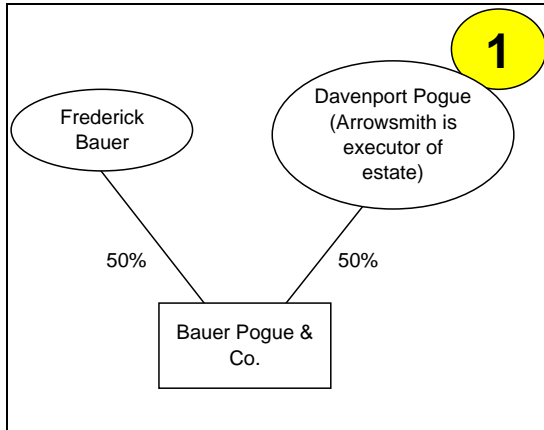


Arrowsmith v. Commissioner
344 U.S. 6 (1952)

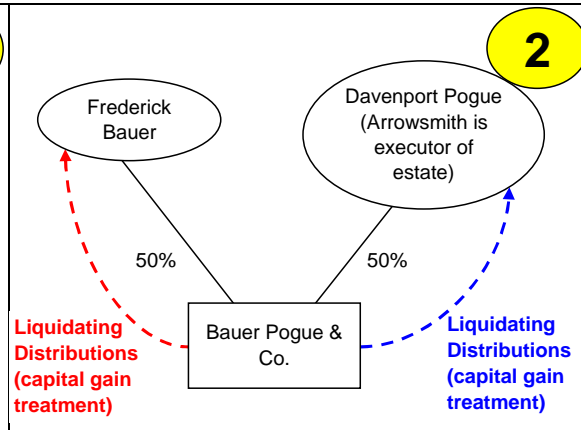
Relation Back Doctrine

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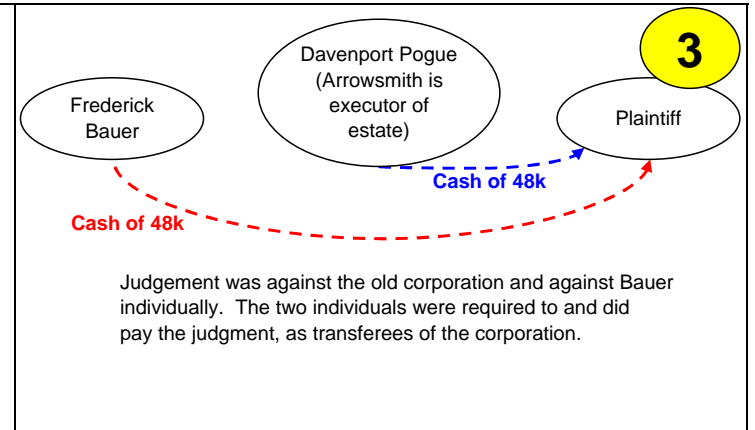
Initial Structure



Liquidation (1937-1940)



Lawsuit Judgment (1944)



Excerpt from Smith v. Commissioner, 67 T.C. 570 (1976)

In Arrowsmith . . . , two taxpayers, corporate shareholders, decided in 1937 to liquidate and divide the proceeds of a corporation. They reported the profits obtained upon liquidation as capital gains. In 1944, however, a judgment was rendered against the old corporations and one distributee of its stock. The two taxpayers were required to pay the judgment for the corporation, being transferees of its assets. The taxpayers claimed ordinary business losses for the payments they made. The Commissioner disagreed, viewing the 1944 payment as part of the original liquidation transaction requiring classification as a capital loss since the taxpayers had treated the original dividends as capital gains. The Supreme Court held that the payment was a capital loss because liability was imposed on them as transferees of liquidation distribution assets, a capital transaction; and that the principle of separate units of annual accounting for tax purposes was not violated "by considering all the 1937-1944 liquidation transaction events in order properly to classify the nature of the 1944 loss for tax purposes."

Excerpt from United States v. Skelly Oil Co., 394 U.S. 678 (1969)

[T]he annual accounting concept does not require us to close our eyes to what happened in prior years. For instance, it is well settled that the prior year may be examined to determine whether the repayment gives rise to a regular loss or a capital loss. Arrowsmith v. Commissioner The rationale for the Arrowsmith rule is easy to see, if money was taxed at a special lower rate when received, the taxpayer would be accorded an unfair tax windfall if repayments were generally deductible from receipts taxable at the higher rate applicable to ordinary income. The Court in Arrowsmith was unwilling to infer that Congress intended such a result.

Ending Point

