CHAPTER 7

Complete Liquidations

A. Introduction

We have been present at the creation of a corporation and nurtured the corporate entity as it engaged in distributions, redemptions, partial liquidations and maneuvers to mitigate the double tax. This chapter shifts the focus to the end of a C corporation's life cycle.

A few definitions are in order to set the stage. The Code does not define "complete liquidation," but the regulations provide that liquidation status exists for tax purposes "when the corporation ceases to be a going concern and its activities are merely for the purpose of winding up its affairs, paying its debts, and distributing any remaining balance to its shareholders."[1] Legal dissolution under state law is not required for the liquidation to be complete, and a transaction will be treated as a liquidation even if the corporation retains a nominal amount of assets to pay any remaining debts and preserve its legal existence.[2]

Liquidations often are preceded by a sale of substantially all of a corporation's assets and a distribution of the sales proceeds to the shareholders in exchange for their stock. Alternatively, the buyer of a corporate business may acquire all the stock of the target company and either keep the old corporation alive or cause it to be liquidated. But liquidations do not necessarily involve sales. The corporation simply may distribute its assets in kind to the shareholders, who either may sell the assets or continue to operate the business outside of corporate solution. Or a parent corporation may wish to rearrange its holdings by liquidating or selling the stock of a subsidiary.

All these transactions raise challenging tax issues at the shareholder and corporate levels. Historically, individual shareholders have hoped to emerge from a complete liquidation or the sale of a profitable corporate business by realizing a capital gain on their stock and, on an installment sale, by deferring recognition of the gain until cash payments are received. At the corporate level, the goals generally have been to avoid recognition of gain on a distribution or sale of assets while providing the shareholders (in a liquidation) or the purchaser (in an acquisition) with a fair market value basis in the distributed or acquired assets. At one time, most of these objectives could be met with careful planning, but liquidations of profitable companies became far more expensive after the Tax Reform Act of 1986 This chapter surveys the current landscape, considering first the general shareholder and corporate level tax

1 Reg. § 1.332–2(c). This regulation technically applies only to the liquidation of a subsidiary, but it has long been assumed to apply also to ordinary liquidations.

2 See, e.g., Rev. Rul. 54–518, 1954–2 C.B. 142.

consequences of complete liquidations and then turning to the special problems raised on the liquidation of a subsidiary. Later chapters will consider the closely related topic of taxable acquisitions of corporate assets or stock, tax-free acquisition techniques known as corporate reorganizations, and the carryover of tax attributes following an acquisition.[3]

B. COMPLETE LIQUIDATIONS UNDER SECTION 331

1. CONSEQUENCES TO THE SHAREHOLDERS

Code: §§ 331; 334(a); 346(a); 453(h)(1)(A)–(B).

Regulations: §§ 1.331–1(a), (b), (e); 1.453–11(a)(1), (2)(i), (3), –11(d).

The complete liquidation of a corporation presents an opportunity to revisit several policy issues that recur throughout the study of Subchapter C. Consider the appropriate tax consequences to Owner, a sole shareholder of X Corporation, who desires to liquidate X and continue to operate its business as a proprietorship. Assume that X has been profitable and has ample earnings and profits at the time of its liquidation. From Owner's standpoint, should the liquidation be treated as: (1) a nonrecognition transaction akin to an incorporation, (2) a dividend distribution, (3) an exchange of the stock for the distributed assets or (4) some combination of the above?

If Owner continues to operate the business as a sole proprietorship, the liquidation results in a mere change in the form of his investment. Since Congress granted nonrecognition treatment to Owner when he transferred the business into corporate solution, is it not also appropriate to treat the transfer of those assets back into Owner's hands as a tax-free event? This analogy has a superficial appeal but Congress has never seriously considered it except in very limited situations.[4] Nonrecognition is inconsistent with the double tax regime of Subchapter C because it would facilitate the tax-free bailout of earnings and profits. Moreover, many complete liquidations involve the sale of a business followed by a distribution of the cash proceeds to the shareholders. Cash distributions do not lend themselves to a nonrecognition regime because it is impossible to assign money the substituted basis that would be necessary to preserve the shareholder's gain for recognition at a later time. Similarly, any attempt to preserve the liquidated corporation's earnings and profits in the hands of its former shareholders would be cumbersome and inconsistent with the termination of the corporation.

A stronger case can be made for treating a liquidating distribution as a dividend to the extent of the corporation's remaining earnings and profits. Because earnings and profits disappear on a complete liquidation, this is the last chance to tax a shareholder's withdrawal of

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[3] See Chapters 8, 9, and 12, infra.

[4] See, e.g., I.R.C. § 332, discussed in Section C of this chapter, infra.

corporate profits as ordinary income. By triggering the distribution rules of Sections 301 and 316, this approach would focus on the source of the liquidating distribution rather than the shareholder's relationship to his investment. Dividend treatment, however, is inconsistent with Section 302, which treats a distribution in redemption as an exchange if the shareholder completely terminates or substantially reduces his interest in the corporation. Why should a complete termination of the interests of all the shareholders be treated any less favorably? Moreover, if liquidating distributions were treated as dividends to the extent of the corporation's earnings and profits, a shareholder's stock basis might never be recovered.

The redemption analogy suggests a third approach, which would treat a complete liquidation as a sale of stock by the shareholder. This solution is imperfect, if only because it ignores the disappearance of the earnings and profits account, a clean sweep that does not occur on a sale of stock. But after a period of waffling,[5] Congress opted to treat liquidations as exchanges, an approach that permits shareholders to avoid the dividend sting and be taxed at capital gains rates. Congress concluded that the dividend threat was "preventing liquidation of many corporations" because of the high tax cost it imposed and therefore was generating only minimal revenue.[6] It regarded exchange treatment as "consistent with the entire theory of the [Code]" and as "the only method * * * which can be easily administered."[7]

The Congressional policy is codified in Section 331(a), which provides that amounts received by a shareholder in complete liquidation are treated as full payment in exchange for the shareholder's stock. The vast majority of shareholders hold their stock as a capital asset and thus will recognize capital gain or loss in an amount equal to the difference between (1) the money and the fair market value of the property received and (2) the shareholder's adjusted basis in the stock surrendered. Section 334(a) provides that the shareholder's basis in property distributed by a corporation in a complete liquidation that is taxable at the shareholder level shall be the fair market value of the property at the time of the distribution.

Computation of a shareholder's gain or loss on a complete liquidation is ordinarily a straightforward affair. The shareholder's amount realized is the money and the fair market value of all other property received from the liquidating corporation. If a shareholder assumes corporate liabilities or receives property subject to a liability in a liquidating distribution, the amount realized is limited to the value of the property received, net of liabilities. In keeping with the principles of the *Crane* case, however, it is

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[5] Liquidations were first treated as exchanges in the Revenue Act of 1924. Congress changed its mind briefly from 1934 to 1936 and then reinstated the present system.

[6] H.R.Rep. No. 2475, 74th Cong., 2d Sess. (1936), reprinted in 1939–1 (Part 2) C.B. 667, 674.

[7] S.Rep. No. 368, 68th Cong., 1st Sess. (1924), reprinted in 1939–1 (Part 2) C.B. 266, 274.

assumed that the distributee shareholder will pay the liabilities and he thus obtains a full fair market value basis in the property under Section 334(a).

Shareholders who hold several blocks of stock with different bases and acquisition dates must compute their gain or loss separately for each block rather than on an aggregate basis.[8] This method generally makes a difference, however, only when some shares are held long-term and others short-term; otherwise, the tax consequences will be identical whether the shareholder uses a share-by-share or an aggregate approach.[9]

The timing of a shareholder's gain or loss on a complete liquidation raises thornier questions. A liquidating corporation often is unable to distribute all of its property at one time or within the same taxable year. Recognizing these practical constraints, Section 346(a) defines a complete liquidation to include a series of distributions occurring over a period of time if they are all pursuant to a plan of complete liquidation. Shareholders normally prefer to treat these "creeping complete" liquidations as open transactions so they can defer reporting any gain until the amounts received exceed their stock basis.[10] This cost recovery approach has been sanctioned by the Service in the liquidation context[11] even though it would appear to be foreclosed by Section 453, which requires ratable basis recovery as payments are received even in cases where the selling price cannot be readily ascertained.[12] Since liquidating distributions are treated as payments in exchange for the shareholders' stock, Section 453 technically seems to apply and, if so, shareholders wishing to defer their gain should be required to use the installment method, allocating each distribution between recovery of basis and taxable gain.[13] But taxpayers who choose to use the cost recovery

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8 Reg. § 1.331–1(e). For example, assume that Shareholder ("S") holds 60 shares of X, Inc. stock long-term with a $30,000 basis and 40 shares short-term with a $50,000 basis. If S receives $100,000 in complete liquidation of X, he must allocate the amount realized ratably between the two blocks as follows:

Long-Term		Short-Term	
60 shares		40 shares	
A.R.	$60,000	A.R.	$40,000
A.B.	30,000	A.B.	50,000
LTCG	$30,000	STCL	$10,000

9 For the problems of valuation of the liquidating distribution and handling contingent claims, see Bittker & Eustice, Federal Income Taxation of Corporations & Shareholders ¶ 10.22[2].

10 See, e.g., Burnet v. Logan, 283 U.S. 404, 51 S.Ct. 550 (1931). Cf. I.R.C. § 453(d) (installment method applies unless taxpayer elects out of Section 453).

11 Rev. Rul. 68–348, 1968–2 C.B. 141, amplified by Rev. Rul. 85–48, 1985–1 C.B. 126.

12 See I.R.C. § 453(j)(2); Reg. § 15A.453–1(c).

13 Cf. Reg. § 1.453–11(d), which appears to support the position taken in the text but only when the liquidating corporation distributes an installment obligation described in Section 453(h). See infra notes 14–16 and accompanying text. Installment sale reporting is not available if the stock of the liquidating corporation is publicly traded. See I.R.C. § 453(k)(2). If open transaction reporting is still generally available to liquidating distributions, this restriction

approach are not likely to be challenged in light of the Service's longstanding position in published rulings.

