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James F. Hoge
University of Kentucky

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provide for the issuance of a search warrant of the person.[20]

Admittedly constitutions protect only against unreasonable search and seizure,[21] and the reasonableness of the search is determined from the facts of each case.[22] From this it may be strongly urged that the search of an individual pursuant to a warrant commanding it is not unreasonable and consequently not unconstitutional, if the facts justify the issuance of the warrant. The answer to this argument is that such search is historically and traditionally contrary to the policy of the common law which vigorously protected the rights of the individual citizen. Being contrary to public policy, such search is illegal, and being illegal, it is unreasonable as a matter of law.[23]

However, the legislature, in the exercise of its policy-making power, may change that policy by statute and thereby authorize such search.[24]

WILLIAM A. RICE

TAXATION: DISTRIBUTION IN KIND OF CORPORATE ASSETS—UNITED STATES v. LYNCH

In *United States* v. *Lynch*[1] the taxpayer, one of several stockholders in a closed corporation, received from the assets a dividend in kind consisting of 21,977 boxes of apples. At the time of the distribution the corporation had three stockholders and was in the business of growing and marketing fruits and vegetables. The dividend in apples was declared at a stockholder's meeting on February 28, 1944, and approximately two months later they were sold pursuant to a pooling

[20] Collins v. Lean, *supra* note 16.

[21] People v. Preston, 341 Ill. 407, 173 N.E. 383 (1930).

[22] United States v. Thompson, 113 F. 2d 643 (7th Cir. 1940).

[23] State v. Wills, 91 W. Va. 659, 114 S.E. 261 (1922).

[24] Quaere: Does a court, also a policy-making body, have inherent power to extend the law to permit a search of an individual under a search warrant in the absence of a statute? That the early common law courts issued warrants to search property in the exercise of inherent power is not disputed; that today such inherent power remains in the courts is conceded. Further, it is conceded that the courts have, and always have had, inherent power to issue warrants to search the person, although they have not exercised it. Nevertheless, it is the writer's position that, even though a court could today conceivably invoke its inherent power to issue warrants to search the person not pursuant to statute, as a practical matter it would not invoke such power, and for this reason: The courts, as clearly reflected in the cases, deem it sound public policy to let the legislature govern the issuance of search warrants to search the person, and consequently they would look to statutes as governing the issuance of such warrants.

[1] 192 F. 2d 718 (C.C.A. 9th 1951), certiorari denied 343 U. S. 934 (1952).

agreement between the stockholders whereby the apples remained in the corporation's warehouse up until the time of the sale and the corporation acted as agent in making the sale. Then on April 29, 1944, the corporation was liquidated. The Commissioner of Internal Revenue found that the excess of the sale price of the apples above cost was taxable to the corporation as corporate income. The trial court[2] found as matters of fact that the dividend was a true dividend taxable as income to the *stockholders* and that the amounts received by the stockholders in sales of the assets distributed over and above the basis of such assets to the corporation did not constitute income taxable to the *corporation*. The Court of Appeals[3] for the Ninth Circuit reversed the trial court and held that the profits from the sale were taxable to the corporation on the theory that it was the same as if the corporation had itself sold the assets at a gain. The appellate court stated that apparently the only motive for the dividend was to escape taxation and further that it was not a distribution in kind under the statute[4] and must therefore be ignored for tax purposes. The circumstances that the corporation gave the shareholders very favorable treatment by not charging them a selling commission and that certain customary handling charges were not imposed enabled the court to attribute the sale to the corporation. The court concluded that since the corporation continued to operate for a period of two months after declaration of the dividend, it was not intended to be a liquidating dividend made in winding up corporate affairs.

