Robin Haft Trust v. Commissioner, 61 T. C. 398 (1973)

The attribution rules of IRC Section 318 must be applied when determining whether a stock redemption is essentially equivalent to a dividend under IRC Section 302(b)(1), regardless of family discord.

Summary

In *Robin Haft Trust v. Commissioner*, the United States Tax Court addressed whether a stock redemption in the context of a divorce settlement qualified as a capital gain or a dividend under IRC Sections 302 and 318. The trusts, created by Joseph C. Foster for his grandchildren, held stock in Haft-Gaines Co. and sought redemption during a family dispute. The court held that the redemption was essentially equivalent to a dividend because the attribution rules must be applied, resulting in no meaningful reduction in the shareholders' interest. The decision underscores the rigidity of attribution rules and their impact on redemption transactions, emphasizing that personal family conflicts do not negate these statutory provisions.

Facts

Joseph C. Foster created trusts for his grandchildren, transferring 100,000 shares of Haft-Gaines Co. stock to them. During a contentious divorce between Marcia Haft and Burt Haft, the trusts negotiated the redemption of their shares for $200,000. Before the redemption, each trust owned 25,000 shares, representing 5% of the corporation's total shares. After redemption, no shares were directly held by the trusts, but through attribution, their ownership interest increased from 31 2/3% to 33 1/3% due to Burt Haft's ownership.

Procedural History

The trusts reported the redemption proceeds as long-term capital gains on their 1967 tax returns. The Commissioner of Internal Revenue determined deficiencies, treating the gains as dividends. The Tax Court consolidated the cases of the four trusts and upheld the Commissioner's determination, ruling against the trusts.

Issue(s)

1. Whether the redemption of the trusts' stock was not essentially equivalent to a dividend under IRC Section 302(b)(1).
2. Whether the redemption resulted in a complete termination of the trusts' interest in the corporation under IRC Section 302(b)(3).

Holding

1. No, because the attribution rules under IRC Section 318 must be applied, resulting in no meaningful reduction in the shareholders' proportionate interest in

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the corporation.
2. No, because the trusts did not file the required agreement under IRC Section 302(c)(2)(A)(iii), thus the attribution rules were applicable, and the redemption did not result in a complete termination of their interest.

Court's Reasoning

The court applied the attribution rules of IRC Section 318, following the Supreme Court's decision in *United States v. Davis*, which emphasized the plain language of the statute and the legislative intent to provide definite rules for redemption transactions. The court rejected the trusts' argument that family discord should negate the application of these rules, stating that doing so would introduce uncertainty and contradict the statute's purpose. The court calculated that the trusts' ownership interest increased after redemption when applying the attribution rules, and thus, the redemption was essentially equivalent to a dividend. The court also noted the trusts' failure to file the required agreement to avoid attribution, which precluded them from qualifying for a complete termination of interest under IRC Section 302(b)(3).

Practical Implications

This decision reinforces the strict application of attribution rules in stock redemption cases, regardless of personal or family circumstances. Legal practitioners must advise clients on the necessity of filing agreements to avoid attribution when seeking to qualify redemptions as exchanges under IRC Section 302(b)(3). The case has implications for tax planning in family-owned businesses, especially during divorce or family disputes, as it highlights the potential tax consequences of stock redemptions. Subsequent cases have followed this precedent, solidifying the principle that attribution rules are not flexible based on family relationships.

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