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

Relation Back Doctrine

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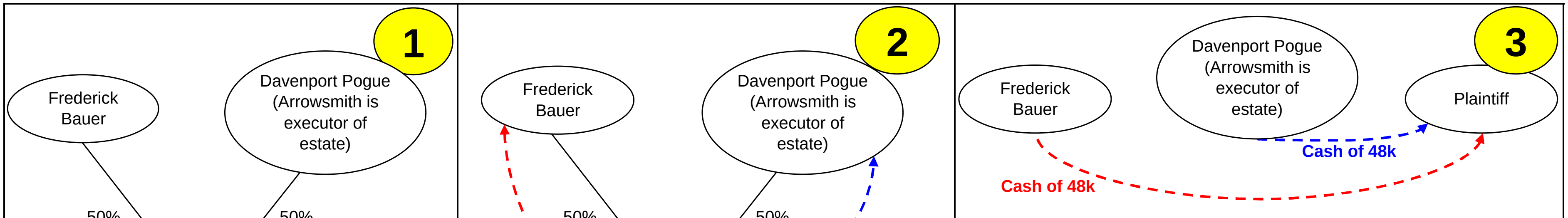
Initial Structure | Liquidation (1937-1940) | Lawsuit Judgment (1944)



Judgement was against the old corporation and against Bauer individually. The two individuals were required to and did pay the judgment, as transferees of the corporation.

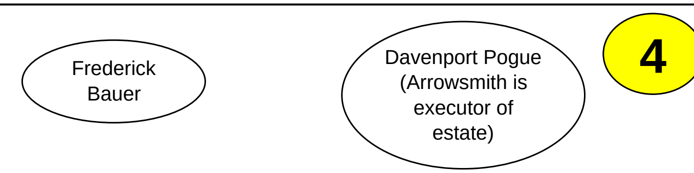
Excerpt from Smith v. Commissioner, 67 T.C. 570 (1976)

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



Bauer & Pogue each had 48k in losses. The taxpayers claimed ordinary losses. The Commissioner argued for capital losses. The Commissioner won.

Excerpt from Seagate Technology v. Commissioner, 80 TCM 759 (2006):

Courts have applied the Arrowsmith . . . relation-back doctrine in favor of both the taxpayer and the Government in a myriad of factual settings. The relation-back doctrine has also been invoked under different labels, such as the "tax benefit rule" . . . or the "origin of claim" rule . . . . Regardless of the label given to the principle, this Court has consistently framed it as follows: "the most appropriate tax treatment of the transaction in the later year is obtained by examining the circumstances surrounding the related transaction in the earlier year, because of the relationship between the transactions, and it is immaterial whether such a result favors the taxpayer or the Government."

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