A different issue is presented when a liquidating corporation sells certain assets for installment obligations and then distributes the obligations in complete liquidation. In that situation, shareholders who receive the installment obligations may be able to defer part of their Section 331(a) gain on the liquidation by using the installment method of reporting under Section 453. Installment sale reporting is accomplished by treating the shareholders' receipt of payments on the distributed installment obligations as if they were received in exchange for the shareholder's stock.[14] To qualify for this treatment, the obligations must have been acquired by the corporation in respect of a sale or exchange of property during the 12-month period beginning on the date a plan of complete liquidation is adopted and the liquidation must be completed within that 12-month period.[15] Installment obligations arising from the sale of inventory or other "dealer" property by the corporation are eligible for installment sale treatment in the hands of the distributee shareholders only if the obligation resulted from a bulk sale—i.e., the sale was to one person in one transaction and involves substantially all of the property attributable to a trade or business of the corporation.[16] Installment sale reporting is not available, however, if the stock of the liquidating corporation is publicly traded,[17] or if the shareholder elects out of Section 453.[18]

PROBLEM

A owns 100 shares of Humdrum Corporation which he purchased several years ago for $10,000. Humdrum has $12,000 of accumulated earnings and profits. What are the tax consequences to A on the liquidation of Humdrum Corporation in the following alternative situations:

(a) Humdrum distributes $20,000 to A in exchange for his stock?

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should not apply when a shareholder of a public company receives a series of distributions straddling two or more taxable years. See also I.R.C. § 453(d), which permits a taxpayer to "elect out" of installment sale treatment. In the case of a liquidation, an election out would require the shareholder to report his entire gain in the year of the first distribution except, perhaps, where the value of future distributions is unascertainable. See Reg. § 15A.453–1(d).

14 I.R.C. § 453(h)(1)(A); Reg. § 1.453–11. A shareholder who receives liquidating distributions that include installment obligations in more than one taxable year must reasonably estimate the gain attributable to distributions received in each taxable year based on the best available information and allocate his stock basis pro rata over all payments to be received. When the exact amount of gain is subsequently determined, any adjustment is made in the taxable year in which that determination is made. Alternatively, the shareholder may file an amended return for the earlier year. I.R.C. § 453(h)(2); Reg. § 1.453–11(d).

15 Id. See Reg. § 1.453–11(c).

16 I.R.C. § 453(h)(1)(B); Reg. § 1.453–11(c)(4).

17 I.R.C. § 453(k)(2); Reg. § 1.453–11(a)(2)(i). But if a nonpublicly traded liquidating corporation distributes an installment obligation arising from a corporate-level sale of publicly traded stock, the obligation generally qualifies for installment sale reporting under Section 453(h). Reg. § 1.453–11(c)(2).

18 I.R.C. § 453(d).

(b) What result in (a), above, if A receives $10,000 in the current year (year one) and $10,000 in year two? Would there be any problem if Humdrum does not adopt a formal plan of complete liquidation in year one?

(c) Humdrum distributes $8,000 cash and an installment obligation with a face and fair market value of $12,000, payable $1,000 per year for 12 years with market rate interest. The installment obligation was received by Humdrum two months ago, after the adoption of the plan of liquidation, on the sale of a capital asset. Would the result be different if Humdrum's stock were publicly traded? See I.R.C. § 453(k).

(d) Same as (c), above, except the installment obligation was received two years ago and no payments have yet been made.

(e) What result in (a), above, if two years later, A is required to pay a $5,000 judgment against Humdrum in his capacity as transferee of the corporation? Compare this with the result if the judgment had been rendered and paid by the corporation prior to the liquidation. See Arrowsmith v. Commissioner, 344 U.S. 6, 73 S.Ct. 71 (1952).

2. CONSEQUENCES TO THE LIQUIDATING CORPORATION

Code: § 336(a)–(d). Skim § 267(a)(1), (b), (c).

It should come as no surprise at this juncture that Subchapter C requires property distributions by corporations to their shareholders to be analyzed at both the corporate and shareholder levels. Earlier chapters have chronicled the gradual erosion of the *General Utilities*[19] doctrine, under which a corporation generally did not recognize gain on nonliquidating distributions of appreciated property. We have seen that recognition of gain (but not loss) is now the statutory norm in the nonliquidation setting.[20] Should the same rules apply to liquidating distributions and sales of assets by a liquidating corporation? Once again, a brief historical interlude is appropriate before considering the current answers to what was once a debated question.

a. BACKGROUND

Although the *General Utilities* case involved a distribution of appreciated property by an ongoing business, the doctrine also applied to liquidating distributions. Until the enactment of the 1986 Code, a corporation generally did not recognize gain or loss on the distribution of property in complete liquidation.[21] Prior to the 1954 Code, however, sales of assets by a liquidating corporation were fully taxable.

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[19] General Utilities & Operating Co. v. Helvering, 296 U.S. 200, 56 S.Ct. 185 (1935); see Chapters 4D1 and 5E1, supra.

[20] I.R.C. § 311(a), (b).

[21] I.R.C. § 336(a) (pre-1987). This general nonrecognition rule was subject to various exceptions, such as the statutory recapture of depreciation provisions and the judicially created

To illustrate the disparate tax treatment of liquidating distributions and sales under the pre-1954 regime, assume that A is the sole shareholder of Target Corporation ("T") and has a $100,000 basis in her T stock. T's only asset is a parcel of undeveloped land ("Gainacre") with a fair market value of $400,000 and a zero adjusted basis. Purchaser ("P") wishes to acquire Gainacre for $400,000 cash. If T distributed Gainacre to A in complete liquidation, it recognized no gain under the *General Utilities* doctrine, and A took Gainacre with a $400,000 fair market value basis. On a sale of Gainacre to P for $400,000 following the liquidation, A thus would recognize no gain. If, instead, T had sold Gainacre directly to P, it would have recognized $400,000 gain under the pre-1954 regime. In either case, A recognized gain on the liquidation of T, measured by the difference between the amount of the distribution and her $100,000 adjusted basis in the T stock.

The different tax results of these economically equivalent transactions prompted savvy taxpayers to "postpone" sales of corporate assets until after a liquidation in order to avoid a corporate-level tax. The ignorant did what came naturally—and often was a practical necessity for large corporations with many assets and shareholders—by selling assets at the corporate level prior to the liquidation. With such high tax stakes, the courts were called upon to determine who *in substance* made the sale—an inquiry that engendered some anomalous results, as evidenced by the two Supreme Court decisions that follow.

Commissioner v. Court Holding Co.

Supreme Court of the United States, 1945.
324 U.S. 331, 65 S.Ct. 707.

■ MR. JUSTICE BLACK delivered the opinion of the Court.

An apartment house, which was the sole asset of the respondent corporation, was transferred in the form of a liquidating dividend to the corporation's two shareholders. They in turn formally conveyed it to a purchaser who had originally negotiated for the purchase from the corporation. The question is whether the Circuit Court of Appeals properly reversed the Tax Court's conclusion that the corporation was taxable under § 22 of the Internal Revenue Code for the gain which accrued from the sale. The answer depends upon whether the findings of the Tax Court that the whole transaction showed a sale by the corporation rather than by the stockholders were final and binding upon the Circuit Court of Appeals.

It is unnecessary to set out in detail the evidence introduced before the Tax Court or its findings. Despite conflicting evidence, the following findings of the Tax Court are supported by the record:

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tax benefit rule and assignment of income doctrine. See, e.g., Hillsboro National Bank v. Commissioner, 460 U.S. 370, 103 S.Ct. 1134 (1983).

The respondent corporation was organized in 1934 solely to buy and hold the apartment building which was the only property ever owned by it. All of its outstanding stock was owned by Minnie Miller and her husband. Between October 1, 1939 and February, 1940, while the corporation still had legal title to the property, negotiations for its sale took place. These negotiations were between the corporation and the lessees of the property, together with a sister and brother-in-law. An oral agreement was reached as to the terms and conditions of sale, and on February 22, 1940, the parties met to reduce the agreement to writing. The purchaser was then advised by the corporation's attorney that the sale could not be consummated because it would result in the imposition of a large income tax on the corporation. The next day, the corporation declared a "liquidating dividend," which involved complete liquidation of its assets, and surrender of all outstanding stock. Mrs. Miller and her husband surrendered their stock, and the building was deeded to them. A sale contract was then drawn, naming the Millers individually as vendors, and the lessees' sister as vendee, which embodied substantially the same terms and conditions previously agreed upon. One thousand dollars, which a month and a half earlier had been paid to the corporation by the lessees, was applied in part payment of the purchase price. Three days later, the property was conveyed to the lessees' sister.

The Tax Court concluded from these facts that, despite the declaration of a "liquidating dividend" followed by the transfers of legal title, the corporation had not abandoned the sales negotiations; that these were mere formalities designed "to make the transaction appear to be other than what it was" in order to avoid tax liability. The Circuit Court of Appeals drawing different inferences from the record, held that the corporation had "called off" the sale, and treated the stockholders' sale as unrelated to the prior negotiations.

There was evidence to support the findings of the Tax Court, and its findings must therefore be accepted by the courts. Dobson v. Commissioner, 320 U.S. 489; Commissioner v. Heininger, 320 U.S. 467; Commissioner v. Scottish American Investment Co., 323 U.S. 119. On the basis of these findings, the Tax Court was justified in attributing the gain from the sale to respondent corporation. The incidence of taxation depends upon the substance of a transaction. The tax consequences which arise from gains from a sale of property are not finally to be determined solely by the means employed to transfer legal title. Rather, the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title. To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.

