Crowe v. Commissioner, 62 T. C. 121, 1974 U. S. Tax Ct. LEXIS 119, 62 T. C. No. 14 (1974)

A corporation is not collapsible if a shareholder's stock sale is compelled by circumstances beyond their control, not reflecting a pre-existing intent to sell before substantial income is realized.

Summary

In Crowe v. Commissioner, the Tax Court ruled that Rayburn Land Co. was not a collapsible corporation under IRC Section 341 because Joseph Crowe's sale of his stock was compelled by circumstances beyond his control. Crowe was forced to sell his shares to Time, Inc. due to policy disagreements, not with a pre-existing intent to sell before the company realized substantial income. The court emphasized that the lack of free choice negated the view to sell stock as required by the collapsible corporation rules, allowing Crowe to treat his gain as long-term capital gain rather than ordinary income.

Facts

Joseph Crowe purchased 50% of Rayburn Land Co. 's stock from Time, Inc. , with each party investing $50,000. As part of the deal, Crowe reluctantly agreed to a five-year unilateral option allowing Time to repurchase his shares at a predetermined escalating price. Crowe became president and general manager of Rayburn, which was engaged in real estate development at Sam Rayburn Lake. Disagreements over development policy led to Crowe's attempt to gain control or sell his shares. Time exercised the option in the second year, buying Crowe's stock for $350,000. Crowe reported the gain as long-term capital gain, while the IRS argued it should be treated as ordinary income under the collapsible corporation rules.

Procedural History

The IRS determined a deficiency in Crowe's 1966 federal income taxes, treating the gain from his Rayburn stock sale as ordinary income under Section 341. Crowe petitioned the U. S. Tax Court, which heard the case and issued its opinion on April 30, 1974, ruling in favor of Crowe.

Issue(s)

1. Whether Rayburn Land Co. was a collapsible corporation under IRC Section 341, given that Crowe's stock sale was compelled by circumstances beyond his control?

Holding

1. No, because the sale was compelled by circumstances beyond Crowe's control, negating any pre-existing view to sell the stock as required by Section 341.

Court’s Reasoning

The court applied the collapsible corporation rules of IRC Section 341, focusing on whether Crowe had the requisite “view to sell” his stock before Rayburn realized substantial income. The court distinguished this case from others by noting that Crowe’s sale was not a free choice but was compelled by Time’s exercise of its option due to policy disagreements. The court cited Commissioner v. Lowery and Commissioner v. Solow, where similar compelled sales were not treated under Section 341. The court rejected the IRS’s arguments that Time’s control over Rayburn’s policies or the option’s existence indicated a pre-existing view to sell. Instead, the court found that the option was a remote possibility at the time of the agreement, and Crowe’s actions were a response to unforeseen circumstances, negating the “view to sell” required for collapsible corporation treatment.

Practical Implications

This decision clarifies that a shareholder’s compelled sale of stock, due to circumstances beyond their control, does not trigger collapsible corporation treatment under IRC Section 341. Practitioners should analyze whether a client’s stock sale was a free choice or compelled by external factors when determining tax treatment. This ruling may encourage the use of options in shareholder agreements as a protective measure without fear of collapsible corporation consequences, provided the option’s exercise is not anticipated at the time of the agreement. Subsequent cases like Commissioner v. Solow have reinforced this principle, emphasizing the importance of the shareholder’s control over the decision to sell.

