Mr. E. H. Stetson December 28, 1953

W. W. Mangels

As agreed by yourself, Mr. Murray, and myself, a letter was sent to taxpayer's counsel on December 21 recommending that the petition be granted.

The issue was whether (1) there was an exempt distribution in liquidation to a sole shareholder followed by an occasional sale of the assets by that shareholder to a purchaser or (2) whether there was a taxable sale (of the capital equipment) directly from the corporation to the new purchaser. We determined that the first situation existed.

It appears that the following facts existed. It was decided to liquidate the taxpayer corporation, hereinafter referred to as P. It was decided that this should take place in a manner whereby the amount of federal income tax would be minimized. Therefore, at no time, apparently, did the P corporation agree to sell the assets directly to the prospective purchaser (Informally, orally, or otherwise) with the transaction merely in form a distribution followed by a sale by the shareholder since if an informal agreement had been reached, or perhaps even if there had been substantial negotiations between the corporation and F,*the gain would have been attributed to the P corporation under the decision in Commissioner of Internal Revenue v. Court Holding Company, 324 U.S. 331. (See also lower court opinions in same case in 2 Tax Court 531 and 143 Fed. 2d 823.)

It was explained by P's counsel that the corporation did not agree to sell and accordingly that the transaction was exactly as the formal contracts and writings indicate, an exempt distribution followed by a sale by the shareholder governed by the reasoning in United States v. Cumberland Public Service Company, 338 U.S. 451. (See particularly the opinion of the lower court in 83 Fed. Supp. 843.) In that case the corporation never agreed to sell the assets and, in fact, flatly refused. Thereafter, the shareholders agreed to take the utility property out of the corporation and sell it to the purchaser. In that case, as you know, it was held that the sale was not made by the corporation and therefore the gain was not attributed to the corporation.

Returning to the problem at hand, P's counsel denies the existence of any preliminary negotiations leading to an agreement between P and F Corporation, the purchaser, hereinafter referred to as F.

*the purchaser

The form of the transaction was as follows. On June 23, 1952, all the stock was assigned to B), the other shareholder consenting in writing to the liquidation of P, and to the distribution of assets to B, who was to convey them to F for the purchase price and to account to the other shareholders for the proceeds.

On June 24, B entered into an agreement with F whereby as soon as the assets were distributed from P to B, B would sell them to F. F was not to assume the liabilities of P. The closing date (transfer of title date) was expected to be July 1 when B would acquire the assets from P. This contract was carefully worded to clearly point out that B, not P, was selling to F, and upon inspection thereof Mr. Murray and myself were of the opinion that there were no clauses in the contract which could be regarded as inconsistent with a bona fide transfer from B to F, particularly in the light of the holding in the Cumberland case.

Dated June 27 is the written election of the sole shareholder B to wind up and dissolve the P corporation directing the officers and directors to take action to accomplish that objective.

Dated June 30 are the written minutes of P corporation directing the officers to distribute the assets to B.

Dated July 1 is the bill of sale from P to B and a separate bill of sale from B to F.

Dated July 1 is an assignment by P to B of all of P's rights in inventions and patents of another person and by separate document there is a transfer of the same rights from B to F.

Dated July 8 is a certificate of election of P to wind up and dissolve.

All these documents are carefully drafted and seemingly bring this matter within the purview of the Cumberland case.

If there had been a prior agreement between the P corporation and F, we would have followed the reasoning in the Court Holding case and have concluded that there was a taxable sale by P, irrespective of the form of documents thereafter drafted.

Mr. Murray and myself concluded that there was no evidence of any such agreement. P's counsel flatly states that there was no such agreement. The only possible evidence of such a prior agreement between P and F is the fact that F acquired a San Bernardino city license to carry on the manufacturing operations, as I understand it, at the place of business involved 5 days before B, as sole shareholder, was said to have contracted to sell the assets to F on June 24. However, the acquisition of this license at the earlier date could just as easily have been for the reason that negotiations with the shareholder had nearly been completed by June 19, with P not technically in the picture at all.

Accordingly, we concluded that there was no prior agreement between P and F. Therefore, we determined that no sale was made by P.

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(1) The distribution was for no consideration. If there had been any consideration, such as an assumption of liabilities, there would have been a sale from the corp to the shareholder, & it would have been taxable unless the shareholder purchased the property for resale in a taxable sale (a person cannot purchase property other for resale in an occasional sale since that isn't a sale in the regular course of business for purposes of the sales & use Tax Law).

(2) There was a legitimate business reason for doing it this way other than the avoidance of sales tax. Otherwise, the transaction would have been disregarded & it would have been a taxable sale from the corp to the 3d party.

(3) the shareholder, presumably held no permit & made no other sales. Otherwise, his sale would not have been exempt.

10/28/97