It is urged that respondent corporation never executed a written agreement, and that an oral agreement to sell land cannot be enforced in Florida because of the Statute of Frauds, Comp.Gen.Laws of Florida, 1927, vol. 3, § 5779. But the fact that respondent corporation itself never executed a written contract is unimportant, since the Tax Court found from the facts of the entire transaction that the executed sale was in substance the sale of the corporation. The decision of the Circuit Court of Appeals is reversed, and that of the Tax Court affirmed.

It is so ordered.

United States v. Cumberland Public Service Co.

Supreme Court of the United States, 1950.
338 U.S. 451, 70 S.Ct. 280.

■ MR. JUSTICE BLACK delivered the opinion of the Court.

A corporation selling its physical properties is taxed on capital gains resulting from the sale. There is no corporate tax, however, on distribution of assets in kind to shareholders as part of a genuine liquidation. The respondent corporation transferred property to its shareholders as a liquidating dividend in kind. The shareholders transferred it to a purchaser. The question is whether, despite contrary findings by the Court of Claims, this record requires a holding that the transaction was in fact a sale by the corporation subjecting the corporation to a capital gains tax.

Details of the transaction are as follows. The respondent, a closely held corporation, was long engaged in the business of generating and distributing electric power in three Kentucky counties. In 1936 a local cooperative began to distribute Tennessee Valley Authority power in the area served by respondent. It soon became obvious that respondent's Diesel-generated power could not compete with TVA power, which respondent had been unable to obtain. Respondent's shareholders, realizing that the corporation must get out of the power business unless it obtained TVA power, accordingly offered to sell all the corporate stock to the cooperative, which was receiving such power. The cooperative refused to buy the stock, but countered with an offer to buy from the corporation its transmission and distribution equipment. The corporation rejected the offer because it would have been compelled to pay a heavy capital gains tax. At the same time the shareholders, desiring to save payment of the corporate capital gains tax, offered to acquire the transmission and distribution equipment and then sell to the cooperative. The cooperative accepted. The corporation transferred the transmission and distribution systems to its shareholders in partial liquidation. The remaining assets were sold and the corporation dissolved. The shareholders then executed the previously contemplated sale to the cooperative.

Upon this sale by the shareholders, the Commissioner assessed and collected a $17,000 tax from the corporation on the theory that the shareholders had been used as a mere conduit for effectuating what was really a corporate sale. Respondent corporation brought this action to recover the amount of the tax. The Court of Claims found that the method by which the stockholders disposed of the properties was avowedly chosen in order to reduce taxes, but that the liquidation and dissolution genuinely ended the corporation's activities and existence. The court also found that at no time did the corporation plan to make the sale itself. Accordingly it found as a fact that the sale was made by the shareholders rather than the corporation, and entered judgment for respondent. One judge dissented, believing that our opinion in Commissioner v. Court Holding Co., 324 U.S. 331, required a finding that the sale had been made by the corporation. Certiorari was granted, 338 U.S. 846, to clear up doubts arising out of the *Court Holding Co.* case.

Our *Court Holding Co.* decision rested on findings of fact by the Tax Court that a sale had been made and gains realized by the taxpayer corporation. There the corporation had negotiated for sale of its assets and had reached an oral agreement of sale. When the tax consequences of the corporate sale were belatedly recognized, the corporation purported to "call off" the sale at the last minute and distributed the physical properties in kind to the stockholders. They promptly conveyed these properties to the same persons who had negotiated with the corporation. The terms of purchase were substantially those of the previous oral agreement. One thousand dollars already paid to the corporation was applied as part payment of the purchase price. The Tax Court found that the corporation never really abandoned its sales negotiations, that it never did dissolve, and that the sole purpose of the so-called liquidation was to disguise a corporate sale through use of mere formalisms in order to avoid tax liability. The Circuit Court of Appeals took a different view of the evidence. In this Court the Government contended that whether a liquidation distribution was genuine or merely a sham was traditionally a question of fact. We agreed with this contention, and reinstated the Tax Court's findings and judgment. Discussing the evidence which supported the findings of fact, we went on to say that "the incidence of taxation depends upon the substance of a transaction" regardless of "mere formalisms," and that taxes on a corporate sale cannot be avoided by using the shareholders as a "conduit through which to pass title."

This language does not mean that a corporation can be taxed even when the sale has been made by its stockholders following a genuine liquidation and dissolution.[3] While the distinction between sales by a

[3] What we said in the *Court Holding Co.* case was an approval of the action of the Tax Court in looking beyond the papers executed by the corporation and shareholders in order to determine whether the sale there had actually been made by the corporation. We were but emphasizing the established principle that in resolving such questions as who made a sale, fact-finding tribunals in tax cases can consider motives, intent, and conduct in addition to what

corporation as compared with distribution in kind followed by shareholder sales may be particularly shadowy and artificial when the corporation is closely held, Congress has chosen to recognize such a distinction for tax purposes. The corporate tax is thus aimed primarily at the profits of a going concern. This is true despite the fact that gains realized from corporate sales are taxed, perhaps to prevent tax evasions, even where the cash proceeds are at once distributed in liquidation.[4] But Congress has imposed no tax on liquidating distributions in kind or on dissolution, whatever may be the motive for such liquidation. Consequently, a corporation may liquidate or dissolve without subjecting itself to the corporate gains tax, even though a primary motive is to avoid the burden of corporate taxation.

Here, on the basis of adequate subsidiary findings, the Court of Claims has found that the sale in question was made by the stockholders rather than the corporation. The Government's argument that the shareholders acted as a mere "conduit" for a sale by respondent corporation must fall before this finding. The subsidiary finding that a major motive of the shareholders was to reduce taxes does not bar this conclusion. Whatever the motive and however relevant it may be in determining whether the transaction was real or a sham, sales of physical properties by shareholders following a genuine liquidation distribution cannot be attributed to the corporation for tax purposes.

The oddities in tax consequences that emerge from the tax provisions here controlling appear to be inherent in the present tax pattern. For a corporation is taxed if it sells all its physical properties and distributes the cash proceeds as liquidating dividends, yet is not taxed if that property is distributed in kind and is then sold by the shareholders. In both instances the interest of the shareholders in the business has been transferred to the purchaser. Again, if these stockholders had succeeded in their original effort to sell all their stock, their interest would have been transferred to the purchasers just as effectively. Yet on such a transaction the corporation would have realized no taxable gain.

Congress having determined that different tax consequences shall flow from different methods by which the shareholders of a closely held corporation may dispose of corporate property, we accept its mandate. It is for the trial court, upon consideration of an entire transaction, to determine the factual category in which a particular transaction belongs. Here as in the *Court Holding Co.* case we accept the ultimate findings of fact of the trial tribunal. Accordingly the judgment of the Court of Claims is

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appears in written instruments used by parties to control rights as among themselves. See, e.g., Helvering v. Clifford, 309 U.S. 331, 335–337; Commissioner of Internal Revenue v. Tower, 327 U.S. 280.

4 It has also been held that where corporate liquidations are effected through trustees or agents, gains from sales are taxable to the corporation as though it were a going concern. See, e.g., First National Bank v. United States, 10 Cir., 86 F.2d 938, 941; Treas.Reg. 103, § 19.22(a)–21.

Affirmed.

■ MR. JUSTICE DOUGLAS took no part in the consideration or decision of this case.

NOTE

The difficulties faced by the courts in reconciling the results in *Court Holding* and *Cumberland* influenced Congress to extend the *General Utilities* doctrine to liquidating sales. Under the 1954 Code version of Section 337, a corporation generally did not recognize gain or loss on a sale of property pursuant to a plan of complete liquidation except for recapture of depreciation and a few other items.[22] Aptly named the "anti-*Court Holding*" provision, former Section 337 usually ensured that the tax consequences of liquidating sales and distributions were the same regardless of the form of the transaction. In either case, the corporation generally did not recognize gain or loss, while the buyer (or distributee shareholder) took a fair market value basis in the acquired or distributed assets. As a result, the principal tax cost of a complete liquidation or taxable disposition of assets by a liquidating corporation was the capital gain recognized at the shareholder level.

Shortly after this extension of the *General Utilities* doctrine, reformers began calling for its repeal.[23] Imposing a tax at the shareholder level, they argued, did not justify exempting a liquidating corporation from tax on the disposition of its appreciated property. Until the 1980's, however, support for repeal was limited to the academic community and a handful of principled practitioners. "The General," it was said, had the loyal backing of the troops—battalions of legislators and their business constituents who looked askance at the double tax.[24] One justification for retaining the *General Utilities* doctrine was that it provided relief from the double taxation of corporate earnings by partially integrating the corporate and individual taxes.[25] More specialized pleaders focused on the adverse impact of the double tax on the "largely inflationary gains" on long-held assets of small "Mom and Pop" businesses.[26]

Despite these arguments, the movement for legislative reform gained momentum in the 1980s.[27] Eventually, the House of Representatives

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[22] I.R.C. § 337 (pre-1987).

[23] See, e.g., Lewis, "A Proposed New Treatment for Corporate Distributions and Sales in Liquidations," 86th Cong., 1st Sess., House Committee on Ways and Means, 3 Tax Revision Compendium 1643 (1959).

[24] We are indebted to the late Professor Walter Blum for the military analogy. See Blum, "Behind the *General Utilities* Doctrine, or Why Does the General Have So Much Support from the Troops," 62 Taxes 292 (1984).

[25] See, e.g., Nolan, "Taxing Corporate Distributions of Appreciated Property: Repeal of the *General Utilities* Doctrine and Relief Measures," 22 San Diego L. Rev. 97 (1985).

[26] See, e.g., "Reform of Corporate Taxation," Hearing before the Committee on Finance, United States Senate, 98th Cong., 1st Sess. 148, 151, 153–157, 174–176, 185, 268–270 (Oct. 24, 1983).

