General Utilities v. Helvering
296 U.S. 200 (1935)

No Gain on In-Kind Corporate Distributions

Stock Acquisition (1/1/1927)

1. Shareholders
   - 100%
   - General Utilities
   - Gillet & Co
   - Islands Edison

In-Kind Distribution (3/22/1928)

2. Shareholders
   - 100%
   - General Utilities
   - Gillet & Co
   - Islands Edison

   In-Kind Distribution of 19,090 shares

Agreement to Sell (3/26/1928)
& Sale (5/14/1928)

3. Shareholders
   - Southern Cities Utilities Co. ("Buyer")
   - General Utilities
   - Gillet & Co
   - Islands Edison

   Cash
   - 100%
   - 40,000 shares

   Shares of Islands Edison
   - 50%
   - 20,000 shares
   - 910 shares
   - 19,090 shares

   20,000 shares

Ending Point

4. Shareholders
   - General Utilities
   - Gillet & Co

   Cash / gain on sale of 19,090 shares
   - 100%
   - 40,000 shares

   Cash / gain on sale of 910 shares

In 1927 General Utilities acquired 20,000 shares of Islands Edison stock for a cost of $2,000. The stock appreciated in value by over $1,000,000. In 1928, General Utilities distributed, as an in-kind dividend, most of the appreciated Islands Edison stock. Soon after the dividend, all of the stock of Islands Edison was sold to Southern Cities Utilities Co. The Commissioner sought to tax General Utilities on the gain recognized by its shareholders. The theory was that upon the declaration of the dividend General Utilities became indebted to its stockholders and that the discharge of that liability by the delivery of property costing less than the amount of the debt constituted income under Kirby Lumber Co., 284 U.S. 1 (1931).

The Supreme Court, in affirming both the Board of Tax Appeals and the Fourth Circuit on this issue, held for the taxpayer, stating that the taxpayer "derived no taxable gain from the distribution . . . . This was no sale; assets were not used to discharge indebtedness."

A second argument, that the sale was in substance made by General Utilities but in form was made by the shareholders, was not raised at the trial court level. When raised at the appellate court, the Fourth Circuit held in favor of the Commissioner. The Supreme Court reversed, stating that "the court undertook to decide a question not properly raised." This issue was dealt with in a later case. Commissioner v. Court Holding, 324 U.S. 331 (1945).

The result of this case was known as the General Utilities doctrine and was codified in the Internal Revenue Code of 1954. However, this doctrine was repealed in a piecemeal manner (with the final nail in the coffin in 1986). Under current law, in-kind distributions of appreciated property trigger taxable gains. See sec. 311(b).

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