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MINIMIZING FEDERAL INCOME TAXES UPON THE SALE OF CORPORATE ASSETS

By JACKSON D. ALTIZER*

The proverb that this or that prospective event is "as certain as death and taxes" is of special significance in an era marked by desperate attempts to balance state and national budgets. But for the same taxing power to levy a double tax of the same kind upon the same property, or in the case of the income tax upon what is essentially the same profit, is a burden which the average taxpayer does not expect, and, with a degree of justification, heartily resents when he finds himself the victim.[1] Nevertheless, when a corporation markets its assets at a profit, liquidates and dissolves, the Treasury, under existing laws, assesses against what is actually the same gain two distinct taxes since on strict analysis two taxable transactions are involved. The first is the disposition by the corporation of its assets, whereupon a tax accrues against it on the resultant profit[2] measured by the difference between the cost or other basis to it of the assets sold and the amount received therefor.[3] The second is the distribution of the proceeds of the sale to the stockholders in liquidation, causing a tax to become payable by each stockholder on his individual profit[4] represented by the difference between the cost or other basis to him of his stock and the amount of his liquidating dividend.[5] The corporation tax is fixed under the present statute at 13-3/4% of the net profit.[6] The tax which will be assessed against each stockholder depends upon the amount of his net income for the year or years in which the liquidating dividend is received, or, in other words, the rate of surtax which he must pay.[7] Taken together there is imposed upon the profit arising from

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[1] When congress has clearly expressed its intention the statute must be sustained even though double taxation results. Hellmich v. Hellman, 276 U. S. 233, 48 S. Ct. 244 (1928). Double taxation is not prohibited by the Fourteenth Amendment. Cream of Wheat Co. v. Grand Forks County, 253 U. S. 325, 330, 40 S. Ct. 558 (1920); Patton v. Brady, 184 U. S. 608, 22 S. Ct. 493 (1902).

[2] REVENUE ACT OF 1932, § 22 (a).

[3] *Id.* §§ 111 and 113.

[4] *Id.* § 115 (c).

[5] *Supra* n. 2.

[6] REVENUE ACT OF 1932, § 13 (a). However, if the corporation is affiliated with another corporation or corporations and a consolidated return is filed, the rate of tax for the years 1932 and 1933 is 14½%. *Id.* § 141 (c).

[7] *Id.* § 12.

such transaction a rate of tax which is only equaled by the surtax rates applicable to large individual incomes.[8]

To illustrate, let us suppose that the X corporation is organized in the year 1923 with an authorized and issued capital stock of $100,000.00 which is fully paid in by the stockholders. The capital thus acquired is used to purchase assets which, in the year 1933, have so greatly increased in value that an opportunity is presented to dispose of them for the sum of $700,000.00. The residual cost of the assets plus capital additions equals $200,000.00. If this sale is consummated by the corporation, a profit of $500,000.00 will be realized upon which a tax of $68,750.00 will be payable by the corporation. In addition, the stockholders will be liable for a tax on the difference between the cost of their stock ($100,000.00) and the amount distributed to them in liquidation. The corporation tax is, of course, deductible in arriving at the liquidating profit,[9] and supposing that expenses incident to the sale amount to $31,250.00, the net proceeds for distribution will be $600,000.00, of which $500,000.00 is profit to the stockholders and taxable not as a dividend paid by a going-concern, but at both the normal and surtax rates,[10] or in the case of stockholders who have held their stock over two years, at the special capital net gain rate of 12½%.[11] In other words, the actual beneficial owners of the assets thus disposed of are doubly taxed on the resultant profit as a penalty for conducting business under the corporate form, and if the transaction can be effected by a method which will legally avoid the corporate tax, there is a net saving to the stockholders of the difference between such tax and its value as a deduction in arriving at net proceeds from distribution, depending upon the rates of tax to which the individuals will be subjected, or which they may claim under the capital net gain provisions of the Act. In the supposed case if the original stockholders have remained unchanged they may, if they so desire, avail themselves of the 12½% rate, and consequently, in

[8] Even if the stockholders are in a position to take advantage of the capital net gain provisions of the Act, the total tax rate is 26¼% which is equivalent to the current surtax rates on net incomes of between $56,000.00 and $58,000.00.

[9] Under REVENUE ACT OF 1932, § 23 (c), the corporation tax is not deductible in computing its net profit but the amount thereof will be subtracted in arriving at the net liquidating dividend.

[10] The conflict between the Sixth and Eighth Circuits on this point has been definitely put to rest. Hellmich v. Hellman, *supra* n. 1.

[11] REVENUE ACT OF 1932, § 101.

the even the corporate tax can be avoided, they will save approximately $60,000.00.

The right to conduct business transactions in a manner designed to keep taxes at a minimum, providing full disclosure is made to the representatives of the Commissioner of Internal Revenue, cannot now be questioned. A distinction is made by the courts between tax evasion, which implies concealment and is illegal, and tax avoidance, an open assertion of rights which is not only lawful but commanded by the dictates of good judgment where such a course is made possible by the circumstances, and does not involve sacrifices which outweigh the benefits which ensue. "We do not speak of evasion", said Mr. Justice Holmes in *Bullen v. Wisconsin,*[12] "because, when the law draws a line, a case is on one side or the other, and if on the safe side is none the worse legally that a party has availed himself to the full of what the law permits." And as the Board of Tax Appeals has said in a recent case: "A corporation may clearly do what it has a legal right to do even for the sole purpose of reducing its tax liability. It is not required to pursue a course which gives rise to a greater tax liability if another course is open to it which will give rise to a less tax liability."[13] These remarks are particularly apt where a heavy federal tax, imposed on the privilege of doing business as a corporation at the very moment when the privilege is, in effect, surrendered, may be avoided.[14]

It is proposed, therefore, to discuss briefly the question of to what extent, if any, the tax burden incident to profitable corporate liquidation may be lessened and further, to consider possible methods of liquidation which may result in keeping taxes at the minimum provided for by law.

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[12] 240 U. S. 625, 36 S. Ct. 473 (1915).

[13] Fruit Belt Telephone Co. v. Commissioner, 22 B. T. A. 440 (1931).

