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CORPORATE REDEMPTION IN THE CONTEXT OF MARITAL DISSOLUTIONS: I.R.C. § 1041 AND ARNES v. UNITED STATES

Thomas Monaghan

Abstract: In Arnes v. United States the Ninth Circuit held that Temporary Treasury Regulation § 1.1041-1T, A-9 extended nonrecognition treatment to an ex-wife whose 50 percent interest in a corporation was redeemed pursuant to a divorce settlement, thereby leaving her ex-husband as the sole owner of the corporation. In doing so, the court not only contradicted the precedential treatment of bootstrap stock acquisitions but also misapplied its own interpretation of this regulation. This Note argues that a transaction such as that in Arnes falls outside of the scope of the regulation and, therefore, the precedent surrounding bootstrap acquisitions should have controlled.

Many divorce settlements involve the transfer of appreciated property from one spouse to the other. Typically, such direct transfers do not produce recognizable gain to either spouse. But what if the spouses use a corporate redemption to effect the transfer of appreciated stock? Consider the following example: H and W jointly own a corporation. Pursuant to their divorce settlement, they agree that H will take over the corporation. Rather than having H buy W’s stock directly, they agree that the corporation will redeem W’s stock for one million dollars. H consequently becomes 100 percent owner of the corporation. In such a case, who should pay the tax on the one million dollars which has been distributed from the corporation to W? The Ninth Circuit answered this question in Arnes v. United States, effectively finding that H would be taxed in the above scenario, while W would be afforded nonrecognition treatment. In so finding, the Ninth Circuit construed Temporary Treasury Regulation § 1.1041-1T, A-9, one of the regulations governing the nonrecognition of transfers pursuant to divorce.

This Note concludes that the Ninth Circuit erroneously applied its own interpretation of section 1.1041-1T, A-9 to the facts in Arnes. Part I examines the facts of Arnes as well as the Ninth Circuit’s decision. The Note then reviews the purpose of I.R.C. § 1041 as well as the law surrounding bootstrap stock acquisitions in parts II and III. Subsequently, this Note shows how Arnes contradicts settled precedent concerning tax consequences of bootstrap stock acquisitions. It then demonstrates how the Ninth Circuit’s interpretation of Temporary

2. 981 F.2d 456 (9th Cir. 1992).
Treasury Regulation § 1.1041-1T, A-9 is inconsistent with the actual transaction in *Ames*, rendering its decision inappropriate. Finally, this Note identifies the ideal types of transactions covered by section 1.1041-1T, A-9.

I. **ARNES v. UNITED STATES: WINDING UP A MARRIAGE**

John and Joann Arnes, husband and wife, formed Moriah Valley Enterprises, Inc. (Moriah) to operate a McDonald's franchise which they jointly owned. Moriah subsequently issued 5,000 shares of its stock in the joint names of John and Joann. Then, in January 1987, John and Joann separated. Upon learning of the impending dissolution of their marriage, McDonald's informed the couple that, after the divorce, John and Joann could no longer co-own the franchise.

John and Joann decided that John was more qualified to run the business, and therefore they agreed that John would become full owner of Moriah. The Arneses' divorce decree incorporated John and Joann's agreement to have Moriah redeem Joann's fifty percent interest in Moriah's outstanding stock for $450,000. In accordance with the terms of the property settlement, Joann sold her stock to Moriah, with John guaranteeing payment of the price. The facts suggest that John and Joann chose the form of this transaction for their respective business reasons.

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3. Brief for the Appellee at 3, Arnes v. United States, 981 F.2d 456 (9th Cir. 1992) (No. 91-35752).
4. Id.
5. Brief for the Appellant at 3, Arnes, 981 F.2d 456 (9th Cir. 1992) (No. 91-35752).
6. Id.
7. Brief for the Appellee at 4, Arnes (No. 91-35752).
8. Brief for the Appellant at 4, Arnes (No. 91-35752).
9. The guarantee provided that John would be "personally liable for any part of the obligation which shall not be paid for any reason by purchaser." Brief for the Appellee at 5, Arnes (No. 91-35752).
10. The government noted in its brief that Joann "received the benefit of the $450,000 redemption price, which, according to an affidavit of John's counsel, was substantially higher than John would have paid had she sold her stock directly to him." Brief for the Appellant at 21, Arnes (No. 91-35752). Moreover, Joann's brief noted that this transaction allowed John to avoid having to finance the direct purchase of Joann's interest with his own funds. Brief for the Appellee at 12, Arnes (No. 91-35752).
On her federal income tax return for 1988, Joann reported that she realized a profit of $447,500 on the sale of her stock. Later, acting upon the advice of her accountant, Joann claimed a refund for all taxes paid in the amount of $53,053. She based her claim on I.R.C. § 1041 and the regulations thereunder. The IRS disallowed Joann's claim, and she commenced suit.

The Ninth Circuit relied exclusively on Temporary Treasury Regulation § 1.1041-1T(c), A-9 to provide nonrecognition treatment to Joann’s gain on her redeemed stock. The Ninth Circuit interpreted section 1.1041-1T(c), A-9 to mean that section 1041 nonrecognition treatment applies when the nontransferring spouse’s obligation or liability is satisfied through the other spouse’s transfer to a third party. Thus, according to the Ninth Circuit, transfers to a third party that satisfy a liability of the nontransferring spouse will be considered “on behalf of” that spouse for purposes of section 1.1041-1T(c), A-9.

