Niedermeyer v. Commissioner, 62 T. C. 280 (1974)

Section 304(a)(1) applies to treat stock sales between related corporations as redemptions, even when the seller does not directly own stock in the acquiring corporation.

Summary

In Niedermeyer v. Commissioner, the U. S. Tax Court ruled that the sale of AT&T common stock by Bernard and Tessie Niedermeyer to Lents Industries, a related corporation, was a redemption under Section 304(a)(1). The court found that despite the Niedermeyers' lack of direct ownership in Lents, their sons' control of both corporations triggered constructive ownership rules. The transaction did not qualify as an exchange under Section 302(b)(1) or (b)(3), resulting in the proceeds being taxed as dividends. This case highlights the application of constructive ownership rules and the importance of meeting specific tests for tax treatment as an exchange.

Facts

Bernard and Tessie Niedermeyer owned 22. 58% of AT&T's common stock and 125 shares of its preferred stock. Their sons owned 67. 91% of AT&T's common stock and 67% of Lents Industries' common stock. On September 8, 1966, the Niedermeyers sold their AT&T common stock to Lents for $174,975. 12 and later donated their AT&T preferred stock to a charity. The IRS treated this sale as a dividend, not a capital gain, leading to a tax dispute.

Procedural History

The IRS assessed a deficiency against the Niedermeyers for 1966, treating the proceeds from the stock sale as a dividend. The Niedermeyers petitioned the U. S. Tax Court, arguing the sale should be treated as a capital gain. The Tax Court ruled in favor of the Commissioner, applying Section 304(a)(1) and determining the transaction did not qualify as an exchange under Section 302.

Issue(s)

1. Whether the sale of AT&T common stock by the Niedermeyers to Lents Industries was a redemption through the use of a related corporation under Section 304(a)(1).
2. Whether the redemption qualified for treatment as an exchange under either Section 302(b)(1) or Section 302(b)(3).

Holding

1. Yes, because the Niedermeyers constructively owned stock in both AT&T and Lents, triggering Section 304(a)(1).
2. No, because the redemption did not result in a meaningful reduction of the Niedermeyers' proportionate interest in AT&T under Section 302(b)(1), and they did

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not completely terminate their interest in AT&T under Section 302(b)(3).

Court’s Reasoning

The court applied the constructive ownership rules of Section 318(a) to find that the Niedermeyers controlled both AT&T and Lents, thus triggering Section 304(a)(1). The court rejected arguments to avoid attribution rules based on family disputes, emphasizing the mandatory nature of these rules. For Section 302(b)(1), the court found that the Niedermeyers’ ownership decreased from 90. 49% to 82. 96% post-redemption, which was not a meaningful reduction. Under Section 302(b)(3), the court ruled that the Niedermeyers did not completely terminate their interest in AT&T due to retaining preferred stock until December 28, 1966, and failing to establish a firm plan to donate it earlier.

Practical Implications

This decision underscores the importance of understanding constructive ownership rules under Section 304 when structuring transactions between related corporations. It serves as a reminder that family disputes do not negate attribution rules. Practitioners should carefully analyze whether transactions qualify as exchanges under Section 302, considering the timing and completeness of interest termination. The case also highlights the necessity of documenting and executing plans to ensure favorable tax treatment. Subsequent cases, such as Coyle v. United States and Fehrs Finance Co. , have reinforced the application of Section 304 and the attribution rules.

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