The case is illustrative of a fairly typical problem which arises when a corporation has on its hands appreciated assets which it would normally sell and pay a tax on the gain, either as ordinary income or as a long term capital gain depending upon the nature of the assets. In this situation if the corporation makes the sale and the resulting profits are later passed on to the shareholders, they also must pay a tax on their gain. One method of attempting to avoid this so-called double taxation has been for the corporation not to sell the assets itself but instead to distribute them in kind to the shareholders, thus coming under the code provision[5] which declares that there shall be no tax to the corporation from the distribution in kind of its assets in

[2] USTC 51-1, Par. 9175 (D.C.E.D. Wash. 1950).

[3] *Supra*, note 1.

[4] 26 U.S.C.A. sec. 115(a).

[5] "... No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however, they may have appreciated or depreciated in value since their acquisition. . . ." U. S. Treas. Reg. 111, sec. 29.22 (a)-20 (1943). See Guant & Harris v. United States, 110 F. 2d 651 (C.C.A. 6th 1940); General Utilities and Operating Co. v. Helvering, 296 U. S. 200 (1935).

partial or complete liquidation. The basic consideration in these cases is whether the transaction will be recognized as a distribution in kind to the shareholders and thus free of all tax to the corporation, or whether on the other hand, the transaction will be looked through and treated as in reality a sale by the corporation and, therefore, taxable to the corporation.

Commissioner v. *Court Holding Co.*[6] is the leading case upholding the tax on a corporation after an attempted distribution in kind to the shareholders followed by a sale to a third party. In this case the negotiations for sale to a third party had been entered into before the corporation was actually dissolved and the Supreme Court treated the entire transaction as if the sale had been effectuated by the corporation. The *Court Holding Co.* case was followed by several decisions in which it was assumed that if the corporation holds title to the assets at the time of commencement of negotiations and has not completed the distribution of such assets prior to instituting the negotiations, the gain on the scale must then be imputed to the corporation.[7] This decision appeared to leave the law somewhat doubtful with regard to the proper tests for determining when a sale should be attributed to the corporation.

Thereafter arose the case of *United States* v. *Cumberland Public Service Co.*[8] wherein the Supreme Court granted certiorari to clear up

[6] 324 U. S. 331 (1945), rev'g 143 F. 2d 823 (C.C.A. 5th 1944) rev'g 2 TC 531 (1943). Taxpayer, a Florida corporation had acquired an apartment building at the time of its organization. A Mrs. Miller and her husband owned all of the outstanding shares of stock. In 1939 the lessees of the building entered into negotiations with the Millers for the purchase of the property. Later when the parties met to execute a written contract of sale, the purchaser was advised that the petitioner would not consummate the sale, since to do so would result in a large tax. The very next day the corporate directors adopted a resolution for its complete liquidation, and all property was conveyed to the two stockholders. Several days later the sale to the same purchaser was agreed upon on the same terms as had previously been decided. Similarly: Kaufmann v. Commissioner, 175 F. 2d 28 (3rd Cir. 1949); Wichita Terminal Elevator Co. v. Commissioner of Internal Revenue, 162 F. 2d 513 (C.C.A. 10th 1947). Earlier decisions to the same effect: Fairfield S. S. Corp. v. Commissioner, 157 F. 2d 321 (C.C.A. 2d 1946), certiorari denied, 329 U. S. 774 (1946); Embry Realty Co. v. Glenn, 116 F. 2d 682 (C.C.A. 6th 1940); James Duggan v. Commissioner of Internal Revenue, 18 BTA 608 (1930).

[7] Kaufmann v. Commissioner of Internal Revenue, 175 F. 2d 28 (3rd Cir. 1949); Wichita Terminal Elevator Co. v. Commissioner of Internal Revenue, 162 F. 2d 513 (C.C.A. 10th 1947).

