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*February*

STATE OF WISCONSIN  
TAX APPEALS COMMISSION

STATE OF WISCONSIN  
DEPARTMENT OF REVENUE  
**RECEIVED**  
JAN 26 1982  
LEGAL DIVISION

\* \* \* \* \*  
ELEANOR V. COVELLI,  
  
Petitioner,  
  
vs.  
  
WISCONSIN DEPARTMENT OF REVENUE,  
  
Respondent.  
\* \* \* \* \*

DOCKET NO. I-7663  
DECISION AND ORDER  
(Drafted by  
Chairman Boykoff)

The above-entitled matter was heard by the Commission. The petitioner, Eleanor V. Covelli, appeared in person and by her attorney, Bruno M. Rizzo of Joling, Rizzo & Willems, S.C. of Kenosha, Wisconsin. The respondent, Wisconsin Department of Revenue, appeared by its attorney, Veronica Folstad. Having considered the evidence and arguments of the parties, this Commission hereby finds and decides as

FINDINGS OF FACT

1. This is a timely filed appeal to this Commission for review of the respondent's decision on the petitioner's petition for redetermination of an assessment of additional income taxes for the tax years 1974, 1975 and 1976.
2. During the period under review, the petitioner was a Wisconsin resident, subject to the income tax provisions of Chapter 71, Wis. Stats.

3. Under date of March 26, 1979, respondent issued to petitioner an assessment of individual income tax in the amount of \$4,736.01 (\$3,711.31 income tax and \$1,024.70 interest).

4. Under date of April 20, 1979, petitioner filed with respondent a petition for redetermination which, under date of February 4, 1980, respondent denied.

5. On October 28, 1974, petitioner was the sole shareholder, president, treasurer and a member of the board of directors of Badger Cheese Market, Inc. (hereafter, "Badger Cheese"), a Wisconsin corporation. On that date, Badger Cheese adopted a plan of complete liquidation under section 337 of the Internal Revenue Code (hereafter "IRC"). To be eligible for the benefits of section 337, IRC, Badger Cheese was required to completely liquidate within one year of the adoption of the plan for complete liquidation, i.e., October 28, 1975.

6. On November 1, 1974, Badger Cheese sold its assets to James Benko and James Greco. The sale was an installment sale. The total sale price was \$63,500. The payment terms were that the purchasers gave Badger Cheese \$18,000 in cash and a promissory note for \$45,500 with interest at 9% per year, payable in 179 monthly installments of \$461.50 and a 180th monthly, last payment of \$458.31.

7. On October 1, 1975, petitioner created the "Eleanor V. Covelli Irrevocable Trust for Our Lady of Mount Carmel Church". The trustee testified that the trust was initially funded by \$100 cash. The trust instrument named Gino Villani as the sole trustee

and provided that the trust was to terminate on September 30, 1990, at which time the entire trust estate shall be paid to Our Lady of Mount Carmel Church. Under the trust instrument, the trustee is directed to pay to petitioner the net income from the trust property annually during the trust's term and, if petitioner were to die prior to the trust's termination, the trustee is directed to pay the net income annually to William Covelli, petitioner's husband. If both petitioner and William Covelli were to die during the trust's term, the trustee is directed to pay the net income to Our Lady of Mount Carmel Church.

8. The trust instrument appointed Gino Villani as trustee. If he was unable to so act, the instrument provided that Michael S. Rizzo or Bruno M. Rizzo shall appoint a successor trustee to administer the trust. Gino Villani was a licensed certified public accountant in the private, general practice of accounting. He testified that he believes he was selected as trustee as he had known and worked with Bruno M. Rizzo in tax matters and was a "convenient" third party. Bruno M. Rizzo was petitioner's attorney who drafted the October 1, 1975 trust instrument and the agreement of the same date described in finding of fact 10 below.

9. On October 1, 1975, the balance due to Badger Cheese on the November 1, 1974 promissory note of James Benko and James Greco was \$44,126.51. The only other asset of Badger Cheese was \$6,609.97 cash. The total of these amounts is \$50,736.48.

10. On October 1, 1975, petitioner entered into an agreement with Badger Cheese and the trust. As part of the agreement, Badger Cheese distributed all of its assets in liquidation.

to the trust, the assets consisting of \$6,609.97 cash and the promissory note with a balance due of \$44,126.51, in exchange for 150 shares of Badger Cheese, being all of the shares outstanding. Also as part of the agreement, petitioner sold all of her 150 shares of Badger Cheese to the trustee for \$50,736.48, payable with \$6,609.97 cash and the balance of \$44,126.51, together with interest thereon at the rate of 9% per year payable in 168 monthly installments of \$461.50 commencing November 1, 1975 and a final installment of \$458.31. The monthly installments provided for in this agreement by the trust to petitioner are identical in amounts to the payments anticipated to be made by Messrs. Benko and Greco on the outstanding balance due on the promissory note from the sale of the corporate assets.

