W. & B. Liquidating Corp. v. Commissioner, 71 T. C. 493 (1979)

A corporation must recognize gain from an involuntary conversion if it liquidates before completing the replacement of the converted property.

Summary

In W. & B. Liquidating Corp. v. Commissioner, the Tax Court ruled that a corporation must recognize gain from an involuntary conversion when it liquidates before fully replacing the converted property. W. & B. Liquidating Corp. 's machine shop was damaged by fire, and the company began reconstruction. However, before completion, W. & B. sold its assets, including the insurance proceeds and reconstruction contract, to another company. The court held that W. & B. must recognize the gain from the conversion, minus the amount it reinvested before the sale, because it did not "purchase" the replacement property as required by section 1033(a)(3)(A) of the Internal Revenue Code after the sale.

Facts

On March 2, 1972, W. & B. Liquidating Corp. 's machine shop was severely damaged by fire. W. & B. contracted with Frank Conlon to reconstruct the shop. On May 9, 1972, W. & B. adopted a plan of complete liquidation under section 337. On May 31, 1972, W. & B. sold all its assets to Syracuse China Corp. , including the right to the fire insurance proceeds and the obligation to complete the reconstruction. W. & B. had paid Conlon $43,007. 36 for work completed by May 31, 1972. Syracuse completed the reconstruction and received the insurance proceeds. W. & B. distributed its remaining assets to shareholders on March 15, 1973, and was dissolved on April 20, 1973.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in W. & B. 's income tax for the taxable year ending June 30, 1972, and assessed transferee liability against W. & B. 's shareholders. W. & B. and its shareholders petitioned the U. S. Tax Court, which consolidated the cases for trial, briefing, and opinion. The Tax Court ruled in favor of the Commissioner, holding that W. & B. must recognize the gain from the involuntary conversion.

Issue(s)

1. Whether W. & B. Liquidating Corp. must recognize the income realized through the involuntary conversion of its machine shop.

Holding

1. Yes, because W. & B. did not "purchase" replacement property within the meaning of section 1033(a)(3)(A) after selling its assets to Syracuse China Corp. ,

and thus must recognize gain to the extent its gain on the involuntary conversion exceeded the $43,007 reinvested amount.

Court's Reasoning

The court applied section 1033(a) of the Internal Revenue Code, which generally requires recognition of gain from an involuntary conversion unless the taxpayer purchases replacement property within a specified period. The court found that W. & B. did not "purchase" the reconstructed machine shop after May 31, 1972, when it sold its assets to Syracuse, as Syracuse assumed ownership and control of the shop and its reconstruction. The court rejected W. & B. 's argument that it purchased the replacement property through its contract with Conlon, as Syracuse assumed the liability under that contract. The court also found no agency relationship between W. & B. and Syracuse, distinguishing this case from others where fiduciaries acted on behalf of taxpayers. The court relied on the principle that for section 1033(a)(3)(A) purposes, a purchase occurs when the benefits and burdens of ownership are acquired, which W. & B. did not possess after the sale to Syracuse.

Practical Implications

This decision clarifies that a corporation must complete the replacement of involuntarily converted property before liquidating to qualify for nonrecognition of gain under section 1033(a)(3)(A). Corporations planning to liquidate after an involuntary conversion should ensure they retain ownership and control of the replacement property until its completion. The ruling may affect how corporations structure asset sales and liquidations in the context of involuntary conversions, requiring them to carefully time their actions to minimize tax liability. This case has been cited in subsequent decisions addressing similar issues, reinforcing the principle that the benefits and burdens of ownership must be held by the corporation seeking nonrecognition treatment.