[27] See Staff of the Senate Finance Committee, The Subchapter C Revision Act of 1985: A Final Report Prepared by the Staff, 99th Cong., 1st Sess. 6–8, 42–44, 52–54, 59–68 (S.Prt. 99–47, 1985), recommending repeal of the *General Utilities* doctrine except for liquidating

included *General Utilities* repeal, along with a permanent exception for certain closely held corporations, in its version of the 1986 tax reform legislation.[28] The House Ways and Means Committee report summarized the rationale for repeal in the liquidation setting:[29]

> The committee believes that the *General Utilities* rule, even in the more limited form in which it exists today, produces many incongruities and inequities in the tax system. First, the rule may create significant distortions in business behavior. Economically, a liquidating distribution is indistinguishable from a nonliquidating distribution; yet the Code provides a substantial preference for the former. A corporation acquiring the assets of a liquidating corporation is able to obtain a basis in assets equal to their fair market value, although the transferor recognizes no gain (other than possibly recapture amounts) on the sale. The tax benefits may make the assets more valuable in the hands of the transferee than in the hands of the present owner. The effect may be to induce corporations with substantial appreciated assets to liquidate and transfer their assets to other corporations for tax reasons, when economic considerations might indicate a different course of action. Accordingly, the *General Utilities* rule may be responsible, at least in part, for the dramatic increase in corporate mergers and acquisitions in recent years. The committee believes that the Code should not artificially encourage corporate liquidations and acquisitions, and believes that repeal of the *General Utilities* rule is a major step towards that goal.
>
> Second, the *General Utilities* rule tends to undermine the corporate income tax. Under normally applicable tax principles, nonrecognition of gain is available only if the transferee takes a carryover basis in the transferred property, thus assuring that a tax will eventually be collected on the appreciation. Where the *General Utilities* rule applies, assets generally are permitted to leave corporate solution and to take a stepped-up basis in the hands of the transferee without the imposition of a corporate-level tax. Thus, the effect of the rule is to grant a permanent exemption from the corporate income tax.

The Senate had originally included *General Utilities* repeal in its version of the 1986 bill, but that provision was later dropped, reportedly because of concerns over its adverse impact on corporate entrepreneurs. In reconciling the two bills, the Conference Committee adopted the House's approach. To the surprise of even the tax reformers, the conferees went beyond the earlier proposals by eliminating any permanent exceptions for closely held corporations and providing only limited transitional relief. The General, so it seemed, had been deserted by the troops once the battle went behind closed

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distributions or sales of certain long-held (over five years) assets by closely held corporations with under $2 million in assets.

28 H.R. 3838, 99th Cong., 1st Sess. (1985), §§ 331–335.

29 H.R.Rep. No. 99–426, 99th Cong., 1st Sess. 281 (1985).

doors. Against that background we turn to the current corporate-level tax treatment of liquidating distributions and sales.

b. LIQUIDATING DISTRIBUTIONS AND SALES

The current version of Section 336(a) is the reverse of its 1954 Code predecessor. The general rule requires a liquidating corporation to recognize gain or loss on the distribution of property in complete liquidation as if the property were sold to the distributee at its fair market value. If the distributed property is subject to a liability or the distributee shareholder assumes a liability in connection with the distribution, the fair market value of the property is treated as being not less than the amount of the liability.[30] In strengthening the double tax regime of Subchapter C, Congress greatly increased the tax cost of a complete liquidation. Whenever a corporation makes a liquidating distribution of appreciated property, gain generally will be recognized at the corporate level and the distribution also will be a taxable event to the shareholders.[31]

Once Congress required a liquidating corporation to recognize gain or loss on liquidating distributions, it took the next logical step by conforming the tax treatment of liquidating sales. A corporation generally must recognize gain or loss on any sale of its assets pursuant to a complete liquidation plan.[32] As a backstop against creative taxpayer planning, the Treasury was given authority in Section 337(d) to issue regulations as necessary or appropriate to prevent circumvention of these rules.

c. LIMITATIONS ON RECOGNITION OF LOSS

The general rule in Section 336(a) differs in one important respect from the rules in Section 311 governing nonliquidating distributions. It allows the distributing corporation to recognize loss as well as gain. Moreover, although Section 267 disallows losses on sales of property by a corporation to a "related" party (e.g., a controlling shareholder), it does not disallow them on liquidating distributions to related parties.[33] This license to recognize corporate-level losses quickly rattled the Congressional nervous system. To prevent taxpayers from recognizing losses "in inappropriate situations" or inflating the amount of loss

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[30] I.R.C. § 336(b). Cf. I.R.C. § 7701(g); Commissioner v. Tufts, 461 U.S. 300, 103 S.Ct. 1826 (1983), rehearing denied, 463 U.S. 1215, 103 S.Ct. 3555 (1983).

[31] The general rule is subject to two exceptions. Nonrecognition of gain or loss is preserved for: (1) distributions in complete liquidation of a controlled—i.e., 80 percent—subsidiary (I.R.C. § 337, see Section C2 of this chapter, infra), and (2) distributions in certain tax-free reorganizations (I.R.C. § 336(c), see Chapter 9C2, infra).

[32] A corporation that sells or distributes stock in an 80 percent or more subsidiary may elect under Section 336(e), however, to treat the sale as a disposition of the subsidiary's assets and ignore any gain or loss on the sale or distribution of the stock. See also I.R.C. § 338(h)(10) and Chapter 8C3, infra.

[33] I.R.C. § 267(a)(1).

actually sustained on a liquidation, Section 336(d) imposes two separate loss limitation rules.[34]

Distributions to Related Persons. Section 336(d)(1) partially reinstates the policy of Section 267 by providing that no loss shall be recognized by a liquidating corporation on the distribution of property to a Section 267 related person if either: (1) the distribution is not pro rata among the shareholders, or (2) the distributed property was acquired by the liquidating corporation in a Section 351 transaction or as a contribution to capital within the five-year period ending on the date of the distribution. These restrictions thus initially focus on the recipient of the loss property. For this purpose, related persons usually will be shareholders who own directly, or through the Section 267 attribution rules, more than 50 percent in value of the stock of the distributing corporation.[35]

Neither the statute nor the legislative history explains when a distribution is "not pro rata" among the shareholders. Congress presumably intended to single out situations where a majority shareholder receives an interest in loss property that is disproportionate to his stock interest in the corporation.[36] The legislative history provides scant illumination of the rationale for this rule. The conferees merely expressed an intent to restrict the ability of taxpayers to recognize losses in "inappropriate situations."[37] Perhaps Congress believed that it was necessary to apply the loss disallowance policy of Section 267 to liquidating distributions where the parties exercised a measure of control by targeting distributions of loss property to majority shareholders—but at the same time concluded that pro rata liquidating distributions were less likely to be motivated by tax avoidance.[38]

The rationale for limiting losses on distributions of recently contributed property to a related party is easier to discern—or at least it was before Congress imposed limitations on the transfer of built-in losses in Section 351 transactions.[39] Before the enactment of Section 362(e)(2), taxpayers could duplicate a single economic loss for tax purposes by transferring property with a built-in loss to a corporation in a Section 351 transaction or as a contribution to capital. For example, assume Sole Shareholder ("Sole") transferred Lossacre (adjusted basis—$1,000; fair market value—$500) to her wholly owned X Corporation ("X") in

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34 See H.R.Rep. No. 99–841, 99th Cong., 2d Sess. II–200 (1986).

35 I.R.C. § 267(b)(2), (c).

36 For example, assume X Corporation has a net worth of $1,000 and is owned 75% by A and 25% by five unrelated shareholders. X distributes Lossacre (value—$750; basis $1,000) to A and $250 cash to the other shareholders. Since Lossacre was not distributed to the shareholders in proportion to their respective stock interests, the distribution is not pro rata and X may not recognize its $250 loss.

37 H.R.Rep. No. 99–841, supra note 34, at II–200.

38 Even if the distribution is pro rata, however, losses may be disallowed if the asset distributed to a related person is "disqualified property" within the meaning of Section 336(d)(1)(B). See text accompanying notes 44–45, infra.

39 See I.R.C. § 362(e)(2) and Chapter 2A, infra.

exchange for $500 of X stock in a Section 351 nonrecognition transaction. Under prior law, Sole took a $1,000 exchanged basis in her new X stock,[40] and X took Lossacre with a $1,000 transferred basis.[41] Assume further that, three years later, when Lossacre had the same basis and value, X liquidated, distributing Lossacre and its other assets to Sole. Without an "outbound" limitation, both Sole Shareholder and the corporation would recognize a $500 loss on the liquidation—two losses for the price of none considering that, when the smoke cleared, Sole still owned Lossacre.[42] The same technique was effective for controlling shareholders who owned less than 100 percent of the corporation if on liquidation they received their pro rata share of each corporate asset.[43]

Section 336(d)(1)(A)(ii) attacks this form of "stuffing" with a rule that extends Section 267 principles to pro rata liquidating distributions of "disqualified property" to a related person. "Disqualified property" is defined as any property acquired by the liquidating corporation during the five-year period preceding the distribution in a Section 351 transaction or as a contribution to capital.[44] Section 362(e)(2), however, now imposes a similar limitation on duplication of losses in "inbound" transfers of built-in losses in Section 351 transactions. Applying that limitation to the above example, Sole would still take a $1,000 exchanged basis in her X stock, but X's basis in Lossacre would be limited to its $500 fair market value at the time it was transferred to X. As a result, on its liquidation three years later, X would have no recognized loss and Section 336(d) would not apply.