The court reasoned that Joann’s redemption of her stock to Moriah relieved John of an obligation because Joann could have sued John, as guarantor, directly for payment without first suing Moriah. Joann’s transfer to Moriah, according to the court, was therefore “on behalf of”

11. Joann had a basis in the Moriah stock of $2,500, and she sold this property for $450,000. Pursuant to I.R.C. § 1001(e), she computed her gain to be $447,500. See Brief for the Appellant at 5, Ames (No. 91-35752).
12. Brief for the Appellee at 6, Ames (No. 91-35752).
13. Id.
14. Id.
15. The Ninth Circuit stated: “The regulations, particularly as explained by Question and Answer 9, in Temp. Treas. Reg. § 1.1041-1T, demonstrate that the statute is meant to apply to situations such as this one, where a transfer is made on behalf one’s former spouse.” Ames, 981 F.2d at 460.
16. Id. at 459. The district court interpreted the regulation as meaning that the transfer is made “on behalf of” the nontransferring spouse when that spouse receives a “benefit.” See Ames v. United States, No. C90-728C, 1991 U.S. Dist. LEXIS 15632 at *1--*2 (W.D. Wash. Apr. 11, 1991). The district court found that John had received this requisite benefit because Joann’s transfer had settled any future community property claims that Joann could have asserted against him. Id. at *1.
17. See Ames, 981 F.2d at 459. In arriving at this definition of “on behalf of,” the Ninth Circuit relied on two cases. In the first, Old Colony Trust Co. v. Commissioner, 279 U.S. 716, 729 (1929), the Supreme Court determined that an employee realized income when his employer satisfied his income tax obligation. In Schroeder v. Commissioner, 831 F.2d 856, 859 (9th Cir. 1987), a corporation’s assumption of a shareholder’s bank loan in return for the shareholder’s redemption of stock produced a taxable constructive dividend to the shareholder.
18. Ames, 981 F.2d at 459. The court’s finding was based on a Washington statute, a Uniform Commercial Code provision which states: “‘Payment guaranteed’ or equivalent words added to a signature mean that the signor engages that if the instrument is not paid when due he will pay as according to its tenor without resort by the holder to any other party.” WASH. REV. CODE ANN. § 62A.3-416(1) (West 1966).
Consequently, the court recast this transaction under Temporary Treasury Regulation § 1.1041-1T, A-9, treating Joann’s transfer of her stock as a constructive transfer to John, followed by his transfer of this stock to Moriah. Thus, the court held that Joann’s transfer of stock was subject to section 1041 nonrecognition treatment, and she did not have to recognize gain on the redemption. The implication is that John should be treated as receiving the $450,000 himself from Moriah as a dividend in payment for the redeemed stock—a taxable constructive dividend.

II. I.R.C. § 1041: NONRECOGNITION TREATMENT FOR TRANSFERS SURROUNDING THE MARITAL RELATIONSHIP

Congress enacted section 1041 of the Internal Revenue Code to allow spouses and divorcing spouses to transfer assets between one another tax free. If section 1041 did not exist, spouses would have to recognize gains and losses on intra-marital dispositions of property. However, under this provision, gain or loss is not recognized upon the transfer of

19. The court initially asserted that “the obligation to purchase Joann’s stock was John’s, not Moriah’s.” Ames, 981 F.2d at 459. However, the court subsequently asserted that John’s guarantee of Moriah’s obligation to purchase Joann’s stock made him “liable, with Moriah, for the payments due Joann.” Id. (emphasis added).

20. Id. Note that the court did not fully describe the recast transaction. Pursuant to section 1.1041-1T(c), A-9, see infra note 27, the court treated Joann as conveying her shares directly to John, with him then transferring these shares to Moriah and receiving the $450,000 in return. However, this recasting then requires that John be treated as turning this $450,000 directly over to Joann. The court’s analysis failed to mention the quid pro quo that Joann received from her redemption “on behalf of ” John. See infra notes 93–97 and accompanying text.


22. Although the court decision did not directly address this issue, in its discussion of section 1.1041-1T(c), A-9, the court noted that “the regulation seems to provide for shifting the tax burden from one spouse to the other, where appropriate.” Id. at 458. Thus, it follows that if Joann is exempted from recognizing gain, this burden must shift to John. Indeed, if Joann avoids taxation, the only other potential source of tax on the transfer is John. In fact, the IRS immediately filed a protective income tax deficiency against John to ensure that someone would pay the tax on the $450,000. See id. at 457 (emphasis added).

23. See H.R. REP. No. 432, 98th Cong., 2d Sess., pt. 2, at 1491 (1984), reprinted in 1984 U.S.C.C.A.N. 697, 1134 (noting that Congress’s enactment of section 1041 was a direct response to United States v. Davis, 370 U.S. 65 (1962), in which the Supreme Court found that a husband’s transfer of appreciated stock to his wife constituted a taxable event which generated gain to him in an amount equal to the excess of the fair market value of the stock over his basis therein).

property to the taxpayer’s spouse, or, in the case of transfers which occur incident to divorce, to a former spouse.  

The Treasury Department published Temporary Treasury Regulation § 1.1041-1T to interpret section 1041. In addition to transfers between spouses, this regulation allows one spouse to transfer assets to a third party without incurring tax consequences when the transfer is “on behalf of” the other spouse. Both section 1041 and its regulations reflect a perception that property transfers within the marital context should be accorded special tax treatment.

