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Federal Taxation -- Stockholders' Sale of Assets of Liquidating Corporation

refused to accept conclusions in the name of "science" which would be rejected if presented under any other authority.[10]

FEDERAL TAXATION—STOCKHOLDERS' SALE OF ASSETS OF LIQUIDATING CORPORATION

Plaintiff corporation's stockholders, at all times carrying on negotiations for themselves and not the corporation, caused the company to be dissolved and the physical assets to be distributed to themselves as a liquidating dividend. They thereupon sold the assets to another corporation, the entire procedure being for the avowed purpose of avoiding double taxation. Plaintiff corporation brought suit in the Court of Claims to recover a tax deficiency assessment, the tax having been paid and a claim for refund disallowed. *Held,* this was a sale of assets by the stockholders as individuals and not a sale by the corporation. The corporation was therefore entitled to a refund. *Cumberland Public Service Company v. United States,* 83 F. Supp. 843 (1949).[1]

In recent years the courts have been confronted with an ever-recurring problem as to whether or not the sale of assets by a liquidating corporation through its stockholders is taxable both to the corporation and to the stockholders. This question generally arises where a corporation is owned by a small number of stockholders [2] who are disposing of all or nearly all of the physical assets of the company, and the current market value of the assets exceeds

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10. The admissibility of evidence obtained by use of the "Harger Drunkometer" is on appeal to the Supreme Court of Florida. Because the defendants' submission to the drunkometer had been voluntary, the matter of constitutional rights was not in issue. This case points this out by showing that though a so-called test be taken voluntarily, its results still are not admissible until the prosecution has carried the burden of showing that it really is a "test," and a test of sufficient soundness to sustain expert testimony based upon it. The court attempts to dispel the tendency to confuse the constitutional right against self-incrimination with the totally irrelevant matter of the dependability of a given "test."

1. *Cert. granted,* 70 Sup. Ct. 88 (1949). *But cf.* Kaufmann v. Comm'r of Int. Rev., 175 F.2d 28 (5th Cir. 1949) (This decision, one week prior to that of the instant case, ruled that where negotiations were begun by a corporation before the commencement of liquidation proceedings, the sale, though subsequently cast in the form of an agreement with the stockholders, was actually made by the company).

1a. After this Note was approved the Supreme Court of the United States affirmed the instant case, United States v. Cumberland Public Service Co., 18 U.S.L. WEEK 4076 (U.S. Jan. 9, 1950), P-H 1950 FED. TAX SERV. 72,006. Said Mr. Justice Black, 18 U.S.L. WEEK at 4077, "While the distinction between sales by a 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."

2. *E.g.,* Comm'r v. Court Holding Co., 324 U.S. 331 (1945) (corporation had two shareholders and its president was husband of the principal stockholder); Fairfield Steamship Co. v. Comm'r, 157 F.2d 321 (2nd Cir. 1946) (liquidating corporation 100% owned by the corporation negotiating the sale); Cumberland Public Service Co. v. United States, 83 F. Supp. 843 (1949) (two men and their families owned all of the stock).

3. See Ayers, *Stockholder or Corporate Sale of Assets in Liquidation as Affected by Court Holding Company and Howell Turpentine* in N.Y.U. INSTITUTE ON FEDERAL TAXATION 364 (6th Annual ed. 1947).

their book value.[3] It is done solely to avoid the corporate tax,[4] in accordance with the right of taxpayers to decrease or avoid potential taxes by legal means.[5]

The Supreme Court, in the leading case of *Commissioner v. Court Holding Company*,[6] dealt with a somewhat similar situation. The corporation itself began negotiations, withdrew, and after a liquidating dividend in kind the stockholders sold the assets to the same purchaser. The Court concluded that the intervening steps were merely formal devices to avoid tax liability and that the company never abandoned the sales negotiations.[7]

In an effort to adhere to the *Court Holding Doctrine* a variety of artificial distinctions, based mainly upon chronology,[8] have been created. Where the stockholders have *commenced* negotiations in their own name the courts have usually ruled against the corporate tax,[9] but where they were begun by the corporation and later carried on by the stockholders payment of both the corporate and individual taxes was generally required.[10] In many of these cases the courts have made a nebulous distinction between the company and the shareholders which for all practical purposes were identical since the company was completely controlled by one or a very few stockholders.[11] And in nearly all of these cases there existed the same broad purpose—sale of the corporate assets and a legal avoidance of double taxation.[12] It has been recognized that recent decisions on this point are in a highly confusing state.[13]

The principal case can be distinguished from the *Court Holding Company* decision in form but not in substance.[14] Taxpayers should not be subjected to the hardship of being treated differently on the same question in different courts. The Supreme Court, having granted certiorari in the instant case,[15] may judicially resolve a uniform doctrine, sounder and clearer than the one now followed. Legislative action may well be the best solution to the problem.

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4. U.S. Treas. Reg. 111, § 29.22(a)-20 (1943). ("No gain or loss is realized by a corporation from the mere distribution of its assets in kind in partial or complete liquidation, however they may have appreciated or depreciated in value since their acquisition.")