In its haste to adopt an inbound loss limitation rule, Congress may not have paused to ask whether the outbound limitations in Section 336(d)(1) should be modified. One answer that may explain the continuing existence of Section 336(d)(1) is that it does not exclusively target *duplication* of losses. It also applies to liquidating distributions of loss property to related persons that are not pro rata or are of "disqualified property," even if the loss was realized while the property was held by the corporation. Although the policy for such a limitation is difficult to defend in the context of a complete liquidation, the Code often

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40 I.R.C. § 358(a).

41 I.R.C. § 362(a).

42 Of course, Sole will now hold Lossacre with a stepped-down fair market value basis of $500, but she will have benefitted from two losses without ever having disposed of the property.

43 As noted previously, corporate-level losses on non pro rata ("bullet") distributions to controlling shareholders are disallowed under Section 336(d)(1)(A)(i).

44 I.R.C. § 336(d)(1)(B). The term also includes any property the adjusted basis of which is determined in whole or in part by reference to the adjusted basis of property acquired in a Section 351 transaction or as a contribution to capital—e.g., like-kind property received in a Section 1031 transaction in exchange for property acquired by the corporation in a Section 351 transaction. Id.

limits losses when property is transferred between corporations and shareholders as well as in other related party transactions.[45]

Losses with Tax Avoidance Purpose. Section 336(d)(2) prevents the duplication of *precontribution* built-in losses even on certain distributions to minority shareholders. This limitation applies only if the distributing corporation acquired property in a Section 351 transaction or as a contribution to capital as part of a plan the principal purpose of which was to recognize loss by the corporation on a liquidating sale, exchange or distribution of the property. In that event, Section 336(d)(2) limits the corporation's deductible loss to the amount that accrued after the corporation acquired the property. Precontribution losses are disallowed by a basis step-down rule which requires the corporation to reduce its basis (but not below zero) in the affected property by the amount of built-in loss in the property at the time it was acquired by the corporation.[46]

Section 336(d)(2) is reinforced by a provision that treats any contribution of property after the date that is two years before the adoption of the plan of liquidation as part of a forbidden plan to recognize loss, except as the Treasury may provide in regulations.[47] Congress provided extensive guidance on the operation of this two-year presumption and the escape hatches that it expects to be included in future regulations. For example, although a contribution made more than two years prior to the adoption of a liquidation plan might be made with a prohibited purpose, the Conference Report states that in those circumstances the basis step-down rule in Section 336(d)(2) would apply only "in the most rare and unusual cases."[48] The legislative history also directed the Treasury to issue regulations generally providing that even contributions of property within the period covered by the presumption should be disregarded "*unless* there is no clear and substantial relationship between the contributed property and the conduct of the corporation's current or future business enterprises."[49] A "clear and substantial relationship" generally would include a requirement of a corporate business purpose for placing the property in the particular corporation to which it was contributed as compared to retaining the property outside that corporation.[50] If the contributed property has a built-in loss at the time of contribution that is "significant" relative to the

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45 See, e.g., I.R.C. § 351(b)(2) (no loss on transfers to controlled corporations even if transferor receives boot); § 267(a)(1) (disallowance of losses in related party transactions); § 1015(a) (donee's basis for loss reduced for gifts of built-in loss property).

46 The built-in loss is the excess of the adjusted basis of the property immediately after its acquisition over its fair market value at that time. I.R.C. § 336(d)(2)(A).

47 I.R.C. § 336(d)(2)(B)(ii).

48 H.R.Rep. No. 99–841, supra note 34, at 200. See also Staff of the Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986 ("1986 Act General Explanation"), 100th Cong., 1st Sess. 343 (1987).

49 H.R.Rep. No. 99–841, supra note 34, at II–201.

50 1986 Act General Explanation, supra note 48, at 343.

built-in corporate gain at that time, "special scrutiny of the business purpose would be appropriate."[51]

Section 362(e)(2), which was studied in Chapter 2 in connection with corporate formations, effectively disallows most precontribution losses by stepping down the basis of built-in loss property when it is transferred to a corporation in a Section 351 transaction. This anti-avoidance rule greatly reduces the role of Section 336(d)(2). But there still are situations where the Section 362(e)(2) "inbound" rule does not step down the basis of built-in loss property and Section 336(d)(2) will apply—e.g., where the corporation holds some properties with built-in losses that are subject to Section 336(d)(2) but the inbound stepdown rule does not apply because the aggregate basis of all properties transferred by a transferor in a Section 351 transaction does not exceed their aggregate fair market value. Query, however, whether the section 336(d)(2) loss limitation rule is still necessary in this situation? Perhaps the best explanation is traditional Congressional paranoia regarding abuse of tax losses.

Overlap Situations. If both Section 336(d)(1) and Section 336(d)(2) apply to the same transaction, the harsher rule in Section 336(d)(1) (which disallows the entire loss rather than just the precontribution built-in loss) takes precedence.[52]

PROBLEMS

1. All the outstanding stock of X Corporation is owned by Ivan (60 shares) and Flo (40 shares), who are unrelated. X has no liabilities and the following assets:

Asset	Adj. Basis	F.M.V.
Gainacre	$100,000	$400,000
Lossacre	$800,000	$400,000
Cash	$200,000	$200,000

Unless otherwise indicated, assume that Gainacre and Lossacre each asset have been held by X for more than five years.

On January 1 of the current year, X adopted a plan of complete liquidation. What are the tax consequences to X on the distribution of its assets pursuant to the liquidation plan in each of the following alternatives?

(a) X distributes each of its assets to Ivan and Flo as tenants-in-common in proportion to their stock interests (i.e., Ivan takes a 60% interest and Flo a 40% interest in each asset).

(b) Same as (a), above, except X distributes Lossacre and the cash to Ivan and Gainacre to Flo.

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51 Id.

52 1986 Act General Explanation, supra note 48, at 342, n. 86.

(c) Same as (b), above, except X distributes Gainacre and the cash to Ivan and Lossacre to Flo.

(d) Same as (a), above, except X acquired Lossacre as a contribution to capital four years ago, and X was not required to reduce its basis under § 362(e). Is the result different if Lossacre had a value of $1,000,000 and a basis of $800,000 at the time it was contributed to the corporation?

(e) What result on the distributions in (c), above (i.e., Gainacre and cash to Ivan, Lossacre to Flo) if Lossacre, which had no relationship to X's business operations, was transferred to X by Ivan and Flo in a § 351 transaction 18 months prior to the adoption of the liquidation plan, when Lossacre had a fair market value of $700,000 and an adjusted basis of $800,000? Assume, alternatively, that § 362(e)(2) did and did not apply to the contribution of Lossacre to X.

362(e)(2) = mark everything to market basis

2. All of the outstanding stock of X Corporation is owned by Ivan (80 shares) and Flo (20 shares). X has no liabilities. Ivan contributed Gainacre ($100,000 adjusted basis, $400,000 fair market value) and Lossacre ($800,000 adjusted basis, $400,000 fair market value) to X. Flo contributed $200,000 cash. Assume Lossacre is § 336(d)(1) "disqualified property" and § 362(e)(2) applied to Ivan's contribution, but § 336(d)(2) does not apply because there was no "plan" for X to recognize loss on that property.

(a) What result if pursuant to a plan of liquidation X distributes each of its assets to Ivan and Flo in proportion to their respective stock interests?

(b) Same as (a), above, except assume that § 362(e)(2) applies to Ivan's contributions to X and § 336(d)(2) applies to Lossacre because there was a "plan" by X to recognize loss in that property.

C. LIQUIDATION OF A SUBSIDIARY

1. CONSEQUENCES TO THE SHAREHOLDERS

Code: §§ 332; 334(b)(1); 1223(2).

Regulations: §§ 1.332–1, –2, –5.

Nonrecognition treatment is inappropriate on an ordinary complete liquidation because it would permit individual shareholders to achieve a tax-free bailout as they watch the corporation's earnings and profits account disappear from the scene. Different policy considerations come into play when a parent corporation liquidates a controlled subsidiary. Since the assets of the subsidiary remain in corporate solution, the liquidation is a mere change in form that should not be impeded by the imposition of a tax. The subsidiary's tax attributes, including its earnings and profits, can be inherited by the parent without administrative burdens. Moreover, the subsidiary could have paid tax-free dividends to the parent under Section 243 or the consolidated return rules. All these factors, together with a desire to encourage the simplification of corporate structures, influenced Congress to adopt a nonrecognition scheme by enacting the statutory predecessor of Section 332.

Section 332 provides that a parent corporation recognizes no gain or loss on the receipt of property in complete liquidation of an 80 percent or more subsidiary if certain conditions are met. In that event, the parent generally takes the distributed assets with a transferred basis under Section 334(b)(1)[53] and inherits the subsidiary's earnings and profits and other tax attributes under Section 381(a)(1).[54]

To qualify under Section 332, the subsidiary must distribute property to its parent in complete cancellation or redemption of its stock pursuant to a plan of liquidation, and the liquidation must meet two formal requirements, one relating to control and the other to timing.

Control. Under Section 332(b)(1), the parent must own at least 80 percent of the total voting power of the stock of the subsidiary and 80 percent of the total value of all outstanding stock of the subsidiary from the date of adoption of the plan of complete liquidation and at all times thereafter until the parent receives the final distribution.[55] This condition normally is not a problem if the subsidiary is wholly owned, but any significant minority ownership creates a risk that the transaction will run afoul of the control requirement. Indeed, a parent corporation sometimes is motivated to intentionally violate the 80 percent tests in order to avoid Section 332 and recognize a loss on its stock in the subsidiary.[56] Conversely, an aspiring parent that does not meet the control test may seek to qualify a liquidation under Section 332 by acquiring more stock of the subsidiary or causing the subsidiary to redeem stock held by minority shareholders shortly before the liquidation. As illustrated by the *Riggs* case, below, this strategy may trigger a controversy with the Service over when the liquidation plan was adopted.