11. The purpose of the trust was to avoid the perceived harsh tax consequences affecting shareholders who receive installment obligations as part of a liquidation dividend.

12. At the hearing before this Commission, the parties stipulated that that amount of gain on petitioner's sale is \$35,219, and that the amounts of money and payment terms set out in the October 1, 1975 agreement described in finding of fact 10 are correct.

13. Respondent contends that petitioner is required to recognize the \$35,219 gain in 1975, the year of the liquidation distribution. Petitioner contends that the gain is not recognized in full in 1975 but instead, it can be reported on the installment basis as the payments on the note are received. In order to avoid recognition of the entire gain in a single year, petitioner established the trust as a third party in the liquidation arrangement and, petitioner

contends, this is valid for the purpose.

#### ISSUES FOR DETERMINATION

1. Is the entire gain from the liquidation distribution of Badger Cheese taxable to petitioner, as the corporation's sole shareholder, in the year of liquidation (1975) or is the gain reportable on the installment basis as result of the intercession of the trust?

2. Regardless of the determination of the first issue, is the entire gain from the liquidation on distribution of Badger Cheese taxable to petitioner in the year of liquidation (1975) because the trust is a grantor trust?

#### WISCONSIN STATUTES INVOLVED

ss.71.01(1) and 71.02(2)(b), Wis. Stats.

#### INTERNAL REVENUE CODE PROVISIONS INVOLVED

Sections 331, 337 and 453

#### CONCLUSIONS OF LAW

1. The entire gain from the liquidation distribution of Badger Cheese is taxable to petitioner, as the corporation's sole shareholder, in the year of liquidation (1975) and petitioner is not entitled to report the gain on the installment basis of reporting.

AUTHORITY: Rushing et al. v. Commissioner 71-1 USTC para. 9339, 441 F. 2d 593 (5th Cir. 1971) aff'g 52 TC 888(1969)

2. Because the first issue is decided adversely to petitioner, there is no need to decide the second issue stated by

respondent as a defense.

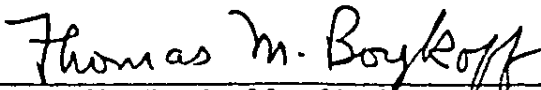
Therefore,

IT IS ORDERED

That respondent's action on petitioner's petition  
for redetermination is affirmed.

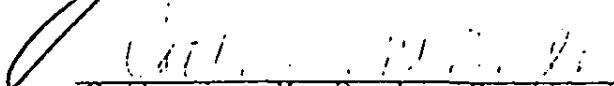
Dated at Madison, Wisconsin this 25th day of January,  
1981.

WISCONSIN TAX APPEALS COMMISSION

  
Thomas M. Boykoff, Chairman

  
Thomas R. Timken, Commissioner

  
John P. Morris, Commissioner

  
Catherine M. Doyle, Commissioner

  
William Bradford Smith, Commissioner

STATE OF WISCONSIN  
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O P I N I O N

The facts in this case are essentially undisputed. There is no disagreement between the parties that a gain was realized by petitioner in 1975 on the liquidation under Section 337 of the Internal Revenue Code (hereafter, "IRC") of Badger Cheese Market, Inc. (hereafter, "Badger Cheese"); nor is there a dispute on the amount of that gain.

The issue for resolution is how the petitioner must report the gain for Wisconsin individual income tax purposes. Respondent contends that the full gain must be reported in 1975, the year of the liquidation and the year it asserts that the gain was constructively received by petitioner. Petitioner contends that she is entitled to report the gain under the installment method provided in section 453, IRC, because the corporate distribution to the trust which she created insulates her for tax purposes from constructive receipt in 1975 and allows her to report the installment payments of the distribution from the trust as the payments are



received over the years by her.

The provisions of the IRC and the Wisconsin Statutes applicable to tax year 1975 and this case provide for taxation of a liquidation distribution, in full, in the year of the distribution. Under Section 331, IRC, amounts distributed to a shareholder in complete liquidation are treated as full payment in exchange for the stock, and gain or loss is recognized in the year of the distribution. A distribution of an installment obligation to a shareholder is similarly taxable in full in the year of distribution even though payments will continue to be received in future years. No provision of the IRC applicable to 1975 permits the shareholder to report gain on such distributions under the installment method.

The decision in Rushing et al. v. Commissioner, 71-1 USTC para. 9339, 441 F. 2d 593 (5th Cir. 1971), aff'g 52 TC 888 (1969), presents a solution to this gap in the Internal Revenue Code and appears to provide the only legally authorized method under the IRC for tax year 1975 permitting installment reporting. Both parties currently before this Commission agree that the Rushing case is central to the current dispute, but differ as to their interpretations of it.

In the Rushing case, W. B. Rushing and Max Tidmore each owned 50% of the stock in 2 corporations. In 1962, the taxpayers, as directors, voted to adopt a plan of liquidation for both corporations under section 337, IRC. Shortly after the decision to liquidate, substantially all of the assets of both corporations were sold.

