Robert O. Anderson and Barbara P. Anderson; the Hondo Company & Subsidiaries, Petitioners v. Commissioner of Internal Revenue, Respondent, 92 T. C. 138 (1989)

Gain from a shareholder's sale of stock distributed by a corporation is not imputed to the corporation unless the corporation significantly participates in the sale and the distributed stock is akin to inventory.

Summary

In Anderson v. Comm'r, the Tax Court addressed whether gain from Robert Anderson's sale of Atlantic Richfield Co. (ARCO) stock, distributed to him by his wholly owned corporation, Diamond A Cattle Co. , should be imputed to the corporation. The court held that the gain should not be imputed because Diamond A did not significantly participate in the sale and the stock was not inventory. The court also determined that the distribution occurred in 1978, not 1979, as Anderson received unrestricted legal control of the stock in 1978. This case clarifies the conditions under which a corporation may be taxed on gains from shareholder sales of distributed property.

Facts

Robert Anderson, the sole shareholder of Diamond A Cattle Co. , requested a distribution of 100,000 shares of ARCO stock from Diamond A in November 1978. The stock had been pledged as collateral for Diamond A's debts to Bank of America. Anderson agreed not to sell the stock until Diamond A reduced its debts, and the bank released the stock from collateral. In January 1979, Anderson sold the stock due to concerns about the oil market, using the proceeds to pay off his personal debts. The IRS argued that the gain from the sale should be imputed to Diamond A and that the distribution occurred in 1979 when Diamond A had earnings and profits.

Procedural History

The IRS issued a deficiency notice to Diamond A for the 1979 tax year, asserting that the corporation realized a long-term capital gain from the sale of the ARCO stock. Anderson and Diamond A filed a petition in the U. S. Tax Court challenging the deficiency. The court addressed whether the gain from Anderson's sale should be imputed to Diamond A and whether the distribution occurred in 1978 or 1979.

Issue(s)

1. Whether the gain from Robert Anderson's January 1979 sale of ARCO stock should be imputed to Diamond A Cattle Co.
2. Whether the distribution of ARCO stock to Robert Anderson occurred in Diamond A's 1978 or 1979 tax year.

Holding

1. No, because Diamond A did not participate in the sale in any significant manner and the distributed stock was not inventory or similar property.
2. The distribution occurred in 1978, because Anderson received unrestricted legal control of the stock at that time.

Court's Reasoning

The court applied the income imputation doctrine, which allows gain from a shareholder's sale of distributed property to be imputed to the corporation if the corporation significantly participates in the sale and the property is akin to inventory. The court found that Diamond A did not participate in the sale beyond minor tasks performed by its officers in their individual capacities for Anderson. The ARCO stock was not inventory or a substitute for inventory, so the sale did not produce operating profits for Diamond A. The court also determined that Anderson's agreement not to sell the stock did not create a security interest for the bank, so he had unrestricted legal control over the stock in 1978. The court rejected the IRS's arguments that the distribution should be disregarded due to tax avoidance motives, as the transaction's substance comported with its form.

Practical Implications

This case clarifies that gain from a shareholder's sale of distributed stock will not be imputed to the corporation unless the corporation significantly participates in the sale and the stock is akin to inventory. This limits the IRS's ability to challenge nonliquidating distributions followed by shareholder sales. The case also establishes that a distribution occurs when the shareholder receives unrestricted legal control of the property, even if there are practical restrictions on its sale. This may impact how corporations structure distributions and how shareholders plan sales of distributed property. The decision may also influence how banks and corporations handle collateral releases in connection with distributions.