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[53] If the liquidating subsidiary is not subject to U.S. tax with respect to the distributed property (e.g., because it is a foreign corporation) and the distributee parent is subject to U.S. tax (e.g., it is a domestic corporation), the distributee's aggregate adjusted basis of the distributed property, if it otherwise would exceed its fair market value, must be limited to the lesser fair market value. I.R.C. § 334(b)(1)(B); Reg. § 1.334–1(b)(3). The purpose of this limitation is to prevent importation of tax losses into the U.S. tax system through the liquidation of a foreign subsidiary. See Chapter 2A, supra, for a similar rule for incorporation transactions.

[54] The parent's basis in the stock of a subsidiary is not taken into account in determining the tax consequences of a Section 332 liquidation and disappears from the scene. This creates the possibility that the parent may be deprived of a loss on its investment in the subsidiary even though it must inherit a low carryover basis in its assets.

[55] The stock ownership requirements are derived from Section 1504(a)(2), which sets forth rules for determining whether a corporation is a member of an "affiliated group." For purposes of the stock ownership requirement, most nonconvertible preferred stock is disregarded. I.R.C. § 1504(a)(4). Reg. § 1.332–2(a), which states that the test is whether the parent owns at least 80 percent of the subsidiary's total combined voting power and 80 percent of all other classes of stock (except nonvoting stock limited and preferred as to dividends), does not reflect legislative changes to Section 332(b)(1).

[56] See Commissioner v. Day & Zimmermann, Inc., 151 F.2d 517 (3d Cir.1945).

Timing. Section 332 includes two timing alternatives. "One-shot" liquidations qualify if the subsidiary distributes all of its assets within one taxable year[57] even if it is not the same year in which the liquidation plan is adopted.[58] Where the distributions span more than one taxable year, the plan must provide that the subsidiary will transfer all of its property within three years after the close of the taxable year in which the first distribution is made.[59] Failure to meet the deadline will cause the liquidation to be retroactively disqualified.[60]

Minority Shareholders. Nonrecognition under Section 332 is only granted to the controlling parent corporation. It is not available to minority shareholders, who must determine their gain or loss in the normal manner under Section 331(a) unless the liquidation also qualifies as a tax-free reorganization—a rare situation that will be explored in a later chapter.[61]

George L. Riggs, Inc. v. Commissioner

United States Tax Court, 1975.
64 T.C. 474.

■ DRENNEN, JUDGE:

Respondent determined a deficiency in petitioner's income tax for the taxable year ended March 31, 1969, in the amount of $589,882.28.

The sole issue for determination is whether the plan of liquidation of Riggs-Young Corp., a subsidiary of the petitioner, was adopted subsequent to the time when petitioner owned at least 80 percent of the outstanding stock of Riggs-Young, thereby rendering section 332, I.R.C. 1954, applicable to the liquidation so that the gain to petitioner thereon is not to be recognized.

FINDINGS OF FACT

[George L. Riggs, Inc., referred to throughout the opinion as "petitioner," was a holding company which as of December, 1967, owned approximately 35.6 percent (2,432 out of 6,840 shares) of the nonvoting preferred stock and 72.13 percent (8,047 out of 11,156 shares) of the common stock of The Standard Electric Time Co. ("Standard"). Standard owned 90 percent of the outstanding stock of a Delaware subsidiary and 99.5 percent of a California subsidiary. The corporations were in the business of manufacturing and marketing electric clocks and signal

57 I.R.C. § 332(b)(2); Reg. § 1.332–3. In this situation, the adoption by the shareholders of the resolution authorizing the distributions in liquidation is considered an adoption of a "plan" of liquidation even though it may not specify the time for completing the transfers.

58 Rev. Rul. 71–326, 1971–2 C.B. 177.

59 I.R.C. § 332(b)(3); Reg. § 1.332–4.

60 Id. To allow the Service to assert deficiencies for the early distributions in the event of a retroactive disqualification, the parent is required to file a waiver of the normal three year statute of limitations and may be asked to post a bond in order to protect the Commissioner's ability to collect past due taxes.

61 Reg. § 1.332–5. See Chapter 9B1, infra.

devices. Standard was the manufacturing arm of the business, and the two subsidiaries handled marketing.

On December 13, 1967, Frances Riggs-Young, the president of Standard and controlling shareholder of petitioner, notified all of Standard's shareholders that the company and its subsidiaries would be seeking approval for a sale of substantially all of the operating assets of the companies. In connection with the sale, Standard changed its name to Riggs-Young Corporation. The sales were consummated on December 29, 1967. In February, 1968, Riggs-Young (formerly Standard) redeemed all of its preferred stock. On April 17, 1968, the directors of Riggs-Young approved the liquidation of the Delaware and California subsidiaries, and authorized Riggs-Young to offer to redeem common stock from all of its shareholders with the exception of petitioner and Frances Riggs-Young. The stated purpose of this tender offer was to eliminate the minority shareholders and provide them with the opportunity to receive cash for their stock. The Tax Court also found that counsel to petitioner and the related subsidiaries "recognized the desirability of petitioner's owning 80 percent of the common stock of Riggs-Young (1) to permit the filing of consolidated returns, and (2) to permit the possible further liquidation of Riggs-Young under section 332 of the Code to simplify the corporate structure." 64 T.C. at 480. The letter informing shareholders of the redemption offer stated that "If this offer is accepted by substantially all of the stockholders to whom it is directed, the Directors will consider liquidation and final dissolution of the Corporation." 64 T.C. at 479.

At the time of its redemption offer, petitioner owned 72.13 percent of Riggs-Young's common stock. The remaining shares were owned by members of the Riggs family, related trusts and a small group of unrelated minority shareholders.

The tender offer was made on April 26, 1968 and expired on May 28, 1968. During this period, owners of 2,738 shares of common stock tendered their shares for redemption. As a result of these redemptions, petitioner owned at least 80 percent of Riggs-Young's common stock on May 9, 1968, and its ownership increased to 95.6 percent by May 28. On June 20, 1968, the directors and shareholders of Riggs-Young approved a plan of complete liquidation and dissolution of the corporation. Between June and December, 1968, when the liquidation was completed, Riggs-Young made distributions to petitioner in excess of $2.2 million.

Petitioner realized a gain of $2,168,975 from the liquidation of Riggs-Young, representing the difference between the liquidating distributions and petitioner's $42,465 basis in its Riggs-Young stock. The gain was reported on petitioner's tax return but not recognized under the authority of Section 332. Ed.]

OPINION

The only question for decision is whether petitioner owned at least 80 percent of the outstanding stock of its subsidiary, Riggs-Young Corp., at the time Riggs-Young Corp. adopted a plan of liquidation within the meaning of section 332, I.R.C. 1954, so that the gain realized by petitioner on the liquidation of Riggs-Young is not to be recognized by virtue of that section. The vital question is when did Riggs-Young adopt a plan of liquidation within the meaning of section 332.

Respondent argues that the plan of liquidation was adopted on December 27, 1967, when about 90 percent of the stock of Riggs-Young (then Standard) was voted in favor of selling substantially all of the assets of Riggs-Young and its two subsidiaries, Delaware and California, to SET; or not later than about April 17, 1968, when the board of directors of Riggs-Young voted to liquidate Delaware and California and to make an offer to purchase all of the common stock of Riggs-Young then outstanding with the exception of the stock owned by petitioner and Frances Riggs-Young.[4]

On the other hand petitioner contends that the plan of liquidation of Riggs-Young was first adopted when it was formally adopted by vote of the stockholders on June 20, 1968, or at the earliest when counsel for petitioner recommended to petitioner in the early days of June 1968 that it liquidate Riggs-Young. Petitioner also contends that section 332 is an elective section and a taxpayer, by taking appropriate steps, can render that section applicable or inapplicable.

The parties are in agreement that by May 9, 1968, petitioner was the owner of at least 80 percent of the outstanding stock of Riggs-Young.

Section 332(a) of the Code provides as a general rule: "No gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation." Subsection (b) of section 332 establishes certain requirements which must be satisfied before subsection (a) becomes applicable. The only requirement of subsection (b) which is in issue in this case is whether petitioner, which received property from Riggs-Young in liquidation, was, on the date of the adoption of the plan of liquidation, the owner of at least 80 percent of the stock of Riggs-Young, the liquidating corporation.

Nowhere in the pertinent statute is the phrase "the date of the adoption of the plan of liquidation" defined. However, in attempting to define this phrase for purposes of the provision of [1954 Code] section 337, the regulations of the Commissioner provide:

> Ordinarily the date of the adoption of a plan of complete liquidation by a corporation is the date of adoption by the shareholders of the resolution authorizing the distribution of all the assets of the corporation (other than those retained to meet claims) in redemption of all of its stock. * * * [Sec. 1.337–2(b), Income Tax Regs.; accord, Virginia Ice & Freezing Corp., 30 T.C. 1251 (1958).]

[4] Respondent specifically does not rely on the "end-result" or "step-transaction" theory in this case. * * *

respondent = government

The date of this shareholder resolution should ordinarily be considered the date of the adoption of the plan of liquidation for purposes of section 332. See sec. 332(b)(2).

This Court has noted, in interpreting section 112(b)(6), I.R.C. 1939 (the predecessor of section 332, I.R.C. 1954), that although the adoption of the plan of liquidation "need not be evidenced by formal action of the corporation or the stockholders. * * * even an informal adoption of the plan to liquidate presupposes some kind of definitive determination to achieve dissolution." Distributors Finance Corp., 20 T.C. 768, 784 (1953). The mere general intention to liquidate is not the adoption of a plan of liquidation. City Bank of Washington, 38 T.C. 713 (1962).

Based on the evidence introduced in the case at bar, we must conclude that a plan for the liquidation of Riggs-Young had not been adopted prior to the critical date of May 9, 1968.

