L. C. Bohart Plumbing & Heating Co. , Inc. , Petitioner v. Commissioner of Internal Revenue, Respondent, 64 T. C. 602 (1975)

A liquidating personal holding company must timely designate part of its liquidating distribution as a dividend to qualify for the dividends paid deduction.

Summary

L. C. Bohart Plumbing & Heating Co. liquidated and distributed its assets to its sole shareholder within 24 months of adopting a liquidation plan. It failed to designate any part of the distribution as a dividend or notify the IRS within the prescribed time. Later, upon an IRS audit, it attempted to retroactively claim a dividends paid deduction. The Tax Court held that the company was not entitled to the deduction because it did not comply with the timely designation requirement under section 316(b)(2)(B)(ii), emphasizing the importance of timely notification to prevent tax evasion by personal holding companies.

Facts

L. C. Bohart Plumbing & Heating Co. , a California corporation, adopted a plan of liquidation on September 11, 1968, and distributed all its assets to its sole shareholder, Lewis C. Bohart, between December 1, 1968, and February 28, 1969. The company did not designate any part of the distribution as a dividend or notify the IRS of its personal holding company status on its final tax return. In 1970, during an IRS audit, the company was informed it was a personal holding company and subject to tax on undistributed personal holding company income. It then filed an amended return, claiming a dividends paid deduction for part of the liquidating distribution, but this was after the prescribed time for such designation had passed.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the company's tax, which the company contested. The case was heard by the United States Tax Court, which issued its decision on July 21, 1975, ruling in favor of the Commissioner.

Issue(s)

1. Whether a liquidating personal holding company can retroactively designate part of its liquidating distribution as a dividend after the expiration of the period fixed by applicable Treasury regulations for such designation?

Holding

1. No, because the company failed to designate the amount as a dividend within the time prescribed by the regulations pursuant to section 316(b)(2)(B)(ii), it is not entitled to a deduction for dividends paid and must include that amount in its

undistributed personal holding company income.

Court's Reasoning

The Tax Court applied section 316(b)(2)(B)(ii), which requires a personal holding company to designate amounts distributed in liquidation as dividends and notify the distributees within the time set by regulations. The court noted that timely designation and notification are crucial to ensure that liquidating distributions are taxed as dividends at the shareholder level, aligning with the legislative intent to prevent tax evasion by personal holding companies. The court rejected the company's argument that the failure to timely designate did not affect the distribution's character, emphasizing that Congress intended to close a loophole where companies could claim a dividends paid deduction without shareholders being taxed at ordinary income rates. The court also upheld the validity of the Treasury regulations setting time limits for designation, stating they were necessary to enforce the statutory purpose. The court concluded that the company's failure to comply with these time limits meant it could not claim the deduction.

Practical Implications

This decision underscores the importance of timely compliance with IRS regulations for personal holding companies undergoing liquidation. Companies must designate dividends and notify the IRS and shareholders within the prescribed time to claim the dividends paid deduction. This ruling affects how tax practitioners advise clients on liquidating distributions, emphasizing the need for careful planning to avoid heavy tax burdens. It also impacts business decisions regarding the timing and structure of liquidations. Subsequent cases have followed this precedent, reinforcing the need for strict adherence to IRS notification requirements in similar situations.