A. The Purpose of I.R.C. § 1041

Congress enacted section 1041 out of an awareness of the special economic nature of the marital relationship. For example, in allowing for nonrecognition of gain or loss on transfers of property, section 1041 provides for the deferral of tax consequences. Under this provision, the transferee spouse assumes the transferor’s adjusted basis in the property. By providing for tax deferral, Congress intended to allow

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25. Section 1041(a) provides that “No gain or loss shall be recognized on a transfer of property from an individual to (or in trust for the benefit of)—(1) a spouse, or (2) a former spouse, but only if the transfer is incident to the divorce.” I.R.C. § 1041(a) (1988). Temporary Treasury Regulation § 1.1041-1T, A-6 (1992) defines a transfer “incident to divorce” as one which “occurs not more than one year after the date on which the marriage ceases” or a transfer which “is related to the cessation of the marriage.” Please note that for the purposes of this Note, the term “spouse(s)” will be used to cover both current spouse(s) as well as former spouse(s) as defined under section 1041(a).


27. Temporary Treasury Regulation § 1.1041-1T (1992) explains the ramifications of section 1041 in a question and answer format. Section 1.1041-1T(c), Q & A-9 reads as follows:

Q-9 May transfers of property to third parties on behalf of a spouse (or former spouse) qualify under section 1041?

A-9 Yes. There are three situations in which a transfer of property to a third party on behalf of a spouse (or former spouse) will qualify under section 1041, provided all other requirements of this section are satisfied. The first situation is where the transfer to the third party is required by a divorce or separation instrument. In the three situations described above, the transfer of property will be treated as made directly to the nontransferring spouse (or former spouse) and the nontransferring spouse will be treated as immediately transferring the property to the third party. The deemed transfer from the nontransferring spouse (or former spouse) to the third party is not a transaction that qualifies for nonrecognition of gain under section 1041.

(Emphasis added). The Ninth Circuit found the first situation, where the transfer to the third party is required by a divorce or separation instrument, to be controlling in Arnes. Arnes v. United States, 981 F.2d 456, 458 (9th Cir. 1992).

28. See Arnes, 981 F.2d at 458 (acknowledging that the policy of section 1041 is “to defer recognition until the property is conveyed to a party outside the marital unit”).

spouses the freedom to determine who will bear the inevitable tax burden. Consistent with this premise, commentators have recognized that section 1041 facilitates tax planning in divorce settlements. Section 1041 also reflects Congress’s belief that spouses should be treated as a “single economic unit.” Section 1041 thus postpones the tax burden accruing to this property until the transferee disposes of it outside of the marital unit.

B. Regulation Section 1.1041-1T(c), A-9 Before Arnes: Private Letter Ruling 90-46-004

Private Letter Ruling 90-46-004 provides the only interpretation of section 1.1041-1T(c), A-9 prior to Arnes v. United States. In the Ruling, a husband, pursuant to a divorce decree, transferred stock in a corporation to his ex-wife, followed by the immediate redemption of this stock by the corporation. The corporation paid with a promissory note that the husband guaranteed. The Internal Revenue Service (IRS) found that in the absence of section 1041, this would have been viewed as a redemption of the stock from the husband followed by his transfer of the proceeds to his ex-wife.

30. The House Committee Report explained that the goal of section 1041 was to “make the tax laws as unintrusive as possible with respect to relations between spouses.” H.R. REP. No. 432, supra note 23 at 1492, reprinted in 1984 U.S.C.C.A.N. at 1135. See also Priv. Ltr. Rul. 90-46-004 (July 20, 1990) (“Under section 1041, Congress gave taxpayers a mechanism for determining which of the two spouses will pay the tax upon the ultimate disposition of the asset.”).


33. See Arnes v. United States, 981 F.2d 456, 458 (9th Cir. 1992). This underlying rationale provides the justification for other nonrecognition provisions such as those surrounding corporate reorganizations, I.R.C. §§ 354–468 (1976). See BORIS I. BITTKER & JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS ¶ 14.01, at 14-3 (5th ed. 1987); see also Laurie L. Malman, Unfinished Reform: The Tax Consequences of Divorce, 61 N.Y.U. L. REV. 363, 387 (1986) (noting that modern divorce laws support the perception that “marriage creates a community of interests economically similar to those of a partnership or joint venture”).


35. Id. The husband’s purpose presumably was to avoid paying his ex-wife from his own assets.

36. Id.

37. Id.
However, the IRS held that section 1041 provides spouses the freedom to choose the tax consequences of property transfer.38 Pursuant to this policy, the IRS found that determining whether a spouse's transfer of property to a third party should be given nonrecognition treatment under section 1.1041-1T(c), A-9 depends on whether the nontransferring spouse exercises "sufficient ownership over the property to be considered a transferee."39 Thus, the IRS defined "on behalf of" as involving those transactions where the nontransferring spouse directs that the property be transferred to a third party.40 In applying its interpretation, the IRS determined that the ex-wife exercised sufficient control over the stock to be treated as the owner, thereby incurring the tax liability.41

III. THE TAX TREATMENT OF BOOTSTRAP STOCK ACQUISITIONS IMPLEMENTED BY CORPORATE REDEMPTIONS

The structure of the Arnese's transaction conforms to the standard "bootstrap" stock acquisition. In a typical bootstrap acquisition of a closely held corporation, the corporation will purchase all of the stock of one of two shareholders, leaving the other shareholder as sole owner of the company.42 Such transactions generally produce consistent tax consequences to both the selling and unredeemed shareholders.43

38. The IRS found that section 1041 lets spouses be:
free to negotiate between themselves whether the "owner" spouse will first sell the asset, recognize the gain or loss, and then transfer to the transferee spouse the proceeds from that sale, or whether the owner spouse will first transfer the asset to the transferee spouse who will then recognize gain or loss upon its subsequent sale.
*Id.*

39. *Id.*

40. *Id.* This interpretation of "on behalf of" differs from the Ninth Circuit's concept of obligation satisfaction. See supra note 17.