Respondent, in an effort to show that the plan of liquidation of Riggs-Young was informally adopted on December 27, 1967, or no later than April 1968, alludes to actions and statements made in connection therewith taken between December 1967 and June 1968. Petitioner offered the testimony of persons involved in those actions to explain what the parties had in mind in taking those actions and making the statements which cast a quite different light on the reasons therefor. This testimony was creditable and not shaken by cross-examination. In light of such evidence, we cannot agree with respondent's inference that these actions constituted an informal adoption of a plan of liquidation of Riggs-Young prior to May 9, 1968.

Respondent argues that the letter dated December 13, 1967, sent to the common shareholders of Standard (Riggs-Young) notifying them of the proposed sale of its assets and that the corporation was contemplating an offer to purchase the common shares held by all shareholders other than petitioner if the sale was approved, clearly indicates that the shareholders at the meeting on December 27, 1967, intended to approve not only the sale of the assets, but also the liquidation of Standard (Riggs-Young).

We believe this infers too much. As petitioner points out, the use of the word "contemplated" shows the acquisition of the common stock of the minority shareholders was merely a possibility about which a final decision had not been made. In any event, from the possibility of a tender offer to the minority shareholders, we cannot conclude, ipso facto, that a plan for the liquidation had been adopted. Petitioner explained that the possibility of this tender offer was made known to the shareholders in order to avoid any possible disclosure problem with the securities law and to apprise the shareholders, from a fairness standpoint, of eventual possibilities resulting from the sale. This explanation is reasonable.

Respondent next points to the fact that on February 23, 1968, all of the 6,840 shares of preferred stock of Riggs-Young were called for redemption as additional evidence that a definite decision to liquidate the corporation had been made. We believe petitioner adequately explained that this redemption was based on sound business reasons. The preferred stock had a par value of $25 per share and a cumulative dividend of 8 percent. This stock was subject to redemption at the option of Riggs-Young upon payment of the par value and any accumulated dividend. The testimony of Norman Vester, a director of Riggs-Young and president of Security National Bank which was cotrustee of Riggs Trust, and Roger Stokey, the attorney for petitioner, Riggs-Young, and Frances Riggs-Young, reveal that the redemption of the preferred stock was motivated by the desire to eliminate the excessive burden of a cumulative dividend of 8 percent and to reduce the number of shareholders with whom Riggs-Young and National Security Bank, as cotrustee of the majority shareholder, would have to deal. Both Vester and Stokey testified that as of January 19, 1968, the date the board of directors of Riggs-Young voted to redeem the preferred stock, no decision had been made to liquidate the corporation, and, therefore, no plan had been adopted.

Respondent next claims that a letter dated April 23, 1968, from Stokey to Scott C. Jordan categorically shows that a plan to liquidate Riggs-Young had been adopted prior to the date of the letter. Stokey's letter was in response to a letter from Jordan on behalf of Frances Riggs-Young inquiring whether she could participate in the tender offer that was about to be made to the minority shareholders of Riggs-Young. In his letter, Stokey said that Frances Riggs-Young might run some tax risks if she accepted a tender offer by Riggs-Young, apparently basing this statement on his belief that the amount she received from a tender offer might be taxed to her at ordinary income rates. As a result of this potential risk, Stokey stated in the letter: "Accordingly, we are arranging for her to receive her money in a liquidation."

Respondent perceives this statement by Stokey as a clear indication that a plan of liquidation of Riggs-Young had been adopted by a definite decision by April 23, 1963. We cannot so conclude. Stokey testified that "we," referred to as arranging the liquidation, meant Stokey and another member of his law firm, William Gorham. This letter merely shows that the attorneys involved in these transactions were contemplating the possibility of a liquidation of Riggs-Young. It in no way proves that the directors or shareholders of the corporation had made a definite decision or informally adopted a plan of liquidation.

Finally, respondent views the letter dated April 26, 1968, drafted by Frances Riggs-Young as president of Riggs-Young, which contained the tender offer to the common shareholders, other than petitioner and Frances Riggs-Young, as an additional indication of a prior adoption of a plan to liquidate. In this letter, Frances Riggs-Young did state that if substantially all of the shareholders accepted the offer, the directors of the corporation would consider liquidation and final dissolution of Riggs-Young.

Stokey testified that Gorham and he inserted, in this April 26 letter, the reference to the possible consideration of liquidating Riggs-Young. He also candidly admitted that he had undoubtedly discussed the possibility of liquidation of Riggs-Young at some prior point with Frances Riggs-Young, but hastened to add that he neither recommended liquidation at this time nor did she direct steps be taken to liquidate. Further, Stokey testified that he would never have recommended liquidation of Riggs-Young if petitioner had failed to achieve the 80-percent ownership.

Petitioner contends that the tender offer to the minority shareholders was made solely for business considerations and not with an eye toward the eventual liquidation of Riggs-Young. Vester and Stokey both testified that since the assets of Riggs-Young had been exchanged for cash, the primary purpose of the tender offer was to eliminate minority shareholders who might have different investment objectives for this cash than the majority shareholder. The bank, as trustee of Riggs, did not want to have to deal with a large group of minority shareholders. Furthermore, Stokey testified that Frances Riggs-Young desired to have the minority shareholders, many of whom were former employees of Standard, receive cash for their stock rather than have them remain locked in as minority shareholders of a personal holding company.

Stokey testified that another objective of the tender offer was to increase petitioner's ownership of Riggs-Young to 80 percent thereby enabling them to file a consolidated return. According to petitioner, the ultimate liquidation of Riggs-Young was not motivated by tax considerations and the sole advantage to be achieved from the liquidation was the simplification of petitioner's corporate structure. Petitioner alleges that Riggs-Young could have been kept in existence without any tax disadvantage. In fact the liquidation of Riggs-Young actually resulted in a tax disadvantage to Frances Riggs-Young personally since she had to pay capital gains tax on her share of the liquidation proceeds. She was a wealthy woman in her seventies and not in need of these funds and could have left this money in corporate solution until her death to enable it to receive a stepped-up basis for the beneficiaries of her estate.

We believe petitioner's explanations of why the actions were taken and the statements were made are true and that the considerations mentioned were taken into account in making the decisions that followed. While the motives enumerated by petitioner do not directly negate the notion that a liquidation may have been contemplated, discussed, or even intended prior to May 9, 1968, they do serve to sufficiently undermine the conclusions drawn by respondent from the actions and statements to offset any presumptions that respondent's inferences are correct. Without more concrete evidence than we have before us, we cannot agree with respondent that a plan of liquidation of Riggs-Young was adopted within the meaning of section 332 prior to May 9, 1968. Lacking such a finding, we believe the date on which the resolution to liquidate was actually adopted by the shareholders should be controlling.

The very most that can be gleaned from the evidence favorable to respondent's contention is that there may have been a general intent on the part of petitioner's advisers somewhere along the line prior to May 9, 1968, to liquidate Riggs-Young when and if petitioner achieved 80-percent ownership of Riggs-Young stock as a result of the tender offer. However, the formation of a conditional general intention to liquidate in the future is not the adoption of a plan of liquidation. *City Bank of Washington,* supra.

A mere intent by a taxpayer-corporation to liquidate a subsidiary prior to meeting the 80-percent requirement of section 332 should not be tantamount to the adoption of a plan of liquidation for the subsidiary at the point in time when that intent is formulated or manifested. Such a result would thwart the congressional intent of section 332 and prior judicial interpretations of this section and its predecessor.

The predecessor of section 332, I.R.C. 1954, was section 112(b)(6), first enacted in 1935. The purpose of section 112(b)(6) was to encourage the simplification of corporation structures and allow the tax-free liquidation of a subsidiary. * * *

* * *

Based on legislative history of [Section 112(b)(6) of the 1939 Code] and prior judicial decisions, we conclude that section 332 is elective in the sense that with advance planning and properly structured transactions, a corporation should be able to render section 332 applicable or inapplicable. The Commissioner in his regulations has conceded corporations this power in a seemingly analogous situation. See sec. 1.337–2(b), Income Tax Regs.

Such power of planning presupposes some right to forethought and the accompanying intent to achieve the desired goal. It would be a logical inconsistency equivalent to a "Catch-22" to say that a corporation has the power to control the application of this section, but that once the corporation formulates the intent to do so (assuming that at or subsequent to the time the intent was formed, it owned less than the required 80 percent but enough stock to cause the liquidation of the subsidiary), it has adopted a plan of liquidation and has precluded itself from the section.

A basic tenet of our tax laws is that a taxpayer has the legal right to decrease or altogether avoid his taxes by means which the law permits. Gregory v. Helvering, 293 U.S. 465 (1935); Daniel D. Palmer, 62 T.C. 684 (1974). At most, petitioner did no more than follow this prerogative.

* elective

The shareholders of Riggs-Young formally adopted the plan of liquidation of the corporation on June 20, 1968. Stokey testified that based on the records contained in his office diary, he did not discuss definite liquidation of the corporation with the corporate officers prior to June 4, 5, or 6, 1968. He concluded that he recommended liquidation on either the 4th or 5th of June 1968, and that a definite decision to liquidate was probably made on June 6, 1968. The testimony of Vester corroborates these statements of Stokey. We recognize that the adoption of a plan of liquidation need not be evidenced by formal action of the corporation or shareholders, *Distributors Finance Corp.,* supra. In this case, however, we find on the evidence that the plan of liquidation was adopted when the formal action was taken on June 20, 1968. Furthermore, even if it can be said that a plan of liquidation was adopted when Stokey first recommended it to the management, see *Distributors Finance Corp.,* supra, this occurred in June 1968 and would satisfy the requirements of section 332.