[8] 338 U. S. 451 (1950), aff'g 83 F. Supp. 843 (1949). In this case the stockholders of an electric utility corporation had attempted to sell its stock to a cooperative, but was unsuccessful because the cooperative did not want all of the corporation's assets and the cooperative was doubtful as to whether it had legal authorization to purchase the stock. Whereupon the stockholders delayed until they could ascertain the tax effects of such sales and finally decided to distribute the assets in kind to themselves and then sell those assets to the cooperative. Then the remaining assets were to be sold by the corporation and the corporation dissolved. The Court of Claims held that the sale had actually been made by the stockholders and thus no liability attached to the corporation for gain on the sale.

uncertainty shown to have arisen in the aftermath of the *Court Holding Co.* case. Here again, as in the *Court Holding Co.* decision, the sale negotiations were entered into prior to any distribution and liquidation of the corporation. This time, however, the Supreme Court held that the sale actually had been made by the stockholders following the distribution to them and therefore no gain was attributable to the corporation. The Supreme Court laid down the following rules: 1) Whether a liquidation distribution is genuine or a sham is a question of fact for the trial court whose findings are to be accepted on appeal if supported by the evidence.[9] 2) Although a corporation is taxable on the gain if it sells all its physical assets and immediately distributes the cash, "sales of physical properties by shareholders following a genuine liquidation distribution cannot be attributed to the corporation for tax purposes"[10] even though the motive for so arranging the sale is tax avoidance.[11]

Facts appearing in the *Cumberland Public Service Co.* case, thus forming the basis of the limitations on the applicability of the *Court Holding Co.* doctrine, are as follows:

> 1. All negotiations were complete and final and the agreement signed before any step toward the liquidation of the corporation was taken.
>
> 2. The corporation continued to operate in order to dispose of the remaining assets in its own name and was not immediately dissolved after the sale.
>
> 3. All transactions leading to the sale were an admitted attempt at tax avoidance.
>
> 4. The negotiations were conducted by officers of the corporation, who were also the stockholders, in an attempt to dispose of the properties of the corporation although the first offer was for the sale of the stock.[12]

The *Cumberland Public Service Co.* case thus appears to have established a more liberal foundation upon which the stockholders can reasonably expect to be able to negotiate for a sale of corporate assets, having been distributed in kind, without having the gain on the sale for tax purposes imputed to the corporation under the *Court Holding Co.* decision.

The court in the *Lynch* case emphasized that the corporation remained a going concern and thus the distribution was not in contempla-

[9] Where there is supporting evidence the findings of the Tax Court must be accepted. Dobson v. Commissioner, 320 U. S. 489 (1943); Commissioner v. Scottish American Investment Co., 323 U. S. 119 (1944); Commissioner v. Heininger, 320 U. S. 467 (1943). It should be noted that the problem stated in the Dobson case still remains to some extent.

[10] 1 CCH 1953 Fed. Tax. Rep., par. 86.017.

[11] *Ibid.*

[12] 1 CCH 1953 Fed. Tax Rep., par. 86.

tion of dissolution and liquidation within the meaning of the tax exemption under section 115 of the Internal Revenue Code. It is assumed that the lapse of two months after the date of the distribution and until the liquidation was the factor which influenced the court to decide that the corporation at the time of the distribution was a going concern and intended to operate as such for a period of time thereafter. This period of time seems scarcely to warrant the inference that the corporation did not intend to liquidate but instead intended to continue to operate indefinitely. A more reasonable position would be to allow the corporation a reasonable time after the distribution to wind up its affairs and then look to the realities of the entire transaction in order to determine whether it is a continuing business or not.

The motive to escape taxation appears also to have influenced the decision in the principal case. The court, in arriving at the motive, points to the favorable treatment granted by the corporation to the shareholders in not charging a selling commission and not imposing certain customary handling charges. Granting that the corporation did intend to avoid the tax, this would not seem controlling in view of the *Cumberland Public Service Co.* decision, wherein the Supreme Court expressed itself very clearly in allowing this motive to exist without holding the corporation responsible for the tax.[13] The trial judge in the principal case followed the *Cumberland* view when he asserted that the stockholders were not acting as a conduit and that although the motive appeared to be tax avoidance the corporation still was not to be charged with the tax. It is submitted that this view is not unreasonable and is in line with previous decisions of the Supreme Court. The Court was explicit upon this point in *Gregory* v. *Helvering* when it stated that "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."[14] Successful avoidance of the tax has been upheld on other occasions, for example where the corporation had taken no part in the pre-liquidation negotiations of the sale or the agreement (the sale in such an instance being consummated after liquidation and the distribution of assets)[15]