41. *Id.; see also infra note 117.*

42. The remaining shareholder will be identified as the unredeemed shareholder for purposes of this Note. Courts and commentators often refer to this remaining shareholder as the continuing or purchasing shareholder. There can be more than one redeemed shareholder in a bootstrap acquisition.

43. See Everett L. Jassy, The Tax Treatment of Bootstrap Stock Acquisitions: The Redemption Route vs. The Dividend Route, 87 HARV. L. REV. 1459, 1460 n.1 (1974). Jassy's article provides a summary of the tax consequences of corporate redemptions that is beyond the scope of this Note.
A. The Tax Treatment of the Selling Shareholder in a Bootstrap Acquisition

Section 302(b) of the Internal Revenue Code treats redemption distributions as payments in exchange for stock if they are “in complete redemption of all of the stock of the corporation owned by the shareholder.” In a common bootstrap stock acquisition, the redemption will usually qualify under section 302(b)(3). This termination of the selling shareholder’s interest in the corporation will produce taxation on the gain received through the transaction.

B. The Tax Treatment of the Unredeemed Shareholder in a Bootstrap Stock Acquisition

Unlike the selling shareholder, the unredeemed shareholder in a bootstrap acquisition does not receive a direct benefit. While the selling shareholder generally realizes cash income, the unredeemed shareholder often receives only “an increase in his proportionate interest in the corporation.” Beyond this indirect benefit, the unredeemed shareholder generally does not receive an economic benefit, because the value of the corporation will be reduced by the amount distributed to the selling shareholder. The issue is then whether this indirect benefit should produce a constructive dividend, taxable to the unredeemed shareholder. A standard common law doctrine has emerged in the case law that addresses this question.

45. Jassy, supra note 43, at 1461 n.3.
46. Id. at 1461. If the corporation issues a note to the seller, the seller may be able to report the gain using the installment method. See I.R.C. § 453 (1990).
47. Jassy, supra note 43, at 1463.
48. Id. This principle can be best illustrated by an example. Assume that A and B each own 50 percent of Ajax Corporation, which is worth $1,000,000. A wants to become the sole shareholder, so A and B agree to have Ajax redeem B’s interest for $500,000. After the transaction occurs, A possesses 100 percent of Ajax. However, the value of A’s shares has not increased, since Ajax is now worth only $500,000. Hence, A has not realized any economic benefit due to this transaction. Cf. Ames v. United States, 981 F.2d 456, 459 (9th Cir. 1992).
1. The Primary Unconditional Obligation Test

Under present law, an unredeemed shareholder will not realize a constructive dividend unless the corporate redemption relieves that shareholder of a primary and unconditional obligation. In assessing whether such an obligation exists, courts often resolve doubts in favor of the unredeemed shareholder. Holsey v. Commissioner generally is recognized as seminal in the formation of the primary unconditional obligation test. In Holsey, a shareholder owning fifty percent of a corporation secured an option to purchase the other fifty percent from the only remaining shareholder. Instead of exercising this option, he assigned it to the corporation, which redeemed the remaining stock and thereby made him the sole shareholder. The Third Circuit concluded that no constructive dividend should be imposed, because the corporation assumed "merely" an option that did not discharge any personal obligation of the shareholder, and therefore, did not benefit him in any "direct sense." The court disregarded the indirect benefit constituted by

50. See Sullivan v. United States, 363 F.2d 724, 728 (8th Cir. 1966), cert. denied, 387 U.S. 905 (1967); Bennett v. Commissioner, 58 T.C. 381, 387 (1972); Kobacker v. Commissioner, 37 T.C. 882, 894 (1962); Rev. Rul. 69-608, 1969-2 C.B. 42 (1969). Anything less than such an obligation would not provide the economic benefit required of a constructive dividend. See infra notes 60-75 and accompanying text. It is also important to note that if a shareholder already has acquired the stock, and the corporation takes over his payment obligation, a constructive dividend will be realized. See Wall v. United States, 164 F.2d 462, 464 (4th Cir. 1947). For a complete analysis and criticism of this doctrine, see generally Michael B. Lang, Dividends Essentially Equivalent to Redemptions: The Taxation of Bootstrap Stock Acquisitions, 41 TAX L. REV. 309 (1986).

51. See e.g., Priester v. Commissioner, 38 T.C. 316 (1962). In Priester, a minority shareholder obligated himself to purchase all of the shares of the only other shareholder. Id. at 318. When he realized he lacked sufficient funds for this purchase, he assigned the purchase contract to a third party who purchased the shares and later redeemed them to the corporation for a predetermined price. Id. at 318-20. Even though the shareholder gave his collateralized guarantee to the third party that the corporation would buy these shares back later, the Tax Court held that this third party, rather than the corporation, satisfied the shareholder's personal obligation. Id. at 326. Consequently, the shareholder did not realize a constructive dividend. Id. The important inquiry was whether the shareholder directly received any financial or economic gain. Id.; see also Enoch v. Commissioner, 57 T.C. 781 (1972). In Enoch, the court held that no constructive dividend resulted when a corporation relieved a shareholder of his agreement that he and/or his nominee would purchase the outstanding stock of a corporation, since, by providing for this possible nominee, the purchaser did not become primarily and unconditionally obligated. Id. at 791-92; see Jassy, supra note 43 at 1466-67.