[14] In United States v. Isham, 17 Wall. 496, 506, 21 L. ed. 728 (1873) the Supreme Court said: "it is said that the transaction proved upon the trial in this case, is a device to avoid the payment of a stamp duty, and that its operation is that of a fraud upon the revenue. This may be true, and if not true in fact in this case, it may well be true in other instances. To this objection there are two answers: 1st. That if the device is carried out by the means of legal forms, it is subject to no legal censure. To illustrate: The Stamp Act of 1862 imposed a duty of two cents upon a bank-check, when drawn for an amount not less than twenty dollars. A careful individual, having the amount of twenty dollars to pay, pays the same by handing to his creditor two checks of ten dollars each. He thus draws checks in payment of his debt to the amount of twenty dollars, and yet pays no stamp duty. This practice and this system he pursues habitually and persistently. While his operations deprive the government of the duties it might reasonably expect to receive, it is not perceived that the practice is

Under no circumstances can the tax to the respective stockholders on their liquidating dividends to the extent that these dividends exceed the cost or other basis of the stock be avoided, nor should it be, since the stockholders will, presumably, receive

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open to the charge of fraud. He resorts to devices to avoid the payment of duties, but they are not illegal. He has the legal right to split up his evidences of payment, and thus to avoid the tax. The device we are considering is of the same nature.'' See also Weeks v. Sibley, 269 Fed. 155 (N. D. Tex. 1920); Fraser v. Nauts, 8 F. (2d) 106 (N. D. Ohio 1925); Andrus v. Burnet, Commissioner, 50 F. (2d) 332 (App. D. C. 1931); Appeal of Robert Jemison, Jr., 3 B. T. A. 780 (1926); Dudley v. Commissioner, 15 B. T. A. 570 (1929). On the other hand, although one may lawfully dispose of his property to escape taxation, it is said that the law will not uphold any mere manipulation, under the guise of disposition, the only effect of which is to defeat a tax. Ransom v. City of Burlington, 111 Iowa 77, 82 N. W. 427 (1900); Mitchell v. Board of Commissioners, 91 U. S. 206, 23 L. ed. 302 (1875); James Duggan v. Commissioner, 18 B. T. A. 608 (1930). In Phelps v. Commissioner, 54 F. (2d) 289 (C. C. A. 7th., 1931), it is said ''that taxing statutes cannot be intentionally circumvented by anticipatory arrangements and contracts is settled by the principle laid down in Lucas v. Earle, 281 U. S. 111, 74 L. ed. 731, 50 Sup. Ct. Rep. 241 (1930).'' That case, however, simply held that a husband's income was taxable in its entirety to him irrespective of a contract between him and his wife to the effect that whatever either should receive should be received and earned by both as joint tenants, Mr. Justice Holmes saying in the opinion: ''There is no doubt that the statute (REVENUE ACT OF 1918, c. 18, §§ 210, 212 (a), 213 (a)) could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from investing even a second in the man who earned it. That seems to us to be the import of the statute before us . . . .'' It cannot be doubted, however, that a complete and final disposition of *property* made chiefly in order to avoid or minimize a tax is valid. Compare the following cases to the effect that where a *bona fide* gift is made even to a close relative, the proceeds from a subsequent sale of the property are not taxable to the donor. Appeal of M. J. Sullivan, 2 B. T. A. 1012 (1925); Appeal of Robert Jemison, Jr., *supra* n. 14; Appeal of Frederick H. Hoffman, 3 B. T. A. 964 (1926); Appeal of Martin Zinn, 3 B. T. A. 969 (1926); L. C. Moore v. Commissioner, 11 B. T. A. 979 (1928); Hiatt v. Commissioner, 22 B. T. A. 1245 (1931); Smith v. Commissioner (B. T. A., decided Jan. 21, 1932). See also Charles W. Wallworth v. Commissioner, 6 B. T. A. 788 (1927) where an assignment of a one-half interest in real estate to the taxpayer's wife prior to its sale in order to minimize the resultant tax was held valid. The legality (and practice) of converting taxable income producing property into tax exempt securities and of selling assets to establish a loss is too well known to require citation.

The gift or other disposition, however, must be real and not pretended since the courts have repeatedly stated that where the admitted intent is to avoid a tax, they will look through the form to the substance of the transaction. Eisner v. Macomber, 252 U. S. 189, 206, 40 S. Ct. 189 (1920); United States v. Phellis, 257 U. S. 156, 168, 42 S. Ct. 63 (1921); Weiss v. Stearn, 265 U. S. 242, 254, 44 S .Ct. 490 (1924); Goodyear Rubber Company v. United States, 273 U. S. 100, 103, 47 S. Ct. 263 (1927); Gulf Oil Corporation v. Lewellyn, 248 U. S. 71, 72, 39 S. Ct. 35 (1918); United States v. Klausner, 25 F. (2d) 608, (C. C. A. 2d, 1928); Brackett v. Commissioner, 19 B. T. A. 1154 (1930), aff'd. 57 F. (2d) 1072 (C. C. A. 7th, 1931); Meurer Steel Barrel Co., Inc. v. Commissioner, 11 B. T. A. 584 (1928), aff'd. 35 F. (2d) 1019 (1929).

and enjoy the benefit of the income upon which the tax is based.[15] On the other hand, a tax assessed against a corporation on profits not retained by it but passing almost immediately to the stockholders to be taxed in their hands is, while logical if the transaction is conducted by the ordinary methods, an unfortunate interposition of the corporate entity resulting in a seemingly disproportionate share of such profits finding their way into the coffers of the Treasury. If, however, the corporate shell can first be broken and the profits be made to result from the act of the stockholders, a single tax confined within reasonable limits is imposed upon those and only those from whom an income tax appears to be actually due.

A review of the cases indicates that there are in general three plans or methods of liquidation which, when properly followed, should result in the elimination of an income tax payable by the corporation.[16] These are (1) by distribution in kind of the assets to the stockholders and a subsequent sale by them; (2) by purchase of the assets by the stockholders and resale by them; and (3) by sale of the stock to the ultimate purchaser, who may then distribute the assets to himself and dissolve the corporation. But whatever method is adopted the difficulty may arise of convincing the Commissioner, the Board of Tax Appeals or the courts, as the case may be, that the transaction was not in substance a sale of assets by the corporation and the distribution by it of the proceeds of the sale to the stockholders in exchange for their stock. At least in so far as the Treasury is concerned (due in part, doubtless, to the depressing effect of an unbalanced budget) the current tendency is to scrutinize such transactions closely and to resolve all doubts against the taxpayer who is admittedly endeavoring to avoid a tax. Nevertheless, the desired result

[15] A useful discussion as to when dividends are considered to be liquidating, *i. e.*, payments in exchange for stock, (and thus subject to both normal and surtax) and when "going-concern" dividends (subject on to surtax), is contained in G. C. M. 8623, IX-2 Cum. Bull. 164.

[16] It has been recently decided that the transfer by a corporation of substantially all its properties for cash and notes of another corporation distributed in pursuance of a plan of "reorganization," is not a "tax free" reorganization under sections 203 (b) (3), 203 (c) (1) and 203 (h) (1) (A) of the Revenue Act of 1926. Pinellas Ice & Cold Storage Co. v. Commissioner, 57 F. (2d) 188 (C. C. A. 5th, 1932); aff'd by U. S. Sup. Ct., U. S. Daily, Jan. 10, 1933, at 1959; Cortland Specialty Co. v. Commissioner, 60 F. (2d) 937 (C. C. A. 2d. 1932). It follows that such a transaction is not a reorganization under sections 112 (b) (4), 112 (d) (1) and 112 (i) (1) (A) of the Revenue Acts of 1928 and 1932. But see § 112 (b) (5) of the 1932 Act and n. 70, *infra*.

is not impossible of accomplishment since, as the Circuit Court of Appeals for the Sixth Circuit has aptly observed, income cannot be created by fiat alone.[17] Where the transaction is honestly and carefully executed to the end that no income at any time is realized by the corporation, no tax liability can result.

