Reitz v. Commissioner, 61 T. C. 443 (1974)

Distributions made by a corporation prior to the gift of its stock are treated as dividends and not as proceeds from a sale, redemption, or partial liquidation.

Summary

In Reitz v. Commissioner, the Tax Court ruled that a distribution made by a corporation immediately before the shareholders gifted all corporate stock to a governmental agency was taxable as a dividend, not as capital gain from a sale or liquidation. Percy and Hazel Reitz, who owned all shares of a hospital corporation, arranged for the corporation to declare and pay a dividend of all its cash and receivables before gifting the stock to a local hospital board. The court emphasized that the substance of the transaction matched its form as a dividend, rejecting the Reitzes' arguments that it should be treated as part of a sale or redemption of their stock.

Facts

Percy A. Reitz and Hazel A. Reitz owned all 200 shares of Pittsburg Medical & Surgical Hospital, Inc. In late 1968, they proposed to gift the stock to a local governmental agency, the Camp County-City of Pittsburg Hospital Board, after the hospital declared and paid a dividend consisting of all its cash, petty cash, bank deposits, and accounts receivable for services rendered prior to December 1, 1968. The dividend, totaling $87,874. 63, was distributed to the Reitzes on November 30, 1968. The following day, the Reitzes transferred the hospital stock to the board, which later dissolved the corporation in April 1969. The Reitzes reported the dividend as long-term capital gain from a stock sale, but the Commissioner of Internal Revenue treated it as ordinary income from a dividend.

Procedural History

The Commissioner determined deficiencies in the Reitzes' income taxes for 1968 and 1969, asserting the distribution should be treated as a dividend. The Reitzes petitioned the U. S. Tax Court, which heard the case based on fully stipulated facts. The court ruled in favor of the Commissioner, holding the distribution to be a dividend.

Issue(s)

1. Whether the distribution of cash and receivables by the hospital corporation to the Reitzes prior to the gift of the stock should be treated as a dividend under section 316 of the Internal Revenue Code.
2. Whether the distribution should instead be treated as proceeds from a sale, redemption, or partial liquidation of the stock, thereby entitling the Reitzes to capital gains treatment.

© 2025 SCOTUSreports.com. All rights reserved.

Holding

1. Yes, because the distribution was a dividend in substance as well as form, consistent with the statutory definition under section 316.
2. No, because there was no evidence of a sale or redemption agreement, and the distribution was not part of a liquidation plan involving the Reitzes.

Court's Reasoning

The court focused on the substance over the form of the transaction, but found that the form accurately reflected its substance as a dividend. The Reitzes proposed the dividend as a condition of their gift, and the hospital board had no role in negotiating the terms or the amount of the distribution. The court distinguished this case from others where distributions were part of a sale or redemption, noting the absence of any bilateral negotiations or contractual agreements to treat the distribution as purchase price or redemption proceeds. The court also rejected the Reitzes' alternative arguments for treating the distribution as a redemption or partial liquidation, finding no evidence to support these characterizations. The court cited the principle that taxpayers are bound by the method they choose to accomplish their goals, referencing cases like Gregory v. Helvering and Carrington v. Commissioner to support its decision.

Practical Implications

This ruling reinforces the principle that the tax treatment of corporate distributions depends on their substance and form at the time they are made. For attorneys advising clients on corporate restructuring or gifting, this case highlights the importance of carefully structuring transactions to achieve desired tax outcomes. If a distribution is intended to be treated as part of a sale or redemption, clear evidence of a binding agreement must be present before the distribution is made. This decision may impact how shareholders and their advisors plan corporate gifts, especially when considering the tax treatment of distributions made close to the time of such gifts. Subsequent cases have cited Reitz v. Commissioner when analyzing the tax implications of pre-gift corporate distributions, often distinguishing the case based on the presence or absence of a sale or redemption agreement.

© 2025 SCOTUSreports.com. All rights reserved.