52. 258 F.2d 865 (3d Cir. 1958).
53. See Jassy, supra note 43, at 1463.
54. Holsey, 258 F.2d at 866.
55. Id. at 867.
56. Id. at 868.
his increase in ownership.\textsuperscript{57} Thus, the Holsey court recognized that the obligation relieved by the corporation must produce "direct pecuniary benefit" to the unredeemed shareholder in order to justify taxation as a constructive dividend.\textsuperscript{58}

2. \textit{The Guarantee Obligation}

In applying the primary unconditional obligation test, the IRS and courts distinguish between primary and secondary obligations. Generally, if an unredeemed shareholder in a bootstrap acquisition is primarily liable for the purchase of the remaining stock, then this shareholder will realize a constructive dividend if the corporation purchases these outstanding shares in lieu of his obligation.\textsuperscript{59} A shareholder's guarantee of a corporation's redemption of shares, however, involves only secondary liability. Relief of a guarantee does not confer economic benefit, and therefore, such obligations will not put an unredeemed shareholder in danger of receiving a constructive dividend when a corporation redeems a seller's shares.\textsuperscript{60} The IRS stated this explicitly in situation 5 of its Ruling 69-608.\textsuperscript{61} Case law dealing with such guarantees has produced a similar result.\textsuperscript{62} Despite this

\textsuperscript{57} Id.

\textsuperscript{58} Id. Cf. Sullivan v. United States, 363 F.2d. 724 (8th Cir. 1966). In Sullivan, a shareholder who owned 62 percent of the stock of a corporation entered into an executory obligation to purchase the remaining 38 percent. However, he had the corporation redeem this stock instead. \textit{Id.} at 725-26. The court defined the unredeemed shareholder's obligation to purchase this stock as primary and unconditional and consequently held that relief of this obligation produced an economic benefit which warranted taxation as a constructive dividend. \textit{Id.} at 728-29.

\textsuperscript{59} See, e.g., Sullivan, 363 F.2d at 729.

\textsuperscript{60} See Bittker \& Eustice, \textit{supra} note 33, ¶ 9.07 at 9-36; see also Jassy, supra note 43, at 1465 ("The requirement of primary [liability] has saved the continuing shareholder from liability where he has guaranteed corporate obligations issued in redemption of stock.").

\textsuperscript{61} Rev. Rul. 69-608, 1969-2 C.B. 42, 44 (1969) (situation 5). In that example, two sole shareholders of a corporation agreed that upon the death of one of them the corporation would redeem the decedent's stock. In the agreement, each guaranteed that the survivor would purchase the decedent's shares in the event that the corporation did not redeem them. Upon the death of one of them, the corporation redeemed the decedent's shares, relieving the unredeemed shareholder of his guarantee obligation. The IRS determined that the survivor's guarantee had only made him "secondarily liable." Due to the lack of a primary obligation, the IRS found that he received no constructive dividend. \textit{Id.}

\textsuperscript{62} See Edenfield v. Commissioner, 19 T.C. 13 (1952). In Edenfield, shareholders put up their shares of stock in a corporation as security for the corporation's assumption of mortgage indebtedness. The Tax Court held that by "merely giving the corporation . . . the benefit of the use of their collateral," this mortgage indebtedness did not become the shareholders' indebtedness. \textit{Id.} at 21. Consequently, they did not receive a constructive dividend when the corporation assumed this indebtedness. \textit{Id.; see also} Bennett v. Commissioner, 58 T.C. 381 (1972). In Bennett, a shareholder
principle, the Ninth Circuit found that John Arnes’s guarantee involved primary liability, thereby exposing him to a constructive dividend.

IV. **ARNES CONTRADICTS ESTABLISHED PRECEDENT REGARDING THE TAX TREATMENT OF CORPORATE REDEMPTIONS**

If section 1041 did not apply in *Arnes*, the income tax consequences would have been clear. Since Joann’s redemption of her stock completely terminated her interest in Moriah, the Internal Revenue Code would treat this redemption as a sale of her stock. She would have been taxed on the amount by which her realized proceeds exceeded her basis in the stock. Not only would Joann have been liable, precedent clearly establishes that John would not have been taxed on the theory that he received a constructive dividend.

A. **John Arnes’s Guarantee of Moriah’s Redemption Does Not Satisfy the Primary Unconditional Obligation Test**

When the Ninth Circuit shifted the tax burden to John, it contradicted precedents affirming the wide latitude generally afforded to unredeemed shareholders in corporate redemptions. Under the typical analysis of corporate redemptions, the determinative question regarding whether or not to impose a constructive dividend upon John would be whether Moriah relieved him of a primary or secondary obligation. John’s guarantee of Moriah’s primary obligation to purchase Joann’s stock personally guaranteed a bank loan obtained by his corporation. *Id.* at 383. He then used these funds to facilitate his direct purchase of the outstanding stock of the corporation. *Id.* The Tax Court found that the corporation, rather than the shareholder, had assumed primary liability for this loan. *Id.* at 385. Therefore, the corporation’s advancement of the funds whereby he was able to purchase the remaining shares was not “essentially” equivalent to a dividend. *Id.* at 389. Instrumental in the court’s decision was the fact that the shareholder received no “financial or economic gain.” *Id.* at 386.