Distribution in Kind and Sale by the Stockholders

The current revenue act provides that the term "gross income includes gains, profits and income derived from . . . . sales or dealings in property, whether real or personal, growing out of the ownership or interest in such property.'"[18] Gross income of a corporation in liquidation is not specifically mentioned in the statute but is treated in the Treasury Regulations in language which is unmistakably clear to the effect that no such income is realized from a distribution to stockholders of assets in kind although gain is recognized for income tax purposes from profitable transactions consummated by officers, trustees or receivers on behalf of the corporation.[19] As a starting point then we have the Treasury very properly taking the official position that no gain or loss is recognized to a corporation upon a distribution by it to its stockholders of its assets in kind. As to the corporation, the transaction is purely a capital one. As to the stockholders, recognizable gain or loss does, of course, result[20] depend-

[17] Taplin v. Commissioner, 41 F. (2d) 454 (1930).

[18] REVENUE ACT OF 1932, § 22 (a).

[19] U. S. Treas. Reg. 74, Art. 71. The income tax regulations covering the 1932 Act have not een issued at this writing. Since there is no change in the statute in this regard presumably art. 71 will be carried into the new regulations unaltered. It is as follows: "Gross income of corporation in liquidation.—When a corporation is dissolved, its affairs are usually wound up by a receiver or trustees in dissolution. The corporate existence is continued for the purpose of liquidating the assets and paying the debts, and such receiver or trustees stand in the stead of the corporation for such purposes. (See sections 274 and 298 and articles 1191 and 1192). Any sales of property by them are to be treated as if made by the corporation for the purpose of ascertaining the gain or loss. 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." But see section 44 (d) and article 355. See also article 392.

The sections of the Act and other articles of the Regulations referred to in the above article pertain to bankruptcy, receiverships and installment obligations and are not material to the topic herein considered.

This article is subsequently identical with U. S. Treas. Reg. 69, Art. 548; U. S. Treas. Reg. 65, Art. 548; U. S. Treas. Reg. 62, Art. 548; and U. S. Treas. Reg. 45, Art. 547, which was approved as a reasonable regulation by the Circuit Court of Appeals for the Fifth Circuit in Taylor Oil & Gas Co. v. Commissioner, *infra* n. 33.

[20] REVENUE ACT OF 1932, sec. 115 (c).

ing on the market value of the assets received as compared with the cost or other basis to each stockholder of his stock, but this is also true where the corporation converts its assets into cash at a profit (and pays a tax) and distributes the money to the stockholders. Unless the practical difficulties are too great,[21] it is to the interest of the stockholders, therefore, first to distribute the assets to themselves and then as individuals to consummate the transaction which may have been originally negotiated on behalf of the corporation. The result will be to increase the distributive surplus by the amount of the corporation tax and the only perceivable disadvantage resulting is that the stockholders will have received a greater profit upon which to pay their individual taxes, that is to say, they will have lost the benefit of the corporate tax as a deduction, which is hardly objectionable in view of the fact that they have saved the tax itself.

At this point it might reasonably be asked whether this method of liquidation does not present two taxable transactions, the first being the receipt of the assets of the corporation by the stockholders in exchange for their stock, and the second, the sale by the stockholders of the assets thus received. The answer is that there are two transactions in which gain or loss is recognizable, but that in the second no gain or loss occurs in fact, since the fair market value of the assets when received by the stockholders from the corporation (and consequently, the basis for income tax purposes to them of such assets)[22] is neither more nor less than the price received therefor from the purchaser. In other words, the price immediately received is adopted by the Commissioner — as it must be — as the best evidence of the market value of the assets in determining the extent of the profit realized by the stockholders when the assets are distributed in kind to them.[23] Consequently, no loss is sustained nor any gain realized on the sale.

Distribution of corporate assets in kind among the stockholders of small corporations is by no means the difficult and complicated task that upon first glance it may appear to be. A change of possession should not and does not appear to be required al-

[21] The methods of liquidating herein discussed — except, possibly, that finally considered — would be impractical in the case of large corporations with widely scattered stockholders. The great majority of corporations, however, are small and closely held.
[22] REVENUE ACT OF 1932, § 113.
[23] G. C. M. 714, V-2 Cum. Bull. 72.

though the *right* to immediate possession must, of course, pass to the stockholders. The chief essential is clearly and unequivocally to divest the corporation of title and to transfer such title to the stockholders, individually, or to their agent or trustee to hold for them in proportions equivalent to their ownership of stock. If, as a matter of substantive law, this purpose is effected, no profit can accrue to the corporation upon the subsequent sale of the same assets by the stockholders.[24]

The first case in the reports where such a transaction was challenged by the Commissioner appears to be that of the *Appeal of Robert Jemison, Jr.*,[25] decided by the Board of Tax Appeals on

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[24] This still appears to be the official position of the Commissioner, despite a change in the official attitude as the result of some recent Board decisions hereinafter considered. In G. C. M. 714, *supra* n. 23, the facts were that pursuant to a contract entered into in 1924 between the M. Company stockholders and the O Company, the M Company was dissolved in that year, the stockholders received the assets in kind by conveyance from the directors as trustees in liquidation in 1925, and the assets were then sold and conveyed to the O Company. *Held,* there was a valid distribution in kind upon dissolution, and no gain or loss was recognized with respect to the M Company. Taxable income was derived by the stockholders to the extent that the amount received in liquidation exceeded the basis to them of their shares of stock in the M Company.

Of course, the mere dissolution of a corporation does not effect a distribution of its assets among its stockholders, nor is such distribution effected simply by turning over the corporate assets to trustees in liquidation who may also be stockholders. Wells Fargo Bank & Union Trust Co. v. Blair, 26 F. (2d) 532 (App. D. C. 1928); Smith v. Commissioner (B. T. A., decided October 12, 1932). An actual transfer to the stockholders is essential.

[25] 3 B. T. A. 780. The facts are important as a typical example of the method discussed above. There Jemison and one W. M. Leary, and their respective wives, were the sole stockholders of the Forest Park Realty Company, and had during the year 1919 successfully completed negotiations to dispose of all the assets of the company for a price which would result in a substantial profit and a heavy tax. With the admitted purpose of lessening the tax burden as far as possible legally and on the advice of counsel, a meeting of the company's directors (consisting of Jemison, Leary and their wives) was held on the 19th day of September, 1919, whereupon it was resolved that the president be authorized and directed to effect a dissolution of the company, and with the secretary to execute and deliver to the stockholders of the company a deed or deeds to all of the company's assets in consideration of their assumption of all its liabilities, conveying such assets to the various stockholders in proportion to their ownership of the company's capital stock. On the following day a meeting of the stockholders was held, at which it was resolved that the company be dissolved, and accordingly, all of the stockholders present at the meeting signed and executed an agreement of dissolution in accordance with the statutes of Alabama, under which the corporation was organized. On September 22d deeds were executed whereby the Forest Park Realty Company and its four stockholders, signing as directors and trustees in dissolution, conveyed to themselves as stockholders, first, the property included in the proposed sale, and second, the balance of the property then owned by the company. On the same date the stockholders conveyed the property included in the sale to the purchaser. This deed was delivered on the 24th and on that day the four former stock-

