

Cullinan Vs. Walker

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Court : US Supreme Court

Decided On : Apr-30-1923

Appeal No. : 262 U.S. 134

Appellant : Cullinan

Respondent : Walker

Judgement :

Cullinan v. Walker - 262 U.S. 134 (1923)

U.S. Supreme Court Cullinan v. Walker, 262 U.S. 134 (1923)

Cullinan v. Walker

No. 301

Argued March 9, 1923

Decided April 30, 1923

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ERROR TO HE DISTRICT COURT OF THE UNITED STATES

FOR THE SOUTHERN DISTRICT OF TEXAS

SYLLABUS

1. The gain accruing to a shareholder through enhancement of the value of his shares, and which, when segregated, becomes legally income subject to the income tax, may be segregated by a dividend made on liquidation of the corporation as well as by an ordinary dividend. P. [262 U. S. 137](#) .

2. Partly to comply with its state law and partly to procure additional credit for the business, an oil corporation was dissolved; its trustees in liquidation formed a producing corporation and a pipeline corporation, in the same state, transferred one-half of the assets to each, receiving from each in return its stock and its bonds, transferred all this stock to a holding corporation, which they formed in another state, receiving in exchange its stock, and distributed this stock, with the bonds of the other two existing corporations, among the persons who had been the stockholders of the dissolved concern. The three new corporations had, at the time of the distribution, no assets other than those so received from the trustees, and the value of the assets was the same as when the trustees held them. *Held*, that the securities thus distributed were not in legal effect a stock dividend, and that a distributee was taxable under the income tax provision of September 8, 1916, c. 463, Tit. I, 1 and 2, 39 Stat. 756, upon the amount by which the securities he received exceeded in value his investment in the shares of the original corporation. P. [262 U. S. 136](#) . *United States v. Phellis*, [257 U. S. 156](#) .

Affirmed.

Error to a judgment of the district court in an action against an internal revenue collector to recover back a tax paid under protest.

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MR. JUSTICE BRANDEIS delivered the opinion of the Court.

A tax of \$156,212.66 was laid upon Cullinan, under the Act of September 8, 1916, c. 463, Tit. 1, 1 and 2, 39 Stat. 756, 757, for additional gain or income of that year,

assessed at \$1,571,760. He paid the tax, under protest, and brought, in the Federal Court for Southern Texas, this action against the local collector of internal revenue to recover the amount. The question was whether certain securities received by Cullinan in that year should be deemed gain or income. The case was tried by the court without a jury, upon agreed facts, and judgment was entered for defendant. Cullinan contends that securities issued to him, which the collector treated as gain or income, were, in legal effect, like a stock dividend, and that, under *Eisner v. Macomber*, [252 U. S. 189](#) , he was not taxable thereon. The government insists that the securities so distributed were gains or income within the rule laid down in *United States v. Phellis*, [257 U. S. 156](#) , and *Rockefeller v. United States*, [257 U. S. 176](#) . This issue, presented on the facts hereinafter stated, is the only matter for decision. The case is here on writ of error under 238 of the Judicial Code, because of the constitutional question involved. *Towne v. Eisner*, [245 U. S. 418](#) .

Farmers' Petroleum Company was, in 1915, a Texas corporation, with a capital stock of \$100,000. Cullinan

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owned 26.64 percent of its stock, for which he had paid (in that and the preceding year) \$26,640 in cash. Later in 1915, the company was dissolved under the Texas law, and Cullinan became one of the trustees in liquidation. In 1916 the trustees organized two Texas corporations, Republic Production Company, a producing concern, and American Petroleum Company, a pipeline concern. To these corporations the trustees transferred the assets held by them, one-half in value to each. From each they received \$1,500,000 par value of its stock and \$1,500,000 par value of its bonds, being the total issues. The trustees also organized under the laws of Delaware a third company, American Republics Corporation, a holding company. To this company the trustees transferred all the \$1,500,000 stock of each of the new Texas corporations; from it they received \$3,000,000 of its stock. They thus held in 1916 the \$3,000,000 stock of the Delaware corporation and the \$1,500,000 bonds of each of the new Texas corporations. All these securities the trustees then distributed *pro rata* among the persons who had been stockholders

in Farmers' Petroleum Company.

Farmers' Petroleum Company had been dissolved solely for the purpose of effecting a reorganization. The reorganization was undertaken partly in order to separate the pipelines from the producing properties, which counsel advised was necessary, and, partly, in order to procure credit required for the developing business. The two new Texas corporations had, at the time of the distribution of the stock of the Delaware corporation, no assets other than those received from the trustees in liquidation. These assets were, at the time of distribution, of the same value as they were when held by the trustees in liquidation. Cullinan received 26.64 percent. of each class of security. The stock and bonds distributed were then all worth par. The aggregate value of the securities received by him was \$1,598,400. The amount which he

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had invested in Farmers' Petroleum Company was \$26,640. On the difference, \$1,571,760, the internal revenue collector assessed the tax here in question.

Cullinan insists that his gain so ascertained was merely an incident of a reorganization. This was equally true in the *Phellis* and the *Rockefeller* cases. It is sought to differentiate those cases on the ground that there, the distributed stock of the new corporation was technically a dividend paid out of surplus, and that here, the segregation is not of that character. But the gain, which when segregated becomes legally income subject to the tax, may be segregated by a dividend in liquidation as well as by the ordinary dividend. If the trustees in liquidation had sold all the assets for \$6,000,000 in cash, and had distributed all of that, on one would question that the late stockholders of Farmers' Petroleum Company would, in the aggregate, have received a gain of \$5,900,000, taxable as income. The result would obviously have been the same if the trustees had taken in payment, and distributed, bonds of the value of \$6,000,000 in some new corporations. And the result must also be the same where that taken in payment is \$3,000,000 of such bonds and \$3,000,000 in stock of a third corporation. All the material elements which differentiate the *Phellis* and *Rockefeller* cases from

Eisner v. Macomber are present also here. The corporation, whose stock the trustees distributed, was a holding company. In this respect, it differed from Farmers' Petroleum Company, which was a producing and pipeline company. It differed from the latter also because it was organized under the laws of another state. It is true that, at the time this Delaware corporation's stock was distributed, it held the stock of the new oil-producing company and likewise the stock of the new pipeline company. But the Delaware corporation was a holding company. It was free at any time to sell the whole or any

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part of the stock in either of the new Texas companies and to invest the proceeds otherwise. By such a sale and change of investments, all interest of the holding company in the original enterprise might be parted with without in any way affecting the rights of its own stockholders. When the trustees in liquidation distributed the securities in the three new corporations, Cullinan, in a legal sense, realized his gain, and became taxable on it as income for the year 1916.

Affirmed.

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