63. *See supra* notes 44–46 and accompanying text.

64. *See Brief for the Appellant* at 12, *Arnes v. United States*, 981 F.2d 456 (9th Cir. 1992) (No. 91-35752). As the government noted in its brief, Joann originally applied the rules regarding recognition of gain on property in her 1988 tax return. *Id.*

65. *See supra* note 51 and accompanying text.

constitutes merely a secondary obligation which cannot provide the grounds for a constructive dividend.\(^6\)

Rather than deciding that section 1.1041-1T(c), A-9 does not depend upon the dichotomy between primary and secondary obligations, the Ninth Circuit attempted to attribute the status of a primary obligor to John.\(^6\) The court initially attempted to do this by simply asserting that "the obligation to purchase Joann's stock was John's, not Moriah's."\(^6\) However, this assertion contradicts the fact that John and Joann mutually agreed to have Moriah, not John, accept such an obligation.\(^7\) Under this agreement, John's liability was clearly limited to the role of guarantor.\(^7\) The Ninth Circuit's assertion inexplicably disregarded the literal terms of the Arneses' property settlement.\(^7\)

After its attempt to attribute primary liability to John, the court seemingly contradicted itself by acknowledging John's guarantor status.\(^7\) The court, however, equated John's guarantor status with Moriah's primary liability under a Washington Commercial Code provision which liberally enables a promisee to sue a guarantor.\(^7\) However, by equating the obligation of a guarantor with that of a primary obligor, the court ignored the precedent holding that a guarantor of a corporate redemption is not considered a primary obligor.\(^7\) A guarantee possesses an amorphous quality which other courts have found insufficient to justify taxation when relieved by a third party.\(^7\)

B. John's Indirect Benefit Is Not Sufficient To Warrant Taxation

The Arneses' transaction provided John with no immediate economic gain, and he therefore should not be taxed on realization of a constructive dividend. In determining whether an unredeemed shareholder received a

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67. See supra notes 59–62 and accompanying text.
68. See Arnes v. United States, 981 F.2d 456, 459 (9th Cir. 1992).
69. Id.
70. Id. at 457.
71. Id. at 459.
72. Although courts can recast the form of transactions, they will only do so when there are substantial reasons for doing so. See infra notes 110–17 and accompanying text.
73. Arnes, 981 F.2d at 459.
74. See supra note 18. By first stating that this was John's obligation and then subsequently acknowledging that John was the guarantor of Moriah's obligation, the court's analysis appears paradoxical.
75. See supra notes 59–62 and accompanying text.
76. Id.

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distribution essentially equivalent to a dividend, precedent requires that
the distribution provide him with a "direct" economic benefit.\textsuperscript{77} John
received no direct economic benefit beyond the increase in his ownership
status. Before the redemption, John possessed fifty percent of a
corporation worth $900,000.\textsuperscript{78} After Moriah’s distribution of corporate
assets to Joann as payment for her redeemed stock, he possessed 100
percent of a corporation which was now only worth $450,000.\textsuperscript{79} This
appreciation in ownership interest is generally considered too abstract to
receive treatment as a constructive dividend.\textsuperscript{80} Joann stands in clear
contrast to John: while he realized no gain since the value of his stock
did not increase, she received cash and debt forgiveness for her
redemption.\textsuperscript{81}

V. THE NINTH CIRCUIT SHOULD NOT HAVE EXTENDED THE
SCOPE OF REGULATION SECTION 1.1041-1T(C), A-9 TO
THE TRANSACTION IN ARNES

If the tax consequences which would have occurred in the absence of
section 1041 treatment are clear, it logically follows that the Ninth
Circuit gave Joann non-recognition treatment solely because of the
exception provided in section 1.1041-1T(c), A-9. However, in doing so,
the court misapplied its own definition of the temporary regulation. In
determining whether or not Joann’s redemption fell within the purview
of this regulation, the Ninth Circuit attempted to define the term “on
behalf of”\textsuperscript{82} by reference to two cases: \textit{Old Colony Trust Co. v.
Commissioner}\textsuperscript{83} and \textit{Schroeder v. Commissioner}.\textsuperscript{84} However, the Ninth
Circuit misapplied these cases to the Arnese’s transaction.

\textsuperscript{77} See \textit{supra} notes 50–62 and accompanying text.
\textsuperscript{78} Arnese v. United States, 981 F.2d 456, 460 (9th Cir. 1992).
\textsuperscript{79} Id.; see \textit{supra} note 48.
\textsuperscript{80} See \textit{supra} notes 50–58 and accompanying text. Note that John’s gain is even more abstract
than the appreciation of the economic value of corporate shares (a gain which is not taxable until this
gain is transferred to the taxpayer’s ex-corporate net worth. \textit{See Eisner v. Macomber}, 252 U.S. 189,
194–95 (1920)). John did not even experience this increase in the value of his shares; his interest is
still worth only $450,000.
\textsuperscript{81} Arnese, 981 F.2d at 460.
\textsuperscript{82} The court noted, “Whether the redemption of Joann’s stock can be construed as a transfer to
John, pursuant to the regulation example in A-9, depends upon the meaning of ‘on behalf of.’”
\textit{Arnese}, 981 F.2d at 459.
\textsuperscript{83} 279 U.S. 716 (1929).
\textsuperscript{84} 831 F.2d 856 (9th Cir. 1987).
A. Old Colony Trust Is Inapplicable to the Facts in Arnes

Because the transaction in *Arnes* is different from the transaction in *Old Colony Trust*, the Ninth Circuit’s reliance on that case was misplaced. In *Old Colony Trust*, the Supreme Court reasoned that the discharge of an employee’s obligation was equivalent to a transaction in which the employer directly gives an employee cash as compensation, and the employee, in turn, transmits this payment to a third party. Although the *Arnes* court reasonably characterized such a transaction as being made “on behalf of” the person relieved of the obligation, the transaction in *Arnes* does not fit into the *Old Colony Trust* mold.