February 17, 1926, where the stockholders as trustees in dissolution had conveyed the assets first to themselves in exchange for their stock and on the same day, as individuals, sold the assets to the purchaser with whom negotiations had been had prior to the distribution. The case was heard by four members of the Board, and the entire Board was unanimous in deciding that the Commissioner erred in determining that a tax was assessable against the corporation and that thé stockholders had been successful in limiting the profit on the transaction to themselves and avoiding a profit and consequent tax to the corporation.[26] Similarly, in 1929 in the case of *W. P. Fox & Sons v. Commissioner*,[27] where the stockholders subscribed to stock in a new corporation to be formed and in payment therefor caused to be transferred to the new corporation all of the assets of the first company, the Board approved the transaction and found in favor of the petitioner pointing out that no part of the consideration paid for the transferred assets was received by the corporation. This finding was made in the face of the fact that the original company did not first transfer its property to the stockholders but conveyed them directly to the purchaser in order to avoid the additional conveyance tax which would result from the transfer of the same assets by the stockholders to the purchasing company. Less than two months later, however, in the case of *Taylor Oil & Gas Company v. Commissioner*[28] the Board promulgated a decision which has been widely cited as a precedent adverse to the taxpayer in subsequent cases which have been before the Board and the courts, and which has seemingly led to a change of attitude on the part of Treasury officials.

In that case the stockholders in meeting assembled, after first resolving that the corporation be dissolved, went on record further as authorizing the board of directors to act as liquidating trustees *for the corporation* and empowering such trustees *in the corporate name* to sell and transfer all of the assets belonging *to the company.* Subsequently, instruments were executed by the

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holders received from the purchaser the agreed consideration for the sale of the property, which was distributed among themselves in accordance with their respective stock ownership in the corporation.

[26] A crude attempt to reach the same result where there was no actual transfer to the stockholders and where the purchase price was paid to the corporation instead of to the stockholders was rejected by the Board two years later. Southern Ice & Fuel Co. v. Commissioner, 10 B. T. A. 1213 (1928).

[27] 15 B. T. A. 115.

[28] 15 B. T. A. 609 (1929).

directors, as trustees, conveying the properties "belonging to said Taylor Oil & Gas Company" to the purchaser with whom negotiations had been had by the corporate officers prior to the stockholders' meeting. The company was incorporated under the laws of Texas, which provided that upon the dissolution of a corporation, its president and board of directors should be trustees for the creditors and stockholders of the company with full power to settle its affairs and in the name of the corporation to sell, convey and transfer all of the real and personal property belonging to such company.[29] The Board held that the conveyance was in fact made by the corporation and the resulting profit taxable to it because the directors were trustees for the corporation and not for the stockholders. The decision seems justified and is clearly distinguishable on its facts from the *Jemison* case[30] and from *G. C. M. 714*[31] since there was no actual preliminary distribution in kind to the stockholders or to trustees for them.[32]

The *Taylor* case was affirmed by the Circuit Court of Appeals for the Fifth Circuit,[33] which, after pointing out that the contract of sale was for all practical purposes consummated by the corporation before the resolution authorizing the distribution to the trustees, and was thus enforceable against the corporation, unnecessarily and with unforeseen results proceeded to declare in general terms that title to the assets remained in the company until such time as its affairs were liquidated and its debts paid.[34]

[29] TEX. REV. CIV CODE (Vernon, 1925) art. 1206. The West Virginia statute is generally similar. W. VA. REV. CODE (1931), c. 31, art. 1, § 83.

[30] *Supra* n. 25.

[31] *Supra* n. 23.

[32] In addition to the fact that the stockholders authorized the board of directors to act as trustees for the corporation and the fact that property "belonging to the corporation" was conveyed by such trustees to the purchaser, the income from the corporate properties from the date of the tentative closing of the negotiations to the date of actual transfer was set out on the books of the selling company in a special account in favor of the purchaser indicating clearly that at no time did the "beneficial ownership" of the assets pass to the stockholders.

[33] Taylor Oil & Gas Co. v. Commissioner, 47 F. (2d) 108 (C. C. A. 5th, 1931).

[34] "It may be doubted that the contract of sale was merely executory. Except for executing the formal deed, there was nothing to be done. The price, the thing, and the effective time of delivery, December 15, 1919, had been agreed upon. But, if it was executory, it was still the contract of the company to be executed before there could be any liquidation of its affairs. Conceding for the purpose of argument that the legal title to the property vested in the trustees by the dissolution, no part of the title passed to the stockholders thereby. The real owner was still the company until such time as its affairs were liquidated, the debts paid, and the residue distributed to the stockholders." *Id.* at 109.

While the *Taylor* case was pending on appeal the Board considered and passed upon two generally similar cases without departing from the principles laid down in the *Jemison* decision.[35] However, in the case of *Fred A. Hellebush v. Commissioner*[36] the Board unexplainably took a stand which has rendered its present attitude in cases of this kind extremely uncertain. A summary of the facts of this case — which held, in effect, that an unrestricted transfer of assets by a corporation to trustees for its stockholders to be sold by them to the purchaser was, in effect, a transfer to its own trustees because the trust had been created by a corporate act and the debts had not first been paid — is set forth in a footnote.[37] The view of the majority of the Board can be fairly criticized on several grounds. In the first place, the dictum of the Circuit Court of Appeals in the *Taylor* case, intended, it is believed, to apply to the facts of that case alone, was accepted by

[35] James Duggan v. Commissioner, 18 B. T. A. 608 (1930) (involving a rather badly bungled attempt by a corporation to distribute its assets in kind to its stockholders preliminary to liquidation with one hand, while closely retaining them for its own purposes with the other, decided adversely to the taxpayer); Lexington Ice & Coal Company v. Commissioner, 23 B. T. A. 463 (1931) (where the Board approved a distribution of assets in kind to an agent for stockholders to be immediately sold on their behalf even where the consideration for the property was paid by the purchaser to the selling corporation and deposited and paid out by checks in its name). Reversed by the Circuit Court of Appeals for the Fourth Circuit, January 10, 1933, on the authority of Taylor Oil & Gas Co. v. Commissioner, *supra* n. 33.

[36] 24 B. T. A. 660 (1931).