Respondent has cited and relied on Rev.Rul. 70–106, 1970–1 C.B. 70, as supportive of his position. This Court is not bound by a revenue ruling. Andrew A. Sandor, 62 T.C. 469 (1974). In addition, we find the facts of this case are greatly dissimilar to those contained in the ruling. The ruling assumes a prior agreement between the minority and majority shareholders concerning the redemption of the minority stockholders' stock. The ruling concludes that the liquidation plan was adopted when this agreement was reached. In the case at bar, there is no evidence of an agreement between the minority and majority shareholders prior to the tender offer. *Madison Square Garden Corp.,* supra at 624 n. 4. Since this revenue ruling is inapplicable, proper judicial restraint dictates that we do not comment on the validity or invalidity of the ruling as limited to the facts contained therein. Ronald C. Packard, 63 T.C. 621 (1975).

Decision will be entered for the petitioner. Reviewed by the Court.

2. CONSEQUENCES TO THE LIQUIDATING SUBSIDIARY

Code: §§ 336(d)(3); 337(a), (b)(1), (c). Skim §§ 381(a)(1), (c)(2), (3); 453B(d); 1245(b)(3); 1250(d)(3).

Regulations: § 1.332–7.

Distributions of Property. A liquidating corporation generally recognizes gain or loss on distributions of property in a complete liquidation.[62] A major exception to this general rule is contained in Section 337,[63] which provides that a liquidating subsidiary does not

[62] I.R.C. § 336(a).

[63] This "new" Section 337 is not to be confused with its 1954 Code counterpart, "old" Section 337, which provided for nonrecognition of gain or loss on certain liquidating sales. Old timers wish Congress had avoided confusion by retiring former Section 337's number and placing it on a monument in "old" Yankee Stadium.

recognize gain or loss on distributions of property to its parent[64] in a complete liquidation to which Section 332 applies. A nonrecognition rule makes sense in this context because the subsidiary's tax attributes, including the built-in gain or loss in its assets, can be preserved in the hands of the parent. Section 334(b)(1) implements this policy by providing that the parent takes a transferred basis in property received from a subsidiary in a Section 332 liquidation. In keeping with this carryover of tax attributes theme, the depreciation recapture provisions do not override Section 337,[65] and recapture potential continues to lurk in the distributed property through the definition of "recomputed basis" in Section 1245 and "additional depreciation" in Section 1250.[66] A liquidating subsidiary likewise does not recognize gain or loss on the distribution of installment obligations if Section 332 applies,[67] and the parent will take a transferred basis in the obligations under Section 334(b)(1).

Distributions to Minority Shareholders. The nonrecognition rule in Section 337(a) is limited to distributions of property by a liquidating subsidiary to "the 80-percent distributee"—i.e., the parent corporation. Distributions to minority shareholders are treated in the same manner as a distribution in a nonliquidating redemption. Accordingly, the distributing corporation will recognize gain but not loss. Recognition of gain is appropriate because minority shareholders do not inherit any built-in gain in the distributed property through a transferred basis but instead take a fair market value basis under Section 334(a). Distributions of loss property are another matter. In order to prevent a controlled subsidiary from recognizing losses (but not gains) by "bullet" distributions of loss property to minority shareholders, Section 336(d)(3) provides that no loss shall be recognized to a subsidiary on a distribution of property to minority shareholders in a Section 332 liquidation.

Transfer of Property to Satisfy Indebtedness of Subsidiary to Parent. Section 337 applies only to liquidating *distributions.* If a subsidiary is indebted to its parent, a transfer of property to satisfy the debt normally would be a taxable event rather than a nontaxable distribution governed by Section 337(a), causing the subsidiary to recognize gain or loss and the parent to take a fair market value basis in the distributed property. The disparate treatment of distributions in complete liquidation and transfers of property to satisfy intercorporate indebtedness might tempt a subsidiary to distribute appreciated property as part of the liquidation while simultaneously using loss property to extinguish any indebtedness to the parent. Section 337(b)(1) prevents this ploy by providing that any transfer of property in satisfaction of a subsidiary's debt to its parent

64 Section 337(a) refers to the parent as "the 80-percent distributee," which is defined in Section 337(c) as a corporation that meets the 80 percent stock ownership requirements specified in Section 332(b).

65 I.R.C. §§ 1245(b)(3); 1250(d)(3).

66 I.R.C. §§ 1245(a)(2); 1250(b)(1), (3).

67 I.R.C. § 453B(d)(1).

shall be treated as a distribution, subjecting the transfer to the general nonrecognition rule of Section 337(a). As a necessary corollary, Section 334(b)(1) provides that the parent takes a transferred basis in the distributed property.

Distributions to Tax-Exempt and Foreign Parents. Ever vigilant, Congress was concerned that taxpayers might turn the deferral provided by Section 337 into a permanent exemption from the corporate-level tax. Consider the following possibility. A and B, the sole shareholders of highly appreciated X Corporation, wish to sell the business and avoid at least one level of tax. They sell all their stock to tax-exempt Charity, Inc. and recognize gain on the sale or, if they are philanthropic, they could donate the stock to Charity and take a charitable deduction. Charity now owns 100 percent of the X stock but it does not wish to operate the business. Charity wishes to liquidate X in a tax-free transaction at both the corporate and shareholder levels under Sections 332 and 337(a). Although Charity must take a transferred basis in the property distributed by X, no tax ever would be collected on the subsequent sale of those assets because Charity is exempt from tax.

This technique might have been vulnerable under the step transaction and other judicial doctrines, but Congress decided to attack it from within the Code. Section 337(b)(2) thus provides that the general corporate-level nonrecognition rule for liquidations of a subsidiary shall not apply where the parent is a tax-exempt organization. Nonrecognition is restored, however, if the distributed property is used by the tax-exempt parent in an "unrelated trade or business" immediately after the distribution.[68] In that event, there is no loophole to plug because the tax-exempt organization is subject to tax on its unrelated business income.[69] A similar rule requires recognition of corporate-level gain in the case of a liquidating distribution to a parent that is a foreign corporation, except as the Treasury may provide in regulations. The legislative history indicates that the regulations should permit nonrecognition if the appreciation on the distributed property is not being removed from the U.S.'s taxing jurisdiction prior to recognition.[70] In both situations where the subsidiary recognizes gain or loss, the parent takes a fair market value basis in the distributed assets.[71]

PROBLEMS

1. P, Inc. ("P") owns 90 percent of the outstanding stock of S, Inc. ("S"). Individual ("I") owns the remaining 10 percent of S. P's basis in its S stock is

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[68] Exempt organizations may be taxable on income from an "unrelated business"—i.e., a regularly carried on trade or business activity that is not substantially related to the organization's exempt purposes. See I.R.C. §§ 511 et seq.

[69] If the tax-exempt parent later disposes of the distributed property or ceases to use it in an unrelated trade or business, any gain not recognized on the earlier liquidation becomes taxable as unrelated business income. I.R.C. § 337(b)(2)(B)(ii).

[70] H.R.Rep. No. 99–841, supra note 34, at II–202.

[71] I.R.C. § 334(b)(1)(A).

Basis

Basis 3K. P 90% I 10%

S

Acc E&P 2K

$3,000. I's basis in his S stock is $200. S has accumulated earnings and profits of $2,000 and the following assets:

Asset	Adjusted Basis	Fair Market Value
Land	$3,000	$8,000
Equipment	$2,500	$1,000
Inventory	$ 100	$1,000

S wishes to liquidate and distribute all of its assets to its shareholders. What are the tax consequences to P, S and I in the following alternative situations?

Carryover basis for L & → land Equip → x G/L for S or P

(a) S distributes the inventory to I and the other assets to P. → inventory → I recognize 800 gain (1K − 200 basis in stock → 800 Inventory basis 1K. S corp recognize 1K − 100

(b) S distributes the equipment to I and the other assets to P. How might S improve this result?

(c) What result in (b), above, if P's basis in its S stock were $30,000 and S had a $30,000 basis in the land?

→ Sell equipment to 3rd party and recognize loss

(d) Is (c), above, a situation where P might wish to avoid the application of § 332? Why? How might this be accomplished? Consider in this regard the § 332 qualification requirements and how a parent might assure that they are not met.

2. Child Corporation has 100 shares of common stock outstanding. Mother Corporation owns 75 shares (basis—$1,000) and Uncle, an individual who recently inherited his stock, owns 25 shares (basis—$3,000). Child has no earnings and profits, a $10,000 net operating loss carryover and the following assets (all held long-term): 10K NOL.

Asset	Adjusted Basis	Fair Market Value
Cash	$2,000	$2,000
Installment Note	1,000	4,000
Land	100	1,000
Equipment (all § 1245 gain)	100	1,000
Total	$3,200	$8,000

Rev Ruling. 70-106

agreement between majority and minority shareholder creates a plan of liquidation and fails the 332 test because control not m

What are the tax consequences in the following alternative situations, disregarding the impact of any tax paid by Child as a result of its liquidating distributions? → total gain 8K − 3.2K = 4.8K offset by NOL [4.8K loss].

(a) Child adopts a plan of complete liquidation and distributes $2,000 cash to Uncle and all its remaining assets to Mother.

(b) Child distributes $2,000 cash to Uncle in redemption of his 25 shares. One week later, it adopts a plan of complete liquidation and distributes its remaining assets to Mother pursuant to the plan. What are Mother and Child trying to accomplish through this reunion? → Then Mother keeps 100% … § 332 apply

But See Rev Ruling 70-521. 322 applies

50% shareholder buys other 50% then liquidates.

3. Parent Corporation ("P") owns all the stock of Subsidiary Corporation ("S"). P has a $1,000 basis in its S stock and also holds S bonds with a basis and face amount of $1,000. S has the following assets:

Asset	Adjusted Basis	Fair Market Value
Inventory	$10,000	$ 1,000
Land	200	10,000
Total	$10,200	$11,000

P intends to liquidate S, but before adopting a formal plan S distributes the inventory in satisfaction of its outstanding $1,000 debt to P. On the next day, S liquidates, distributing the land to P. Why did P and S structure the transactions in this manner? Will they achieve their tax objectives?