Ramm v. Commissioner, 72 T. C. 671 (1979)

Liquidation of a Subchapter S corporation does not qualify as a mere change in the form of conducting a trade or business for investment tax credit recapture purposes if the business's scope and operations are substantially altered post-liquidation.

Summary

In Ramm v. Commissioner, the Tax Court ruled that the liquidation of Valley View Angus Ranch, Inc. , a Subchapter S corporation, and the subsequent distribution of assets to its shareholders, including Eugene and Dona Ramm, triggered the recapture of investment tax credits previously claimed by the shareholders. The court found that the post-liquidation use of the assets in separate ranching businesses by the shareholders did not constitute a "mere change in the form of conducting the trade or business" under IRC § 47(b), necessitating the recapture of $4,790 in tax credits due to the premature disposition of the assets.

Facts

Eugene and Dona Ramm, along with Robert and Helen Ramm, formed Valley View Angus Ranch, Inc. , a Subchapter S corporation, to conduct a ranching operation. The Ramms collectively owned 50% of the shares. In 1974, the corporation adopted a plan of complete liquidation under IRC § 333, distributing all its assets, including section 38 property, to the shareholders. The Ramms continued to use their distributed assets in a ranching business but operated independently from the other shareholders.

Procedural History

The Commissioner of Internal Revenue determined a deficiency of $4,790 in the Ramms' 1974 federal income tax, asserting that the liquidation required recapture of investment tax credits previously claimed. The Ramms petitioned the Tax Court, which upheld the Commissioner's determination.

Issue(s)

1. Whether the liquidation of Valley View Angus Ranch, Inc. , and the subsequent use of the distributed assets by the Ramms in a separate ranching business qualified as a "mere change in the form of conducting the trade or business" under IRC § 47(b), thus avoiding recapture of investment tax credits.

Holding

1. No, because the liquidation and subsequent independent use of the assets by the shareholders constituted a substantial alteration of the business's scope and operations, not merely a change in form.

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Court’s Reasoning

The Tax Court applied the regulations under IRC § 47(b), specifically Treas. Reg. § 1. 47-3(f)(1)(ii), which outline conditions for a disposition to qualify as a mere change in form. The court found that the Ramms failed to meet these conditions, particularly because the basis of the assets in their hands was not determined by reference to the corporation’s basis, as required by paragraph (d) of the regulation. Moreover, the court emphasized that the phrase “trade or business” in the regulation refers to the business as it existed before the disposition, not merely its form. The court noted that after liquidation, the shareholders operated as separate ranch proprietorships, indicating a significant change in the scope and operations of the business. The court cited legislative history and the language of IRC § 47(b) to support its conclusion that the business must remain substantially unchanged post-disposition to avoid recapture. The court also referenced Baker v. United States to distinguish the case, noting that in Baker, the essential economic enterprise continued unchanged despite the change in form.

Practical Implications

This decision clarifies that liquidating a Subchapter S corporation and distributing assets to shareholders who then operate independently may trigger investment tax credit recapture. Attorneys advising clients on Subchapter S corporations should ensure that any liquidation plan considers the continuity of the business’s operations and scope to avoid unintended tax consequences. This ruling may influence how businesses structure liquidations and asset distributions, particularly in cases where shareholders intend to continue the business in a different form. Subsequent cases may need to address whether similar liquidations can be structured to meet the “mere change in form” exception under different circumstances, such as forming a partnership post-liquidation.

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