[37] There the stockholders (whose counsel had obviously made a careful study of the mistakes in a similar transaction attempted by Taylor Oil & Gas Company) after negotiating informally for a sale of the company's assets to a third party, held a special meeting at which it was resolved that the company be dissolved and liquidated, and that all of its assets be transferred to two of its officers as trustees *for the stockholders of the company,* with power to sell and distribute the proceeds among the beneficiaries of the trust. On the same day the officers of the corporation executed formal conveyances to the trustees of all of the company's assets. Following these conveyances the trustees entered into a contract with the purchaser. On the same day the trustees, designating themselves as trustees for the stockholders of the selling company, by deed and bill of sale transferred the real and personal property, formerly owned by the corporation, to the purchaser and received as trustees the consideration which, after deducting expenses and debts, was distributed to the former stockholders, the beneficiaries of the trust. It will be observed that the corporation irrevocably transferred title to its assets to the stockholders prior to the sale, and that it received no part of the purchase price upon the sale by the stockholders to the ultimate purchaser. Nevertheless, the Board with three dissenting members, found in favor of the Commissioner, stating that they felt themselves to be controlled by the decision in the Taylor Oil & Gas Company case despite a very apparent difference in the facts of the two cases. An attempt was made to base the decision on the fact that the corporation was the creator of the trust and must, therefore, be its beneficiary. The transfer in trust "being the act of the corporation, the trustee would necessarily be responsi-

the Board as a general rule of law which it apparently felt obliged to follow. In the second place, it is indefensible to base a decision on the assumption that the creator of a trust *ipso facto* becomes its beneficiary despite a clearly expressed intent to the contrary. Finally, no reason is perceived why an irrevocable transfer by a corporation to its stockholders or their trustees is not valid for all purposes if the transferees assume the payment of the debts of the transferor or such payment is otherwise provided for as by the sale of other assets. "It must be recognized", said Board Member Goodrich in his dissenting opinion, "that there are legal and proper methods by which the accrual of a tax liability upon the disposition of its assets by a corporation may be avoided. Attempts to adopt such devices must be adjudged strictly upon the facts in each case. I think the facts in this case disclose that petitioners successfully availed themselves of such a method . . . ."

The case is now on appeal in the Sixth Circuit and if the Board is affirmed it is to be hoped that the Court will throw some much needed light on the perplexing situation which has arisen since the case was decided, and will not rest its decision on strained and dubious applications of the law of trusts and corporations.[28]

The language of the Fifth Circuit Court of Appeals in the *Taylor* case, which the Board apparently took to mean that there can be no distribution of assets to stockholders prior to liquidation and the payment of debts, has been measurably clarified by a recent decision of the same Court.[29] There, the corporation, by

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ble to and acting for the creator of the trust, even though the stockholders were beneficially interested in the property. The trust was closed when the property was sold, the debts owing the corporation collected, the debts of the corporation paid, and the money distributed to the stockholders. It was then that the stockholders came into the possession of the proceeds of the property."

[28] In the past few months the Board has decided two cases adversely to the taxpayers but with ample justification and upon facts clearly distinguishable from the *Jemison* and *Hellebush* cases, namely, Nibley-Mimnaugh Lumber Co. v. Commissioner (B. T. A., decided September 13, 1932), and Boggs, Burnam & Co. v. Commissioner (B. T. A. decided September 15, 1932). The first case turned principally on the fact that there was no valid transfer of the assets from the corporation to the trustee for the stockholders, but on the contrary the corporation was a party to the instruments which conveyed title to the purchaser. In the second, there was no change in the *beneficial ownership* of the corporate assets inasmuch as the authorizing resolution provided that the corporation retain possession pending the sale by the stockholders, and that they be reconveyed by the stockholders in the event such sale was not consummated.

[29] Snead v. Elmore, 59 F. (2d) 312 (C. C. A. 5th, 1932).

its deed conveyed all of its assets to the stockholders in consideration of the surrender of their stock and their assumption of the corporate liabilities, and the stockholders (who composed a partnership) set up the distributable surplus on the partnership books, dissolved the corporation, and operated the former corporate property for a period of two years when it was sold for cash at a profit equal to the surplus originally set up on the books of the partners. In this case the position of the parties was reversed, the stockholders contending that the profit received by them from the assets of the corporation was income in 1920 when sold for cash and not in 1918 when the distribution was made by the corporation. They maintained — as the Commissioner maintained in the *Taylor Oil & Gas Company* case[40] and the *Hellebush* case[41] — that under the local statute the assets continued vested in the directors as trustees for the corporation after the dissolution until sold for cash in the year 1920. In reversing the District Court which had found in favor of the stockholders, the Circuit Court in an opinion by Judge Sibley, correctly reasoned that since prior to dissolution the corporation had transferred its properties to the stockholders in exchange for their stock and their assumption of the corporate debts, it had no assets to vest in trust in its directors.

Until further enlightenment is had from the appellate courts there will be a degree of uncertainty as to the methods by which the indirect sale may be successfully consummated, and it is possible that the restrictions imposed upon distributions of assets in kind will be so onerous as to render them impractical for the purpose of avoiding the double tax. At this writing it still appears that the stockholders of a corporation may without great inconvenience avoid an income tax against the corporation upon the sale of the corporate assets by an intermediate transfer of such assets to themselves, and it is believed that this right will be sustained in the final clarification of the law in this regard. Each step, however, must be complete in itself and the distribution must be real and not fancied. It is immaterial that the avowed intention of the transaction is to minimize taxes, and it is not fatal or improper that negotiations with the purchaser have been had, and the terms of the sale tentatively agreed upon, prior to the distribution to the stockholders, providing nothing in the na-

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[40] *Supra* n. 28.
[41] *Supra* n. 37.

ture of a contract has been entered into between the officers of the corporation and the purchaser.

The following suggestions, however, might well be borne in mind: (a) It is better that the authorizing resolution direct the officers of the corporation to transfer the assets directly to the stockholders and not to an agent or trustee for them. The stockholders may then for convenience create a trust for their benefit.[42] (b) There must be an actual and irrevocable conveyance from the corporation to the stockholders. Furthermore, it must be clear that the corporation intends to distribute its assets in kind to the stockholders irrespective of the sale by them to the purchaser. The first step must not be contingent upon the second.[43] (c) The capital stock should be surrendered by the stockholders upon receipt of title to the assets and cancelled by the corporation.[44] (d) Formal dissolution of the corporation before the transfer of the assets to the stockholders is unnecessary[45] and may, or may not be subsequently effected, depending on whether there is any reason for keeping the corporate existence intact as in the case

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[42] On principle, it should be possible to make an effective distribution to a trustee but unless the *Hellebush* decision is reversed, the present state of the law seems to require the more inconvenient method of a transfer direct to the stockholders.

[43] Nibley-Mimnaugh Co. v. Commissioner, *supra* n. 38; James Duggan v. Commissioner, *supra* n. 14.

[44] Boggs, Burnam & Co. v. Commissioner, *supra* n. 38.

[45] In the usual case all of the assets are sold or distributed and the corporation is, at approximately the same time, dissolved. But frequently, as under the West Virginia Statute, W. VA. REV. CODE (1931), c. 31, art. 1, § 83, certain formalities must be complied with before the certificate of dissolution is issued and the authorities seem fairly uniform to the effect that actual dissolution does not take place until the consent of the State thereto is manifested. 8 FLETCHER, CORPORATIONS (1919) § 5449.