[13] In accord, United States v. Cummins Distilleries Corp., 166 F. 2d 17 (C.C.A. 6th 1948); Burley Tobacco Warehouse, Inc. v. Glenn, Collector of Internal Revenue, 106 F. Supp. 949 (W. D. Ky. 1952); Herbert v. Riddell, 193 F. Supp. 369 (D.C.S.D. Cal.); Baum v. Dallman, 76 F. Supp. 410 (S.D. Ill. 1948); Doyle Hosiery Corp. v. Commissioner, 17 TC 614 (1952)

[14] 293 U. S. 465 at p. 469.

[15] Howell Turpentine Co. v. Commissioner, 162 F. 2d 319 (C.C.A. 5th 1947); Baum v. Dallman, 76 F. Supp. 410 (S.D. Ill. 1948).

and again when there was a deferment of all negotiations until the distribution in liquidation had been received.[16]

A more recent case which may give some indication of the present trend is *Burley Tobacco Warehouse, Inc.* v. *Glenn, Collector of Internal Revenue*[17] where a corporation, composed of four stockholders who were also the directors and officers, owned and operated a tobacco warehouse. On April 15, 1946, some ten months after first considering dissolution, the stockholders voted for the dissolution of the corporation and the distribution of its assets, including principally its warehouse. However, approximately seven months previously the corporation had entered into negotiations for the sale of the warehouse. Before the stockholders had voted for dissolution the purchaser had completed negotiations and made out checks payable to the corporation which had been indorsed by the stockholders with the name of the corporation struck out. The warehouse was sold on October 27, 1945, more than six months after the actual declared intention to dissolve and liquidate. The court, after careful consideration of these facts, concluded that a sale by the corporation was not intended, and that the corporation was not subject to the tax.[18]

It will be noted that the time between the sale and suspension of operation was six months in the *Burley Tobacco Warehouse* case, but only two months in the *Lynch* case. Further in the *Burley Tobacco Warehouse* case some of the checks in payment for the asset were made out to the corporation, thus evidencing the understanding of the purchaser that the sale was made by the corporation, while this factor did not exist in the *Lynch* case. Finally, negotiations for the sale had been conducted prior to the distribution in the instant case whereas they were conducted after the distribution in the *Lynch* case. All of these factors taken together more strongly indicate a sale by the corporation in the *Burley Tobacco Warehouse* case than in the *Lynch* case. Furthermore, the following facts, indicative of corporate motivation and non-existent in the *Lynch* case were present in the *Burley Tobacco Warehouse* case: while negotiations for the sale were being conducted title to the warehouse was in the corporation, but on the other hand, no resolution was considered or adopted authorizing the officers or anyone to act as agent for the corporation in the sale.[19]

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[16] United States v. Cummins Distilleries Corp., 166 F. 2d 17 (C.C.A. 6th 1948); Ripy Bros. Distilleries, Inc., 11 TC 326 (1948).

[17] 106 F. Supp. 949 (W. D. Ky. 1952).

[18] In accord: Doyle Hosiery Corp. v. Commissioner, 17 TC 641 (1952); Isadore A. Klaus, 11 TCM 357 (1952); Michael J. Shagan, 11 TCM 730 (1952).

[19] The court in the Burley Tobacco Warehouse case brings to our attention the most recent interpretation by the Tax Court of the United States in the case

It is submitted that the distribution in the *Lynch* case satisfactorily meets the requirements for a distribution in kind on partial liquidation of a corporation to be treated by the stockholders as in exchange for the surrender of their stock within Section 115 (c) of the Internal Revenue Code.[20] That being so, the distribution itself should have no tax consequences for the corporation as is expressly provided in the regulations, and any subsequent sale of those same assets by the stockholders should be treated just the same as any other sale of assets by the stockholders and not by the corporation. Therefore, as in the normal case, the gain realized from such sale should be taxed to the stockholders alone and not, in addition, to the corporation. This would obviate the necessity for skillful arrangement of the facts in order to determine the end results.

