Alexander v. Commissioner, 61 T. C. 278 (1973)

A shareholder can be liable as a transferee for a corporation's tax liabilities upon liquidation, even if the purchasing party contractually assumed those liabilities.

Summary

In Alexander v. Commissioner, the U. S. Tax Court addressed the tax implications of a corporate asset sale and subsequent liquidation. Morris Alexander, the principal shareholder of Perma-Line Corp. , received a distribution upon its liquidation. The court held that Alexander was liable as a transferee for Perma-Line's pre-existing tax liabilities, despite the purchasers' contractual assumption of these liabilities. Additionally, the court ruled that an advance received by Alexander was taxable income, and it allocated the sale proceeds between trade accounts receivable and a loan receivable from Alexander. The decision underscores the importance of considering transferee liability in corporate liquidations and the tax treatment of advances and debt cancellations.

Facts

Perma-Line Corp. sold its assets to a partnership (P-L) in October 1966 for $150,000 cash and the assumption of most liabilities, including tax liabilities. Morris Alexander, the president and majority shareholder, received a cash distribution of $117,741. 14 and a life insurance policy upon Perma-Line's liquidation in November 1966. Alexander also received $42,500 from P-L, which he claimed was a loan. Additionally, an open account debt of $149,602 owed by Alexander to Perma-Line was assigned to the Pritzker and Freund Foundations, secured by future commissions Alexander was to receive from P-L. Perma-Line's final tax return claimed a net operating loss, but the IRS determined deficiencies and sought to collect them from Alexander as a transferee.

Procedural History

The IRS determined deficiencies in Alexander's individual income taxes for 1966 and 1967, as well as transferee liabilities for Perma-Line's corporate taxes. Alexander petitioned the U. S. Tax Court to challenge these determinations. The Tax Court consolidated the cases related to Alexander's individual and transferee liabilities.

Issue(s)

1. Whether the cancellation of Alexander's $149,602 debt to Perma-Line was a taxable liquidation distribution under section 331(a)(1)?
2. Was the $42,500 received by Alexander from P-L taxable as income under section 61?
3. Is Alexander liable as a transferee for Perma-Line's unpaid tax liabilities?
4. How should the $400,000 sale price be allocated between Perma-Line's trade accounts receivable and the account due from Alexander?

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5. Had the statute of limitations expired on the assessment of transferee liability against Alexander?

Holding

1. No, because the debt was not canceled but assigned to third parties as part of the asset sale, and Alexander remained obligated to repay it from future commissions.
2. Yes, because the $42,500 was an advance on future commissions and not a true loan, as repayment was contingent on Alexander earning sufficient commissions.
3. Yes, Alexander is liable as a transferee for Perma-Line's tax liabilities existing at the time of liquidation, but not for liabilities arising from post-liquidation refunds.
4. The court allocated $320,000 to trade accounts receivable and $80,000 to the account due from Alexander, based on the fair market values of these assets.
5. No, the notices of transferee liability were issued within one year after the expiration of the limitations period for assessing taxes against Perma-Line, as required by section 6901(c)(1).

Court's Reasoning

The court applied the following legal rules and considerations:
– Under section 331(a)(1), a debt cancellation in connection with liquidation is treated as a distribution, but the court found that Alexander's debt was not canceled but assigned.
– Section 61 taxes all income from whatever source derived, and the court determined that the $42,500 advance was taxable because repayment was contingent on future commissions.
– Under Illinois fraudulent conveyance law, a transferee can be liable for a transferor's debts if the transfer was made without consideration and rendered the transferor insolvent. The court held that the liquidation distribution rendered Perma-Line insolvent, making Alexander liable for its pre-existing tax liabilities.
– The court rejected Alexander's argument that the purchasers' assumption of tax liabilities relieved him of transferee liability, citing the several nature of such liability.
– The allocation of the sale proceeds was based on the fair market values of the assets, considering the slow-paying nature of municipal accounts and the unsecured nature of Alexander's debt.
– The court upheld the timeliness of the transferee liability assessments under section 6901(c)(1), rejecting the argument that a notice of deficiency must be sent to the transferor before assessing transferee liability.

Practical Implications

This decision has significant implications for corporate liquidations and the tax treatment of related transactions:
– Shareholders and corporate officers must be aware of potential transferee liability for corporate tax debts upon liquidation, even if the purchasing party contractually

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assumes those debts.
– Advances to shareholders that are repayable only from future income may be treated as taxable income upon receipt.
– The allocation of sale proceeds in a bulk asset sale should be based on the fair market values of the assets, which may require careful documentation and valuation.
– Practitioners should advise clients on the importance of timely filing corporate tax returns and addressing potential tax liabilities before liquidation to minimize transferee liability risks.
– Subsequent cases have cited Alexander v. Commissioner in addressing transferee liability and the tax treatment of corporate liquidations, including cases involving the application of state fraudulent conveyance laws to federal tax liabilities.

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