Whether or not dissolution is a prerequisite to a valid distribution of all of the corporate assets is fundamentally a question of the law of the state under which the corporation is organized. The West Virginia dissolution statute is clear to the effect that "no division of the assets among the stockholders shall be made until . . . . notice of the resolution of dissolution shall have been published once a week for at least two successive weeks in some newspaper published or of general circulation in the county in which the principal office or place of business of the corporation is located." The statute does not seem, however, to require that the certificate of dissolution be issued before the assets may be divided. On the other hand, it is elsewhere provided in the CODE (c. 31, art. 1, § 64) that "every corporation . . . . existing under the laws of this State, may . . . . sell, lease, or exchange all of its property and assets, including its good will and its corporate franchises, upon such terms and conditions and for such consideration, ... as its board of directors shall deem expedient and for the best interests of the corporation, when and as authorized by the affirmative vote of the holders of sixty per cent. of the stock . . . ." If a distribution of assets in kind to stockholders who thereupon surrender their stock is an exchange within the meaning of this section, the corporation presumably may distribute its assets without the necessity of dissolution. A sale or dis-

where all of the assets are not distributed or sold, and all of the stock is not surrendered. (e) There must be a change in the beneficial ownership of the property from the corporation to the stockholders.[46] It has been pointed out that a change in possession is not essential, but as one of the incidents of absolute title the right of immediate possession must pass to the stockholders. Any income which was earned during the period intervening between the distribution and the sale must be received by or impounded for the stockholders who may, if they wish, subsequently assign the same to the purchaser.[47] (f) The corporation must, of course, not be a party to the conveyance of the assets from the stockholders, or their trustee, to the purchaser.[48] (g) The consideration for the sale must be paid to the stockholders, or their representative, and not to the corporation.[49] Where the purchase price is paid to the stockholders, there is no justification for holding that it is constructively received by the corporation,[50] but it is clearly not alone sufficient that the stockholders receive the consideration where there is no actual transfer to them of the assets prior to the sale.[51] (h) According to the better view it is not essential that the debts of the corporation be paid prior to the distribution, providing they are assumed by the stockholders,[52] unless this is required by the local law[53] or insisted upon by the creditors. (i) The corporation and the purchaser must not have entered into any enforceable sales agreement prior to the distribution to the stockholders.[54]

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tribution of all the corporate assets does not in itself act to dissolve the corporation. Weigand v. Alliance Supply Co., 44 W. Va. 133, 28 S. E. 803 (1897); 8 FLETCHER, CORPORATIONS (1919) § 5438. In any event, a corporation may make a partial distribution to stockholders — subject always to the rights of creditors — and remain in existence.

[46] Duggan v. Commissioner, *supra* n. 14; Warden v. Commissioner, 23 B. T. A. 24 (1931); Boggs, Burnam & Co. v. Commissioner, *supra* n. 38.

[47] *Cf.* Taylor Oil & Gas Co. v. Commissioner, *supra* n. 28.

[48] Nibley-Mimnaugh Co. v. Commissioner, *supra* n. 38; Warden v. Commissioner, *supra* n. 46.

[49] Southern Ice & Fuel Co. v. Commissioner, *supra* n. 26.

[50] W. P. Fox & Sons v. Commissioner, *supra* n. 27.

[51] Warden v. Commissioner, *supra* n. 46.

[52] Snead v. Elmore, *supra* n. 39. *Contra* Hellebush v. Commissioner, *supra* n. 37; Taylor Oil & Gas Co. v. Commissioner, *supra* n. 33 (dictum).

[53] The West Virginia statute requires the payment of all corporate debts and liabilities prior to a division of assets among the stockholders upon disolution. W. VA. REV. CODE (1931), c. 31, art. 1, § 80. But if the corporation is not dissolved and an exchange is made of assets for stock under section 68, it would seem that only creditors could demand that the debts be first paid.

[54] Taylor Oil & Gas Co. v. Commissioner, *supra* n. 33.

Sale to the Stockholders and Resale by Them

An easier but seemingly less justifiable method of avoiding the corporate tax has been successfully accomplished by a sale of the assets at cost or book value to the stockholders who immediately resell them to the ultimate purchaser and realize a profit individually. Under these circumstances there is no corporate distribution in kind[55] but there is a similar saving in the corporate tax. The corporation admittedly disposes of its assets to third parties (the stockholders in a different role), but at little or no profit. The stockholders resell their assets at a profit and pay the normal and surtax, or the twelve and one-half per cent. capital net gain rate, as in the case of liquidating dividends. The corporation tax is avoided or at least substantially reduced. The corporation may then dissolve and return to the stockholders as a liquidating dividend the money paid by them for the assets. The advantage of this method over the other lies in its simplicity. The disadvantage results from the difficulty of showing that the sale to the stockholders was a *bona fide* transaction.

In the case of *Iowa Bridge Company v. Commissioner*[56] the Circuit Court of Appeals for the Eighth Circuit reversed the Board of Tax Appeals and held that an assignment by a corporation of certain valuable contracts to its sole stockholder in consideration of his execution of the contracts and his relieving the corporation of liability with respect thereto was valid, and that the profit accruing upon the completion of the contracts was income to the stockholder and not to the corporation despite the fact that there was no formal assignment other than a resolution of the stockholders and no notice of such assignment was given to the obligees. Moreover, as the petitioner admitted, the obvious

[55] U. S. Treas. Reg. 74, Art. 51, provides that "where property is sold by a corporation to a shareholder, or by an employer to an employee, for an amount substantially less than its fair market value, such shareholder of the corporation or such employee shall include in gross income the difference between the amount paid for the property and the amount of its fair market value. In computing the gain or loss from the subsequent sale of such property its cost shall be deemed to be its fair market value at the date of acquisition by the shareholder or the employee." Similar language is contained in Treas. Reg. 69, Art. 31 and Treas. Reg. 65, Art. 31 and T. D. 3435, II-1 Cum. Bull. 50. This regulation has, however, been practically nullified in cases where there is an actual sale, by recent decisions of the Circuit Courts of Appeals to the effect that it is not warranted by the statutes. See Taplin v. Commissioner, *supra* n. 17, and Commissioner v. Van Vorst, 59 F. (2d) 677 (C. C. A. 9th, 1932).

[56] 39 F. (2d) 777 (1930).

purpose of the transaction was to minimize income taxes.[57] Subsequently, in 1931 the Board decided the case of *Fruit Belt Telephone Company v. Commissioner*[58] where an even more transparent device was presented for its consideration. In that case negotiations had been had looking to the purchase by the Southern Bell Telephone Company of the Fruit Belt Company, and with such purpose in mind the Southern Company had made an appraisal of the Fruit Belt Company's assets. In completing the sale the two stockholders of the selling corporation avoided a substantial corporate tax by the simple expedient of purchasing the assets from the corporation for $32,000.00 cash (about $5,000.00 in excess of book value), and on the same day reselling the same property to the Southern Company for $55,000.00. After the sale the Fruit Belt Company dissolved and returned to the stockholders as a liquidating dividend cash in the amount of the purchase price of the assets theretofore received from them. The corporation reported as income in its return the difference between the cost of the assets and the consideration therefor received from its stockholders on the sale to them, and the stockholders each reported as profit one-half of the difference between $32,000.00 and $55,000.00. The Commissioner proposed a deficiency assessment against the corporation which was reversed by the Board which observed, "So long as neither creditor nor stockholder has any objection to the sale of assets by a corporation, clearly, a corporation is not prohibited by law from selling to its stockholders even at a price less than the value of the assets . . . ." In other cases, however,[59] similar sales have been disregarded for lack of *bona fides* and in the very recent case of *S. A. MacQueen Company v. Commissioner*[60] a closely similar transaction was disapproved by the Board.

