Cohen v. Commissioner, 65 T. C. 554 (1975)

An election under Section 333 of the Internal Revenue Code cannot be revoked except in cases of material mistake of fact.

Summary

In Cohen v. Commissioner, the Tax Court ruled that shareholders of Rucind, Inc. could not revoke their Section 333 election to liquidate the corporation, even though they argued they relied on an erroneous earnings and profits figure. The court found that the shareholders had full knowledge of the sale of the corporation's sole asset and the resulting gain, and their mistake was one of law, not fact. Therefore, the gain from the sale had to be recognized by the corporation, increasing its earnings and profits, and the shareholders were subject to dividend income treatment under Section 333(e). This case underscores the binding nature of Section 333 elections and the limited circumstances under which they can be revoked.

Facts

Rucind, Inc. , a New Jersey corporation, owned a tract of land in Norwood, New Jersey, as its sole asset. On February 18, 1969, Rucind, Inc. contracted to sell this property to John E. Purcell for $440,000. On October 1, 1969, the shareholders and directors of Rucind, Inc. adopted a plan to liquidate the corporation under Section 333. The corporation and its shareholders timely filed the necessary forms for this election. On October 3, 1969, the property was transferred to the shareholders, and on October 7, 1969, the shareholders sold the property to Purcell. The shareholders reported the transaction on their 1969 tax returns as an installment sale, while Rucind, Inc. did not include the gain in its taxable income, relying on the Section 333 liquidation provisions.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the petitioners' federal income taxes for 1969, asserting that the gain from the sale should be recognized by Rucind, Inc. , increasing its earnings and profits, and thus subjecting the shareholders to dividend income under Section 333(e). The petitioners challenged this determination in the Tax Court, arguing that they should be allowed to revoke their Section 333 election due to a material mistake of fact regarding the corporation's earnings and profits.

Issue(s)

1. Whether the sale of the Norwood property was made by Rucind, Inc. , for tax purposes.
2. Whether the shareholders of Rucind, Inc. can revoke or avoid an election made under Section 333, thereby avoiding dividend treatment under Section 333(e) and non-recognition of gain by Rucind, Inc. under Section 337.

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Holding

1. Yes, because Rucind, Inc. executed the contract of sale, the sale was made by the corporation.
2. No, because the shareholders' mistake was one of law, not fact, and thus did not allow for revocation of the Section 333 election.

Court's Reasoning

The court applied the legal principle from Commissioner v. Court Holding Co. that the sale was made by Rucind, Inc. , as evidenced by the corporation's execution of the contract of sale. Regarding the revocation of the Section 333 election, the court relied on the regulation that such elections are irrevocable except in cases of material mistake of fact. The court found that the petitioners' mistake was a misunderstanding of the law, not a mistake of fact, as they were fully aware of the sale and the resulting gain. The court cited Estate of George Stamos and Raymond v. United States to support its conclusion that ignorance of the law or misapplication of the law does not allow for revocation of an election. The court also distinguished the case from Meyer's Estate v. Commissioner, where a material mistake of fact was present.

Practical Implications

This decision reinforces the importance of careful consideration before making a Section 333 election, as it is generally irrevocable. Taxpayers must fully understand the legal and tax consequences of such an election and cannot rely on ignorance of the law or misapplication of the law to revoke it. This case may influence how tax practitioners advise clients on corporate liquidations, emphasizing the need for accurate calculation of earnings and profits and thorough understanding of the applicable tax laws. It also highlights the potential for the IRS to challenge the tax treatment of corporate liquidations and the importance of proper documentation and adherence to tax procedures.

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