5. *See, e.g.*, Gregory v. Helvering, 293 U.S. 465, 469 (1935); United States v. Isham, 17 Wall. 496, 506 (U.S. 1873).

6. 324 U.S. 331 (1945).

7. *Id.* at 334. Mr. Justice Black stated, ". . . the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is revelant. A sale by one person cannot be transformed for tax purposes into a sale by another using the latter as a conduit through which to pass title."

8. See notes 9 and 10 *infra*.

9. Howell Turpentine Co. v. Comm'r of Int. Rev., 162 F.2d 319 (5th Cir. 1947); J. T. S. Brown's Son Co., 10 T.C. 840 (1948); Acampo Winery and Distilleries, 7 T.C. 629 (1946). *Contra:* Fairfield Steamship Co. v. Comm'r, 157 F.2d 321 (2nd Cir. 1946).

10. Comm'r v. Court Holding Co., 324 U.S. 331 (1945); Kaufmann v. Comm'r of Int. Rev., 175 F.2d 28 (5th Cir. 1949).

11. See note 2 *supra*.

12. Ayers, *supra* note 3.

13. See Freeland, *Recent Trends in the Court Holding Co. Principle* in N.Y.U. INSTITUTE ON FEDERAL TAXATION 369 (7th Annual ed. 1948).

14. See P-H 1949 FED. TAX SERV. ¶ 28.201.

15. See note 1 *supra*.

A recent bill,[16] intended to give taxpayers an outlet for avoiding this double tax,[17] died when the Senate of the Eightieth Congress failed to pass it before adjournment. It is indeed possible that the instant decision and its many recent counterparts may force Congress to act soon with a similarly designed bill.

MONOPOLY—DIVESTITURE AS REMEDY FOR VERTICAL INTEGRATION OF MOTION PICTURE COMPANIES

An anti-trust action under the Sherman Act [1] was instituted in 1938 against the eight leading motion picture companies and their subsidiaries.[2] The complaint alleged that these companies, through their integration of production, distribution and exhibition of motion pictures, had conspired in restraint of trade and had formed a concerted monopoly, discriminatory in nature. The Government sought divestiture [3] and other equitable relief against further violation of the Sherman Act and injunctive relief against specific unfair and discriminatory practices.[4] The lower court's opinion [5] was that a system of competitive bidding by exhibitors, separately for each picture and theatre, would eliminate block-booking [6] and blind selling [7] and render divorcement unnecessary. Upon appeal by both sides the Supreme Court remanded the case for a determination of the effect of vertical integration in the industry and

16. H.R. 6712, 80th Cong., 2nd Sess. § 129 (1948) (proposed Revenue Revision Act of 1948).

17. H.R. REP. No. 2087, 80th Cong., 2nd Sess. 15 (1948); 1 RABKIN AND JOHNSON, FEDERAL INCOME GIFT AND ESTATE TAXATION 1318 (1947 ed.); Freeland, *supra* note 13.

1. 26 STAT. 209 (1890), as amended, 50 STAT. 693 (1937), 15 U.S.C. §§ 1, 2 (1946).

2. The defendants were: Paramount Pictures, Inc.; Paramount Film Distributing Corp.; Loew's, Inc.; Radio-Keith-Orpheum Corp.; RKO Radio Pictures, Inc.; Keith-Albee-Orpheum Corp.; RKO Proctor Corp.; RKO Midwest Corp.; Warner Bros. Pictures, Inc.; Vitagraph, Inc.; Warner Bros. Circuit Management Corp.; Twentieth Century-Fox Film Corp.; National Theatres Corp.; Columbia Pictures Corp.; Columbia Pictures of La., Inc.; Universal Corp.; Universal Film Exchanges, Inc.; Big U Film Exchange, Inc.; and United Artists Corp.

3. Divestiture and dissolution are commonly used remedies for anti-trust violations. While there is some distinction between the two there is no definite rule of application. The courts apparently use that remedy which they deem most appropriate. Generally, divestiture is forcing a corporation to sell or otherwise dispose of some portion of its holdings. Dissolution consists of splitting the entire corporation into its component parts.

4. Five of the major companies (Paramount Pictures, Inc.; Loew's, Inc.; Radio-Keith-Orpheum Corp.; Warner Bros. Pictures, Inc.; and Twentieth Century-Fox Film Corp.) entered into a temporary consent decree with the Government in 1940 under the terms of which a status quo was maintained for three years and an arbitration system was established. Although the consent decree lapsed before the issuance of the District Court's opinion in 1946 the "majors" continued to comply with its provisions.

5. United States v. Paramount Pictures, Inc., 70 F. Supp. 53 (S.D.N.Y. 1946). See also United States v. Paramount Pictures, Inc., 66 F. Supp. 323 (S.D.N.Y. 1946).

6. "Block-booking is the practice of licensing, or offering for license, one feature or group of features on condition that the exhibitor will also license another feature or group of features released by the distributors during a given period." United States v. Paramount Pictures, Inc., 334 U.S. 131, 156 (1948).

7. "Blind-selling is a practice whereby a distributor licenses a feature before the exhibitor is afforded an opportunity to view it." United States v. Paramount Pictures, Inc., 334 U.S. 131, 157 n.11 (1948).