[57] Similarly, in Savannah Ship Chandlery & Supply Co. v. Commissioner, 13 B. T. A. 958 (1928), where the president of the petitioner corporation purchased ships from the corporation at one price, sold them at a higher, and divided the profit with the other stockholders in proportion to their ownership of the stock, the Commissioner's attempt to assess the corporation with a tax on the profit resulting from the second sale was overruled. But in Rubay Co. v. Commissioner, 9 B. T. A. 133 (1927), and Rasmussen v. Eddy's Steam Bakery, 57 F. (2d) 27 (C. C. A. 9th, 1932) sales by corporations to their largest stockholders were held to be ineffective for income tax purposes.

[58] *Supra* n. 13.

[59] *Supra* n. 57.

[60] B. T. A., decided October 24, 1932. There the stockholders resolved that the board of directors be authorized and directed to sell to MacQueen (the company's president and largest stockholder) certain real estate owned by the company for such price as the board might deem expedient. On the same day the board resolved that the property be sold to MacQueen for

It is not altogether surprising that the Commissioner has been sometimes successful in challenging a sale of corporate assets to stockholders at a price substantially less than their demonstrated market value. Since the stockholders absolutely control the corporation there is force in the suggestion that there may be no *bona fide,* arms length transaction between them. The stockholders may fix the purchase price at any sum that suits their convenience.[61] Moreover, while the *Fruit Belt Telephone Company* case has been expressly distinguished on doubtful grounds from later cases, it is questionable whether it was not tacitly overruled by the decision in *MacQueen Company v. Commissioner.* For these reasons the sale to the stockholders at a price below market value and a resale by them cannot be safely recommended as a method of avoiding the double tax on the sale of corporate assets. Such a transaction is too apt to be held to be, in the words of Mr. Justice Holmes, "on the wrong side of the line indicated by the policy if not the mere letter of the law."[62] However, if such an attempt is made, it is desirable (a) that the sale be made to the stockholders for a consideration which

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$85,000.00 and that the proper officers be authorized to deliver a deed upon receipt of the stated consideration. The following day MacQueen entered into a contract to sell the same real estate to one Hatfield for $150,000.00. Nine days later MacQueen executed an instrument reciting that he held the difference between $85,000.00 and $150,000.00 in trust for the stockholders of the S. A. MacQueen Company. Approximately three weeks later MacQueen paid the company $65,000.00 and received a deed to the property, and on the same day conveyed the property to Hatfield for $150,000.00 cash, and thereafter divided among himself and the other stockholders the excess of $65,000.00 received from Hatfield. The Board held that the sale to MacQueen was not *bona fide* and that the profit on the sale to Hatfield was taxable to the corporation, principally on the ground that MacQueen was the president and largest stockholder and that he received the profits on the sale as trustee for the corporation.

[61] For cases where the Courts and the Board have disregarded the corporate entity in transactions with stockholders see Appeal of M. I. Stewart & Co., 2 B. T. A. 737 (1925); Hollenberg Music Co. v. Commissioner, 6 B. T. A. 421 (1927); Clancy & Co., Inc. v. Commissioner, 12 B. T. A. 855 (1928); Rubay Co. v. Commissioner, *supra* n. 57; Rasmussen v. Eddy's Steam Bakery, *supra* n. 57; S. A. MacQueen Co. v. Commissioner, *supra* n. 60. For cases *contra* (in addition to those discussed above) see Burnet, Commissioner v. Commonwealth Improvement Co. (Sup. Ct. of U. S., decided December 12, 1932); Burnet, Commissioner v. Clark, (U. S. Sup. Ct., decided December 12, 1932); McDonald v. Commissioner, 52 F. (2d) 920 (C. C. A. 4th, 1931); Strand Amusement Co. v. Commissioner, 3 B. T. A. 770 (1926); Gem Theatre Co. v. Commissioner, 8 B. T. A. 309 (1927); Becker v. Commissioner, 8 B. T. A. 65 (1927); Rogers v. Commissioner, 12 B. T. A. 816 (1928); Brown Coal & Coke Co. v. Commissioner, 14 B. T. A. 609 (1928); 112 West 59th Street Corporation v. Commissioner, 23 B. T. A. 767 (1931); Gregory v. Commissioner (B. T. A., decided December 6, 1932).

[62] Bullen v. Wisconsin, *supra* n. 12.

will reflect at least some profit to the corporation;[63] (b) that the sale be made direct to the stockholders and not to a trustee or, if the stockholders are very numerous, or if for other reasons a conveyance to representatives is unavoidable, such representatives be in no event officers or directors of the company;[64] (c) there must be a change in the beneficial ownership of the assets and the income, if any, accruing therefrom, which includes the right to immediate possession;[65] (d) it must be made clear that the stockholders in receiving title to the assets and subsequently selling the same are not acting for the corporation;[66] and (e) the sale to the stockholders must be irrevocable, complete and made in good faith in the sense that it must be real and not pretended, and if this is the case the transaction will not be invalidated merely because the principal object of the parties was to minimize taxes.[67] Dissolution of the corporation either before or after the sale is unnecessary,[68] and it seems clear that the debts need not first be paid.[69]

Sale of the Stock

Providing a purchaser of *all* the corporate assets is found the simplest and surest method of minimizing income taxes on the sale is by assignment of the stock to the purchaser who, upon assuming complete control of the corporation may cause its dissolution and acquire its assets through liquidation. The difficulty with this method is that it is generally unattractive to the purchaser unless he has some reason for keeping the selling corporation alive. If his object is only to acquire the assets, he is apt to be unwilling to assume the burden and expense of liquidation. Then, too, he may with good reason be reluctant to run the risk of hitherto unasserted claims against the corporation

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[63] This is not essential but as a practical matter may result in securing the Commissioner's approval of the transaction, thus avoiding litigation.

[64] S. A. MacQueen Co. v. Commissioner, *supra* n. 60. The general rule that officers or directors receive secret profits as trustees *for the corporation* is followed in West Virginia. See Young v. Columbia Oil Co., 110 W. Va. 364, 158 S. E. 678 (1931); Petrelli Coal Co. v. Petrelli, 99 W. Va. 72, 127 S. E. 915 (1925); Nickel Plate Land Co. v. Broom, 96 W. Va. 586, 123 S. E. 594 (1924); North American Coal, *etc.*, Co. v. O'Neal, 82 W. Va. 186, 95 S. E. 822 (1918).

[65] S. A. MacQueen Co. v. Commissioner, *supra* n. 60.

[66] Rasmussen v. Eddy's Steam Bakery, *supra* n. 57.

[67] Iowa Bridge Co. v. Commissioner, *supra* n. 56; Fruit Belt Telephone Co. v. Commissioner, *supra* n. 58.

[68] *Supra* n. 45.

[69] *Supra* n. 45, n. 52 and n. 53.

