Hill v. Commissioner, 66 T. C. 701 (1976)

A corporation remains a taxable entity for federal income tax purposes despite involuntary dissolution under state law if it continues to conduct business activities.

Summary

In Hill v. Commissioner, the Tax Court ruled that a corporation remains a viable entity for federal income tax purposes even after its involuntary dissolution under state law if it continues to engage in business activities. The Hills sold property under threat of condemnation and claimed nonrecognition of gain under IRC Section 1033, asserting they reinvested the proceeds in a new property through their corporation, Dumfries Marine Sales, Inc. , which had been dissolved. The court held that Dumfries, despite its dissolution, continued to operate and thus was the owner of the replacement property, not the Hills. Consequently, the Hills were not entitled to nonrecognition of gain, and their adjusted basis in the condemned property was upheld as determined by the Commissioner.

Facts

The Hills purchased Sweden Point Marina in 1960. After a failed sale and subsequent foreclosure, they repurchased the property in 1967. In 1969, they sold it under threat of condemnation to the State of Maryland for $100,000. The Hills claimed nonrecognition of gain under IRC Section 1033, asserting the proceeds were reinvested in a barge and restaurant built by Dumfries Marine Sales, Inc. , their wholly owned corporation. Dumfries was involuntarily dissolved in 1967 but continued to conduct business, including leasing the new restaurant, filing tax returns, and mortgaging property.

Procedural History

The Commissioner determined a deficiency in the Hills' 1969 income taxes, disallowing the nonrecognition of gain. The Hills petitioned the Tax Court, arguing they were entitled to nonrecognition under Section 1033 and challenging the Commissioner's determination of their adjusted basis in Sweden Point. The Tax Court ruled in favor of the Commissioner on both issues.

Issue(s)

1. Whether the Hills are entitled to nonrecognition of gain under IRC Section 1033 when the replacement property was purchased by their wholly owned corporation, Dumfries, which had been involuntarily dissolved under state law.
2. Whether the Hills' adjusted basis in Sweden Point exceeds the amount determined by the Commissioner.

Holding

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1. No, because Dumfries, despite being involuntarily dissolved, continued to exist as a taxable entity for federal income tax purposes and was the owner of the replacement property, not the Hills.
2. No, because the Hills failed to prove their adjusted basis exceeded the Commissioner's determination of $33,375.

Court's Reasoning

The court reasoned that for federal income tax purposes, a corporation's charter annulment does not necessarily terminate its existence if it continues to operate. The court cited cases like J. Ungar, Inc. , Sidney Messer, and Hersloff v. United States to establish that Dumfries' continued business activities post-dissolution meant it remained a viable entity. The court also referenced Adolph K. Feinberg, which held that a taxpayer's wholly owned corporation purchasing replacement property does not fulfill the statutory requirement for nonrecognition under Section 1033. The Hills' failure to provide sufficient evidence to support their claimed adjusted basis in Sweden Point led to the court upholding the Commissioner's determination. The court emphasized that the Commissioner's determinations are presumptively correct, and the burden of proof lies with the taxpayer.

Practical Implications

This decision underscores the importance of understanding the continued existence of a corporation for federal income tax purposes, even after state law dissolution. Practitioners should advise clients that ongoing business activities can maintain corporate status, impacting tax treatment of asset transactions. The ruling clarifies that nonrecognition provisions like Section 1033 apply to the actual owner of replacement property, not just to the individual taxpayer. This case also reinforces the need for taxpayers to substantiate their claimed basis in property with clear evidence, as the burden of proof remains with them. Subsequent cases applying this principle include situations involving corporate dissolution and tax treatment, ensuring consistent application of the rule established in Hill.

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