Rodgers P. Johnson Trust v. Commissioner, 71 T. C. 941 (1979)

A trust can file a waiver agreement under section 302(c)(2) to prevent attribution of stock owned by the beneficiary's relatives, enabling the trust to qualify for tax-favored treatment upon stock redemption.

Summary

In Rodgers P. Johnson Trust v. Commissioner, the U. S. Tax Court ruled that a trust can file a waiver agreement to prevent stock attribution under section 302(c)(2), allowing the trust to qualify for tax-favored treatment upon redemption of its stock in Crescent Oil Co. The trust, created by Rodgers P. Johnson's will, sought to redeem its shares in Crescent Oil for income-producing assets. The court held that the trust's waiver agreement was valid, preventing attribution of stock owned by the beneficiary's mother to the trust, thus qualifying the redemption for exchange treatment under section 302(b)(3). This decision expands the scope of entities eligible to file such agreements, impacting how trusts manage closely held stock.

Facts

Rodgers P. Johnson Trust was created by the will of Rodgers P. Johnson, with Harrison Johnson and Martha M. Johnson as trustees, and Philip R. Johnson as the beneficiary. In 1973, the trust owned 112 shares of Crescent Oil Co. , which did not pay dividends. The trustees sought to redeem these shares for income-producing assets, exchanging them for Union Gas Co. stock. Martha M. Johnson, Philip's mother, owned 920 shares of Crescent Oil. The trustees and Philip filed waiver agreements under section 302(c)(2) to prevent attribution of Martha's shares to the trust, which would otherwise disqualify the redemption from tax-favored treatment.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the trust's federal income taxes for 1972 and 1973, treating the redemption as a taxable dividend. The trust petitioned the U. S. Tax Court, which decided that the redemption should be treated as an exchange under section 302(b)(3) due to the valid waiver agreement filed by the trust.

Issue(s)

1. Whether a trust can file a waiver agreement under section 302(c)(2) to prevent attribution of stock owned by the beneficiary's relatives.
2. Whether the redemption of the trust's stock in Crescent Oil Co. should be treated as an exchange under section 302(b)(3).

Holding

1. Yes, because the term "distributee" in section 302(c)(2) applies to trusts as well

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as estates and individuals, allowing the trust to file a valid waiver agreement.
2. Yes, because the valid waiver agreement filed by the trust prevented attribution of stock owned by Martha M. Johnson to the trust, qualifying the redemption for exchange treatment under section 302(b)(3).

Court's Reasoning

The court's decision hinged on the interpretation of "distributee" in section 302(c)(2), which it found applicable to trusts, estates, and individuals. The court rejected the Commissioner's argument that only family members could file waiver agreements, citing the plain language of the statute and its prior decision in Crawford v. Commissioner. The court emphasized that allowing trusts to file waiver agreements prevents "lock-in" situations where trustees cannot dispose of non-income-producing, closely held stock. The court also noted that the trust's waiver agreement met all formal requirements, and the redemption did not meet the requirements for exchange treatment under sections 302(b)(1) or (b)(2) without the waiver.

Practical Implications

This decision significantly impacts how trusts can manage their investments in closely held stock. By allowing trusts to file waiver agreements, the court enables trustees to replace non-income-producing assets with income-generating ones without adverse tax consequences. This ruling expands the planning options for trusts holding closely held stock, particularly in cases where the stock does not pay dividends. The decision also clarifies that the term "distributee" in section 302(c)(2) is broadly interpreted, which may influence future cases involving estates and other entities. Subsequent cases may need to consider the potential for abuse if beneficiaries acquire stock within the 10-year period following redemption, as this could trigger ordinary income treatment.

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