Estate of Durkin v. Commissioner, 99 T. C. 561 (1992)

A bargain purchase of corporate assets by a shareholder may be treated as a constructive dividend when it is part of a transaction that terminates the shareholder's interest in the corporation.

Summary

In Estate of Durkin v. Commissioner, the Tax Court held that the Durkins' purchase of culm banks from GACC at a price below fair market value resulted in a constructive dividend to them. The Durkins sold their GACC stock to Green and simultaneously purchased the culm banks. The court rejected the Durkins' argument that the transactions should be treated as a redemption, emphasizing that they could not disavow the form they chose after the transaction was challenged. The ruling underscores that taxpayers must accept the tax consequences of their chosen transaction structure and cannot unilaterally recharacterize it to avoid tax liability.

Facts

The Durkins and Green were equal shareholders in GACC. In 1975, the Durkins negotiated with Green to sell their GACC stock and purchase culm banks from GACC. They sold their stock to Green for $205,000, the amount of their basis, and bought the culm banks for $4. 17 million plus a royalty, which was later determined to be undervalued by $3. 08 million. The transactions were structured to avoid federal income tax, and the Durkins reported no gain or loss on the stock sale.

Procedural History

The Commissioner determined deficiencies in the Durkins' federal income tax, asserting that the culm bank purchase was at a bargain price and constituted a constructive dividend. The Durkins argued that the transaction should be treated as a redemption. The case was heard by the U. S. Tax Court, which held that the Durkins received a constructive dividend equal to the undervaluation of the culm banks.

Issue(s)

1. Whether the Durkins' purchase of culm banks from GACC at a bargain price resulted in a constructive dividend to them?
2. Whether the Durkins could disavow the form of the transaction and treat it as a redemption of their GACC stock?

Holding

1. Yes, because the Durkins purchased the culm banks at a price significantly below fair market value, resulting in a constructive dividend equal to the undervaluation.
2. No, because the Durkins could not unilaterally disavow the form of the

transaction they chose after it was challenged by the Commissioner.

Court's Reasoning

The court applied the legal principle that a taxpayer cannot disavow the form of a transaction after it is challenged. It cited Commissioner v. Danielson and other cases to support this principle. The court found that the Durkins and Green jointly controlled the transaction's structure, which was designed to avoid federal income tax. The court rejected the Durkins' attempt to recharacterize the transaction as a redemption, noting that no redemption occurred and that the Durkins had not met the requirements for such treatment under section 302(b)(3). The court also rejected the argument that the undervaluation was a constructive dividend to Green, as there was no evidence that Green had any legal or equitable ownership of the culm banks.

Practical Implications

This decision reinforces that taxpayers must carefully structure transactions to achieve desired tax outcomes and cannot unilaterally recharacterize them after they are challenged. Practitioners should advise clients to consider all tax consequences before entering into transactions, especially those involving the sale of stock and corporate asset purchases. The case also highlights the importance of fair market value pricing in transactions between shareholders and their corporations to avoid constructive dividend treatment. Subsequent cases may reference this decision when dealing with similar transactions, particularly those involving bootstrap acquisitions and the allocation of purchase prices.