1. The Arneses’ Transaction Is Inconsistent with the Paradigm of Old Colony Trust

*Arnes* involved a triangular transaction which completely differs from the transaction in *Old Colony Trust*. In *Old Colony Trust*, the court decided that a transfer that produced income by relieving the employee of his binding obligation to an external third party was a transfer on the employee’s behalf. However, Joann’s transfer to Moriah did not relieve John of any such obligation to a third party. In contrast to the employee in *Old Colony Trust*, John never had any independent obligation to Moriah.

Besides the difference in form, the obligation relieved by the employer in *Old Colony Trust* differs substantively from the obligation relieved in *Arnes*. In *Old Colony Trust*, the employee had a binding personal obligation to the IRS to pay his income taxes. He consequently realized income to the extent that he would have had to pay the IRS out of his own net worth. However, in *Arnes*, Joann’s transfer to Moriah did not effect any such measurable debt relief to John. Despite the court’s attempts to equate John’s liability with Moriah’s, John could still have sought indemnification from Moriah in the event that he was forced to pay on Moriah’s default. The relief of John’s guarantee did

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85. *Old Colony Trust Co.*, 279 U.S. at 729.
86. See supra note 17 and accompanying text.
87. See *Old Colony Trust Co.*, 279 U.S. at 729.
88. *Id*.
89. *Id*.
90. See supra notes 68–74 and accompanying text.
Corporate Redemption in Marital Dissolutions

not produce the economic benefit associated with the discharge of indebtedness envisioned in \textit{Old Colony Trust}. Thus, John should not have been subject to taxation.

2. \textit{The Quid Pro Quo Between Joann and Moriah Renders Inapposite Old Colony Trust}

Another important distinction between \textit{Ames} and \textit{Old Colony Trust} lies in the fact that Joann, unlike the employer in \textit{Old Colony Trust}, received property in return for her transfer. In \textit{Old Colony Trust}, the employer transferred money to the IRS and received nothing in return from the IRS. Consequently, the Supreme Court found that the consideration for this payment consisted solely in the satisfaction of the employee's obligation. This fact triggered the taxable event to the employee, for the distribution could thus only have been made as compensation to the employee. Unlike the employer in \textit{Old Colony Trust}, however, Joann received property in return from Moriah: she redeemed her stock for the $450,000 payment promised to her by Moriah. This illustrates that her transfer to Moriah was not made "on behalf of" John but rather for her own gain. The Ninth Circuit's language in \textit{Ames} reflects its difficulty in equating this transfer between Moriah and Joann with the one-sided transaction between the employer and employee in \textit{Old Colony Trust}. The reciprocal exchange between Joann and Moriah should not have been recast by the court as a transfer by Joann on John's behalf.

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that this fact established John's liability as secondary. Reply Brief for the Appellant at 10, \textit{Ames v. United States}, 981 F.2d 456 (9th Cir. 1992) (No. 91-35752).

92. \textit{See supra} notes 50–62 and accompanying text. Only primary obligations provide the direct economic benefit which is sufficient to warrant taxation when relieved.


94. \textit{Id.}

95. \textit{Id.}


97. At one point, the court noted, "John Ames had an obligation to Joann Ames that was relieved by Moriah's payment to Joann." \textit{Id.} at 459 (emphasis added). However, the court subsequently stated: "We hold that Joann's transfer to Moriah did relieve John of an obligation." \textit{Id.} (emphasis added). It is important to remember that section1.1041-1T(c), A-9 states only that the transfer be made by one spouse to a third party on behalf of the other spouse; it does not anticipate that there will be a corresponding transfer back from that third party to the transferring spouse.
B. The Ninth Circuit Erred in Its Analysis of Schroeder v. Commissioner

Although the Ninth Circuit apparently rejected the government's argument that the line of cases surrounding the taxation of bootstrap acquisitions should govern in *Ames*, it nevertheless relied upon *Schroeder v. Commissioner*, a Ninth Circuit case which drew heavily upon the reasoning set forth in those cases. In *Schroeder*, the taxpayer obtained a loan to purchase stock in a corporation. The corporation later assumed this bank note in exchange for redemption of part of the taxpayer's stock. The Ninth Circuit held that this redemption of the taxpayer's stock constituted a constructive dividend to the taxpayer since the corporation assumed a loan for which he had a primary obligation. The court rejected the taxpayer's reliance upon *Bennett v. Commissioner*, in which the tax court found no constructive dividend had been realized by the petitioner, because in that case "the loan relieved was made directly to the corporation, not the taxpayer." Thus, the Ninth Circuit recognized that the personal guarantee issued by the shareholder in *Bennett* did not rise to the level of a primary obligation. However, in *Ames*, the Ninth Circuit defined John's

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98. Although the Ninth Circuit acknowledged the government's citation of *Holsey v. Commissioner*, 258 F.2d 865 (3d Cir. 1958), the court did not respond to the holding in that case (increases in ownership percentage are insufficiently direct to mandate taxation as a constructive dividend to the purchasing shareholder). See *Ames*, 981 F.2d at 459.