Basically there are three methods by which corporate assets are transferred: 1) an outright sale by the corporation of its assets; 2) a sale by the stockholders of their stockholdings (assuming the corporation is not involved); 3) or a dissolution and liquidation of the corporation and a subsequent sale of the assets received on dissolution by the stockholders.[21] Ordinarily it devolves upon the purchaser and the corporation as to which method of transfer will be used. The purchaser may have certain reasons for not desiring to make an outright purchase of the corporate stock in order to obtain the assets.[22] Taxwise it makes considerable difference to the corporation which method is to be used to accomplish the transfer, especially in small closed corporations usually subject to this type of litigation. In an attempt to solve the problem with certainty the following solutions have been offered: 1) elimination of the tax on any sale in liquidation even if made by the corporation itself; 2) imposition of a corporate tax on

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of Doyle Hosiery Corporation v. Commissioner, 17 TC 641 (1952), wherein a sale of corporate assets was being considered along with a sale of the corporate stock by the stockholders prior to any liquidation and the sale was made by the stockholders. The Tax Court held that the Cumberland Public Service Co. case controlled.

[20] "Distributions in Liquidation. Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed . . . in partial liquidation . . . the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits. . . ."

[21] Gutkin and Beck, *Sale of Assets Received on Liquidation* 28 TAXES 328 (1950).

[22] Magill, *Sales of Corporate Stock or Assets*, 47 COLUMBIA L. REV. 707 (1947). Such reasons could consist of the factor of unknown or hidden liabilities and the transferee becoming liable for the tax.

any device used for transferring the assets, or any part thereof, to one not entitled to receive them in liquidation, and by transferring the purchase money to the shareholders so entitled; 3) taxation of any transfer within an arbitrary time limit of assets to one not entitled to receive them in liquidation; or 4) legislative repeal or judicial overruling of the doctrine that a distribution in kind is tax-free to the corporation.[23]

In conclusion, it is believed that the decision in the *Lynch* case places an unnecessary burden on the corporation to liquidate immediately and to show that the sale of the assets was in fact made by the stockholders and not through the offices of the corporation. In spite of authority to the contrary it appears that tax avoidance is still to be reckoned with when an attempt is made to sell the assets of the corporation. Therefore, one can only conclude that, at least in the Ninth Circuit, some of the clouds created by the *Court Holding Co.* decision still remain.

JAMES F. HOGE

EQUITY–CONTRACTS IN RESTRAINT OF TRADE–PARTIAL ENFORCEMENT–CERESIA V. MITCHELL

Although contracts in total restraint of trade are void as against public policy those in partial restraint only, under certain circumstances, will be enforced. In determining whether or not to enforce a contract admittedly in partial restraint only, the courts have developed certain criteria as to the reasonableness of the restraint. These include an examination of the subject matter, the nature of the business, the situation of the parties and the circumstances of the particular case. Covenants not to engage in a certain occupation or business must not be wider than reasonably required for the protection of the business and good will of the promisee, i.e., the employer or vendee.[1] However, if the restriction affords unusually wide protection to the interests of the promisee but does not interfere with the public interest or impose an undue hardship on the promisor it normally will be enforced,[2] even though, for example, the restriction extends to an entire

[23] Note, 63 HARV. L. REV. 484, 493-4 (1950).

[1] Thomas W. Briggs Co. v. Mason, 217 Ky. 269, 289 S.W. 295 (1926); Owl Laundry Co. v. Banks, 83 N. J. Eq. 230, 89 Atl. 1055 (1914).

[2] 17 C.J.S. 630-632 (1939).