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Federal Income Tax: Who Made the Sale, The Corporation or the Shareholder?

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counter and to point out that, where tax benefits have been made available, the provisions of the statutes and the regulations must be followed to the letter in order for the taxpayer to obtain such benefits.

W. T. STOCKTON, JR.

FEDERAL INCOME TAX: WHO MADE THE SALE,
THE CORPORATION OR THE SHAREHOLDER?

*Howell Turpentine Co. v. Commissioner of Internal
Revenue, 162 F.2d 319 (C. C. A. 5th 1947)*

Howell and his two sons owned 95 per cent of the stock of the defendant corporation. They were also its directors. Having decided to abandon the business for which the corporation was formed, Howell entered into negotiations with a prospective purchaser for the sale of the corporate assets. Later by formal corporate action a resolution to liquidate was adopted. On the same day the Howells, as individuals, executed a written contract for the sale of the corporate assets, which they would own after liquidation. This contract contained a recital of the proposed liquidation. According to plan defendant corporation conveyed its assets to the Howells in proportion to their holdings, and they, in turn, conveyed to the purchaser. The commissioner relying on *Commissioner v. Court Holding Co.*,¹ treated the transaction as one by the defendant corporation and taxed it with the gain resulting from the sale. A divided tax court sustained the commissioner.² On appeal, HELD, the evidence established that the gain realized should have been taxed on the basis that the sale was by the shareholders, as individuals, after a liquidation in kind, and not a sale by the defendant corporation. Judgment reversed.

"Taxes and tax avoidance were probably born twins and are likely to continue their joint existence until the millennium of a taxless world.

¹324 U. S. 331 (1945).

²Howell Turpentine Co. v. Commissioner, 6 T. C. 364 (1946).

Avoidance is Hydra-headed and, as the tax gatherers, aided by the Supreme Court, discover and cut off one escape contrivance, the taxpayer rears up another."³ In the principal case an attempt was made to avoid the double tax involved in a sale of corporate assets and the subsequent distribution of the proceeds to the shareholders.⁴ The contrivance used was a contract by the shareholders to sell their expectancies (their respective rights to pro rata parts of the residue of the corporate property on liquidation). Numerous similar attempts to avoid the double tax have been made, and there has been considerable variance in reasoning and result in the lower court decisions.⁵ The problem was presented to the Supreme Court for the first (and to date, only) time in *Commissioner v. Court Holding Co.*⁶ Deciding in favor of the Commissioner, the majority, through Mr. Justice Black, reiterated the now familiar proposition that the incidence of taxation depends upon the substance of a transaction.⁷ The formalisms employed *solely* for the purpose of altering tax liabilities were considered as veils disguising the true nature of the transaction, and consequently were disregarded. The decision was simply an application of the tax philosophy of the present Supreme Court to another type of tax problem. A cornerstone of this philosophy is judicial support of the tax policies of Congress.⁸

The *Court Holding Co.* case was distinguished from the principal case on the grounds that in the latter, the corporation was never negotiated with, never agreed on, and never carried out any sale. This alleged distinction neatly side-steps the fundamental problem in transactions in which a family corporation is involved, *i.e.*, the difficulty in determining who acted—the individual stockholder or the corporation

³Rudick, *The Problem of Personal Income Tax Avoidance*, 7 LAW & CONTEMP. PROB. 243 (1940).

⁴See INT. REV. CODE, §22 (a).

⁵*Decided for taxpayer:* Commissioner v. Falcon, 127 F.2d 277 (C. C. A. 5th 1942); Louisville Trust Co. v. Glenn, 65 F. Supp. 193 (W. D. Ky. 1946); Williams v. Commissioner, 3 T. C. 1002 (1944). *Decided against taxpayer:* Wichita Terminal Elevator Co. v. Commissioner, 162 F.2d 513 (C. C. A. 10th 1947); Fairfield Steamship Corporation v. Commissioner, 157 F.2d 321 (C. C. A. 2d 1946); S. A. MacQueen Co. v. Commissioner, 67 F.2d 857 (C. C. A. 3d 1933).

⁶324 U. S. 331 (1945).

⁷*See e. g.*, Helvering v. Clifford, 309 U. S. 331 (1940); Commissioner v. Tower, 327 U. S. 280 (1946); Higgins v. Smith, 308 U. S. 473 (1940); Helvering v. National Grocery Co., 304 U. S. 282 (1938).

⁸Rudick, *supra* note 3, at 247.