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or a possible discrepancy between the net worth of the assets as represented and as may ultimately prove to be a fact. However, in the event that a purchaser is found who is content to take over the corporation intact by the purchase of its stock, such a transaction will avoid a double tax since no tax will be payable by the corporation and the stockholders are taxable only on the profit represented by the difference between the cost or other basis to them of their stock and the amount received therefor.[70]

It is important, however, that all papers and records incidental to the sale make it clear that what is sold is actually the stock and not the corporate assets, for while the courts and the Board have laid emphasis on the fact that the true test is whether there is a change of ownership in the stock, confusion has occasionally arisen from the manner in which the sale was executed. The common mistake is to make the records so ambiguous that either a stock sale or a sale of assets might have occurred.[71] Nevertheless, a liberal attitude in cases of this nature has been adopted by the Board which has held the transaction to be a stock sale although the sales agreement provided for a sale of assets and stock, and the stock certificates were returned to the selling stockholders shortly after the acquisition of the assets of the selling corporation by the purchaser.[72] The Board emphasized the fact that there was a change in the ownership of the stock, which was worthless when returned to the sellers. Similarly, in *Patterson v. Motter*[73] a District Court of Kansas held the transaction there involved to be a sale of the corporation's stock by its stockholders and not a sale of assets taxable to the corporation, although the contract of sale provided in the alternative for a transfer of stock or assets on the election of the purchaser, since the corporation was never a party to any sales agreement and was not bound by an agreement of the stockholders which was never executed. But in another case the Circuit Court of Appeals for the Second Circuit determined the transaction to be a sale of as-

[70] If instead of receiving cash the stock is exchanged in pursuance of a plan of reorganization as defined by the Act solely for stock or securities of another corporation a party to the reorganization, the transaction may be entirely exempt from tax. See REVENUE ACT OF 1932, §§ 112 (a) (3) and 112 (i) (1) (2); U. S. Treas. Reg. 74, Arts. 574, 575 and 577; Hendricks, *Federal Income Tax: Definition of "Reorganization"* (1932) 45 HARV. L. REV. 648.

[71] U. S. v. Board, 14 F. (2d) 459 (1926).

[72] Reisner Manufacturing Co. v. Commissioner, 13 B. T. A. 841 (1928).

[73] 55 F. (2d) 692 (D. Kan. 1931).

sets, although nominally a stock sale, where the stockholders of the selling corporation, after endorsing their stock certificates to the purchaser, continued to act as stockholders in dissolving the selling corporation.[74]

In *Dudley v. Commissioner*[75] the Board found that what occurred was a stock sale despite the fact that a preliminary option agreement stipulated for the formation of a new company and the purchase of the selling company's assets by it, and although the minutes of the company thus formed recorded a resolution authorizing the purchase of assets. The Board based its decision on the fact that the selling company was not a party to such negotiations (the option agreement having been entered into between the purchaser and the selling company's stockholders), and that the purchase money was paid directly to the stockholders and not to the selling company.

In two recent cases the Board has been called upon to determine whether or not the acquisition of all of the assets of one bank by another was a sale of stock or a sale of assets and taxable to the selling bank. In the first[76] an offer was made to purchase stock at $40.00 a share, but the minutes of the meetings incident to the transaction and the instruments transferring title referred to a sale of assets. It was held that the transaction amounted to a sale of assets and the assessment proposed by the Commissioner against the selling corporation was sustained although the stock certificates had been subsequently surrendered by the selling stockholders to the former president of their corporation, who had since become a vice-president of the purchasing corporation, and was to some extent at least acting for it. In the other case[77] an agreement was entered into between the two banks, whereby the purchaser agreed to buy the seller's 1,000 shares of outstanding stock at $400.00 a share. Thereafter, the president of the selling company acquired options on the stock of his company and subsequently transferred the same to a representative of the purchaser. The purchaser immediately secured the election of a new board of directors, and, through proper corporate action, the transfer of the assets of the selling corporation to the purchaser. The selling

[74] U. S. v. Klausner, 25 F. (2d) 608 (C. C. A. 2d, 1928).
[75] 15 B. T. A. 570 (1929). The Commissioner has acquiesced in this decision. VII-2 Cum. Bull. 15.
[76] Brady v. Commissioner, 22 B. T. A. 596 (1931).
[77] Stock Yards Bank of Cincinnati v. Commissioner, 25 B. T. A. (decided March 23, 1932).

corporation was thereupon dissolved. It was argued on behalf of the Commissioner that under the laws of Illinois a savings bank was prohibited from investing in the stock of another bank and that, therefore, the transaction must have been a sale of assets. The Board, however, refused to follow this view pointing out that the sale had been approved by the State commissioner of banking, and determined that the true nature of the transaction was a purchase of stock and subsequent liquidation by the purchasing stockholder.

A substantial tax saving may result from a sale of the stock rather than the assets but it is apparent from the foregoing that care must be exercised in managing the details of the sale. The following features of the transaction should be closely observed: (a) There must be an actual change in the ownership of the stock and a transfer of the certificates.[78] (b) The instruments and records pertaining to the sale should make it clear that the subject of the sale is stock in a corporation and not the corporate assets.[79] (c) The consideration must be paid directly to the stockholders and not to the corporation, nor to a liquidating agent for the corporation.[80] The stockholders of the selling corporation must not continue to act as such in order to dissolve the corporation, or for any other purpose.[81] (e) No action must be taken to lessen the value of the stock prior to the transfer of the stock by the distribution to the purchaser of assets of the selling corporation.[82] (f) The corporation must not be a party to any preliminary option agreement, contract of sale, or other instrument pertaining to the transaction.[83]

Conclusion

Under the present state of the law and condition of the Treasury any plan to minimize the taxes imposed upon a profitable sale of corporate assets, however skillfully designed and carefully executed, may be rejected by the Commissioner of Internal Revenue. It is not only expected but demanded of conscientious officials that they assess the tax in any case where they entertain an honest doubt as to the effectiveness of the method

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[78] Reisner Manufacturing Co. v. Commissioner, *supra* n. 72.
[79] Brady v. Commissioner, *supra* n. 76.
[80] *Ibid.*
[81] U. S. v. Klausner, *supra* n. 74.
[82] *Ibid.*
[83] Patterson v. Motter, *supra* n. 73.

employed to avoid it. Fortunately for the taxpayer, there exist the Board of Tax Appeals and the courts which may generally be relied upon to safeguard such rights and remedies as he possesses under the taxing statutes. The exact scope of his ability to avoid legally the double tax on the sale of corporate assets has yet to be determined.[84] An attempt has been made to sketch its probable extent, to define its limitations, and to point out the mistakes of those who have been unsuccessful in their efforts. But if taxes are as certain as death, the law of taxation is as uncertain as life, and whether the suggestions herein contained will be finally approved must, for the time being at least, remain somewhat conjectural.

[84] The Supreme Court of the United States denied an application for a writ of *certiorari* in the case of Taylor Oil & Gas Co. v. Commissioner, *supra* n. 33, on June 1, 1931, 283 U. S. 862, 51 S. Ct. 655. On no other occasion, apparently, has this question been considered by that Court.