Shereff v. Commissioner, 77 T. C. 1140 (1981)

In corporate liquidations under section 333, gain is realized based on fair market value but recognition is limited to specific statutory criteria.

Summary

In Shereff v. Commissioner, the Tax Court clarified the distinction between realization and recognition of gain in corporate liquidations under section 333 of the Internal Revenue Code. The petitioners, who owned shares in Petro Realty Corp. , received assets in a liquidation and argued that the unrealized appreciation in the distributed real estate should not be considered in calculating their gain. The court held that while gain is realized based on the fair market value of distributed assets per section 1001, section 333 only limits the recognition of that gain. Thus, the petitioners had to recognize a gain based on the fair market value of the assets they received, affirming the validity of the related IRS regulation.

Facts

Louis and Anna Shereff owned 60 shares of Petro Realty Corp. , which owned land, buildings, cash, and securities. In March 1977, Petro's shareholders voted to liquidate the corporation under section 333, and by April, the liquidation was completed with assets distributed to shareholders, including the Shereffs. The Shereffs received cash, securities, cancellation of a loan, and a one-third interest in real property, which had a fair market value higher than its book value. The Shereffs claimed a capital loss based on the book value of the real estate, while the IRS calculated a capital gain using its fair market value.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the Shereffs' 1977 federal income tax, leading them to petition the U. S. Tax Court. The Tax Court, after considering the fully stipulated facts, issued a decision in favor of the Commissioner.

Issue(s)

1. Whether, in determining the amount of realized gain or loss from a corporate liquidation under section 333, shareholders must use the fair market value of the distributed property.

Holding

1. Yes, because section 1001 requires that gain or loss be realized based on the fair market value of property received in a liquidation, while section 333 only limits the recognition of that gain.

Court’s Reasoning

The court distinguished between the realization and recognition of gain. It clarified that section 1001 governs the realization of gain by calculating it based on the fair market value of distributed property. Section 333, however, deals with the recognition of that gain and allows qualified electing shareholders to recognize gain only to the extent specified in the statute. The court upheld the validity of section 1. 333-4(a) of the Income Tax Regulations, which applies section 1001 for calculating realized gain, finding it consistent with the statute. The court rejected the Shereffs’ argument that unrealized appreciation should not be included in the realized gain calculation, emphasizing that section 333 does not alter the general rule of section 1001 but rather offers a tax benefit by limiting the recognition of gain.

Practical Implications

This decision underscores the importance of understanding the distinction between realization and recognition of gain in corporate liquidations. Attorneys advising clients on section 333 liquidations must ensure that realized gains are calculated using fair market values of distributed assets, even if recognition of that gain may be limited. This ruling impacts how tax practitioners structure liquidations to minimize tax liability, particularly in cases involving appreciated real property. It also reaffirms the validity of IRS regulations in interpreting tax statutes, providing clarity for future tax planning and compliance. Subsequent cases have relied on this decision to clarify the application of section 333 in various contexts, influencing both tax law practice and corporate restructuring strategies.

