redeemed 19 shares of its stock from Simons and Sunrise, and Enoch purchased 1 share, gaining control of the corporation. The IRS challenged the transaction, claiming Enoch received a constructive dividend from the redemption and that R. R. R. improperly claimed various deductions.

**Procedural History**

The case was heard by the U. S. Tax Court. The IRS determined deficiencies in Enoch’s and R. R. R. ‘s income taxes for several years and imposed additions to the tax due to negligence. The petitioners contested these determinations, leading to a consolidated trial addressing multiple issues.

**Issue(s)**

1. Whether Enoch received a constructive dividend from R. R. R. ‘s redemption of 19 shares of stock?
2. Whether Enoch received a constructive dividend when R. R. R. repaid his personal loan from Union Bank?
3. Whether R. R. R. improperly claimed deductions for prepayment penalties, interest payments, travel expenses, loan and escrow fees, and incremental interest payments?
4. Whether the loss from the sale of U. S. Treasury bonds by R. R. R. was an

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ordinary or capital loss?
5. Whether the payment to Enoch's attorney should be added to Enoch's basis in R. R. R. stock?
6. Whether the amount received by Enoch in the final liquidation of R. R. R. was a repayment of a loan?
7. Whether Enoch's rental loss for 1965 should have been disallowed?
8. Whether the redemption substantially reduced R. R. R. 's earnings and profits account?
9. Whether part of the underpayment of taxes for 1964 and 1965 was due to negligence or intentional disregard of rules and regulations?

**Holding**

1. No, because Enoch was not under a personal, unconditional obligation to purchase all 20 shares of R. R. R. stock.
2. Yes, because the repayment of Enoch's personal loan by R. R. R. was a constructive dividend to him.
3. Yes, R. R. R. improperly claimed deductions for prepayment penalties, interest payments on Enoch's loan, travel expenses, and certain loan and escrow fees.
4. The loss from the sale of U. S. Treasury bonds was an ordinary loss, as the bonds were integral to R. R. R. 's business.
5. Yes, the payment to Enoch's attorney should be added to Enoch's basis in R. R. R. stock.
6. Yes, the amount received by Enoch in the final liquidation was a repayment of a loan.
7. Yes, Enoch's rental loss for 1965 was properly disallowed.
8. Yes, the redemption substantially reduced R. R. R. 's earnings and profits account.
9. Yes, part of the underpayment of taxes for 1964 and 1965 was due to negligence or intentional disregard of rules and regulations.

**Court's Reasoning**

The court analyzed whether Enoch had a personal obligation to purchase all shares, concluding he did not, as evidenced by escrow instructions and the economic realities of the transaction. For the Union Bank loan, the court found it was Enoch's personal obligation, and its repayment by R. R. R. constituted a constructive dividend. The court disallowed certain deductions claimed by R. R. R. because they were personal obligations or not directly related to the corporation's business. The court applied the "economic reality" test from *Goldstein v. Commissioner* to determine the deductibility of interest payments. The court also considered the nature of the U. S. Treasury bonds in relation to R. R. R. 's business and found them integral, justifying ordinary loss treatment. The court used the "capital account" definition from *Helvering v. Jarvis* to assess the impact of the redemption on earnings and profits. Finally, the court upheld the negligence penalty due to Enoch's failure to provide accurate information for his tax returns.

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## Practical Implications

This decision clarifies that a corporate redemption does not result in a constructive dividend to the buyer unless the buyer had a personal, unconditional obligation to purchase the redeemed shares. It emphasizes the importance of distinguishing between corporate and personal obligations in tax planning. The ruling on constructive dividends impacts how similar transactions should be structured to avoid unintended tax consequences. The decision also guides the deductibility of expenses and the treatment of losses from assets integral to a business. Subsequent cases should analyze redemption transactions and constructive dividends in light of this ruling, considering the specific obligations and economic realities involved. The case underscores the need for taxpayers to provide accurate information to their tax preparers to avoid negligence penalties.

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