Immediately before the end of the statutory 12-month period allowed for liquidation under section 337, both taxpayers created irrevocable trusts for each of their children and sold their stock in the 2 corporations to the trusts. The trustee was a bank which purchased the stock by paying part cash and executing notes for the remainder, payable to the taxpayers over a period of years. The notes were to be secured by the general assets of the trusts; the trust corpus in each case included assets in addition to the stock purchased in the transactions under review.

In each instance, the total purchase price payable by the trusts was equal to the anticipated liquidation dividend to be paid on the stock purchased. Shortly thereafter, and still within the 12-month statutory period, the trustee, as shareholder of the 2 corporations, liquidated the corporations and collected the distribution proceeds.

In their 1963 tax returns, the taxpayers did not report their gain from the liquidations, but claimed that they had sold their stock to the trusts which were to make payments on the installment basis. Accordingly, they contended that the gain should be reported on the installment basis only as the payments were received from the trusts.

The IRS refused to allow the taxpayers the benefit of installment sales and contended that the entire gain was taxable in the year of liquidation. The Tax Court ruled in favor of the taxpayers and the Court of Appeals affirmed this holding.

In reaching its conclusion, the Court of Appeals stated (71-1 USTC at p.86,307, citations omitted):

. . . We think it clear. . . that a taxpayer may, if he chooses, reap the tax advantages of the installment sales provision if he actually carries through an installment sale, even though this method was used at his insistence and was designed for the purpose of minimizing his tax. . . . On the other hand, a taxpayer certainly may not receive the benefits of the installment sales provisions if, through his machinations, he achieves in reality the same result as if he had immediately collected the full sales price, or, in our case, the full liquidation proceeds. As we understand the test, in order to receive the installment sale benefits the seller may not directly or indirectly have control over the proceeds or possess the economic benefit therefrom. (Emphasis added)

Applying the above 2 emphasized principles to the case currently before the Commission, I believe that the petitioner met the first principle (i.e., she did not directly or indirectly have control over the proceeds) but not the second (i.e., she possessed the economic benefit therefrom).

Petitioner did not directly or indirectly have control over the liquidation proceeds. She established an irrevocable trust with a trustee to administer it in accordance with a written trust agreement. This autonomous entity controlled the proceeds in accordance with the terms of the trust agreement and petitioner did not retain a right of recapture. In the words of the court in Rushing (71-1 USTC at p.86,307), ". . . the intervening third party, the trustee, was neither a puppet nor an economic serf." In addition

the Court said (71-1 USTC at p.86,308), ". . .The trustee was no alter ego of the taxpayers, it had independent duties and responsibilities to persons other than the taxpayers." In this case, the other persons were the petitioner's husband if she were to die before the trust terminated, and Our Lady of Mount Carmel Church if both the petitioner and her husband died before the trust terminated.

However, in the current case, petitioner possessed the economic benefit from the trust's proceeds. The most significant difference between this case and the Rushing case is that petitioner's trust was established for her benefit and only after her death, or in 1990, for the benefit of others. In the Rushing case, the trusts were established for the benefit of the taxpayers' children.

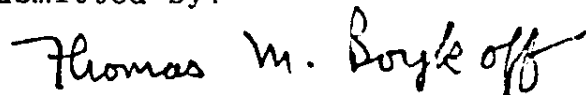
In the current case, the promissory note from James Benko and James Greco to Badger Cheese which was transferred to the trust was the trust's primary asset. Although the trustee testified that the trust was initially funded by \$100 cash, neither the trust instrument nor additional testimony or evidence at the hearing related to this amount.

At the time the promissory note was transferred to the trust, the number and amounts of payments required by Messrs. Benko and Greco on the note were identical to the number and amounts of payments required to be made by the trust to its beneficiary or beneficiaries. At the termination of the trust in 1990, the trust's only assets would be the paid-up promissory note and, possibly, an additional asset derived from the \$100 with which the trust was

originally funded. Thus, petitioner possesses the economic benefits of the promissory note in the same manner as if she had title to the note and executed a will providing, upon her death, for payments on the note to her husband for life and then to Our Lady of Mount Carmel Church.

Another significant difference between this case and the Rushing case is that in Rushing, the trustee became sole stockholder in the 2 corporations once the stocks were sold to it and actually functioned as sole stockholder for a period of time (admittedly, only a few days). In the case currently before the Commission, the transfer of petitioner's stock in the corporation to the trustee and the transfer of the stock by the trustee to the corporation in exchange for its assets occurred simultaneously, in fact, in the same agreement instrument. The Covelli trustee only functioned as sole stockholder of the corporation to transfer the stock, simultaneous with its receipt, to the corporation. It thus appears to me that the simultaneity of the petitioner's transfer of her stock to the trust and the corporation's transfer of its assets to the trust constituted constructive receipt of those assets by petitioner under the law, a taxable event to petitioner in the year of the transfer (1975).

Submitted by:



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Thomas M. Boykoff, Chairman