99. 831 F.2d 856 (9th Cir. 1987).

100. Id. at 857.

101. Id. at 858.

102. See id. at 859. Unlike *Ames*, where John only guaranteed Moriah's purchase of Joann's stock, the taxpayer in *Schroeder* personally executed the loan agreement. The court in *Ames* recognized that the critical issue in *Schroeder* was that the corporation assumed a loan for which the taxpayer was primarily obligated: "The taxpayer had the primary obligation to repay the loan, and the corporation's assumption of the loan relieved the taxpayer of that obligation." *Ames*, 981 F.2d at 459 (emphasis added). While the Ninth Circuit obviously bought into the primary/secondary obligation dichotomy to form its definition of section 1.1041-1T, A-9, it failed to apply this dichotomy correctly to John's particular obligation.

103. 58 T.C. 381 (1972).

104. Schroeder, 831 F.2d at 860 n.7.

105. See supra note 62.

106. The Ninth Circuit noted that "Schroeder's reliance on *Bennett v. Commissioner*, 58 T.C. 381 (1972), is unfounded. In *Bennett*, the loan was made directly to the corporation, not the taxpayer. Here, the loan to Schroeder represented his primary obligation to pay for the . . . stock." *Schroeder*, 831 F.2d at 860 n.7. Similarly, in *Ames*, Joann made an agreement to sell her stock directly to Moriah, not to John.
guarantee as involving primary liability.\textsuperscript{107} In doing so, the court contradicted its earlier reasoning in \textit{Schroeder}. 

Contrary to the court's application, the \textit{Schroeder}-based definition of "on behalf of" should only encompass those situations in which a spouse's transfer to a third party relieves the other spouse of a primary obligation. The court should have recognized, as it did in \textit{Schroeder}, that a shareholder's guarantee of the corporation's obligation is not such an obligation. Thus, to be consistent with its own precedent, the Ninth Circuit should not have effectively imposed a constructive dividend upon John.

The inconsistencies between \textit{Arnes} and both \textit{Old Colony Trust} and \textit{Schroeder} illustrate that, as defined by the Ninth Circuit, section 1.1041-1T, A-9 does not apply to the Arneses' transaction. Therefore, the Ninth Circuit should have treated their transaction as a typical corporate redemption, with Joann receiving the taxable gain.

VI. THE NINTH CIRCUIT'S FAILURE TO RESPECT THE FORM OF THE ARNESES' TRANSACTION YIELDS INEQUITY AND UNFAVORABLE POLICY RAMIFICATIONS

Beyond the Ninth Circuit's misapplication of precedent in \textit{Arnes}, there are several compelling reasons why the court should not have recast this transaction as a section 1041 transfer from Joann to John. First, \textit{Arnes} undercuts the general policy of allowing spouses the freedom to determine who will bear the tax consequences of appreciated property.\textsuperscript{108} The court should not have used section 1.1041-1T, A-9 to recast this transaction to which John and Joann mutually agreed.\textsuperscript{109}

Courts can recast the form of a transaction to mirror its real economic substance.\textsuperscript{110} This premise applies especially to corporate redemptions since I.R.C. § 302(b)(1) forces the decisionmaker to ask if the corporate

\textsuperscript{107} See supra notes 68–74 and accompanying text.
\textsuperscript{108} See supra notes 30–31 and accompanying text.
\textsuperscript{109} See supra notes 7–10 and accompanying text.
\textsuperscript{110} See Gregory v. Helvering, 293 U.S. 465, 470 (1935) (establishing the rule that the incidence of taxation depends upon the substance of the transaction); Higgins v. Smith, 308 U.S. 473 (1940); Commissioner v. Court Holding Co., 324 U.S. 331, 334 (1945); BITTKER & EUSTICE, supra note 33, ¶ 14.51 at 14-170; see, e.g., Wolf v. Commissioner, 357 F.2d 483, 485 n.2 (9th Cir. 1966) (holding that despite compliance with the literal terms of I.R.C. § 351, the transaction in question was recast by the Ninth Circuit according to the court's perception of the "substance and net effect of the transaction").
redemption is "essentially" a dividend.\textsuperscript{111} However, as demonstrated by precedent, the courts have determined that, in essence, no economic benefits accrue to the unredeemed shareholder in a corporate redemption unless he is relieved of a primary and unconditional obligation.\textsuperscript{112} This principle certainly applies to John since he received no increase in his net worth as a result of Joann's redemption. Thus, in the Arneses' transaction, form is congruent with substance: this was a sale from Joann to Moriah.

Besides restructuring according to economic realities, courts may restructure upon a determination that the transaction contradicts the "negotiation substance" of a transaction.\textsuperscript{113} This theory argues that if the negotiations surrounding a transaction are consistent with the form of that transaction, then that form should determine the tax consequences.\textsuperscript{114} This non-economic scrutiny appears to have been adopted by the IRS in its own definition of section 1.1041-1T, A-9.\textsuperscript{115} The IRS ruled that to treat a transfer of property to a third party under section 1041, one spouse must have acted as "owner" by directing that the other make this transfer.\textsuperscript{116} Such a determination must presumably be based upon an examination of the particular facts of a case.\textsuperscript{117}

However, the Arneses' transaction withstands this non-economic scrutiny as well. Examination of the negotiation substance of this transaction suggests that both Joann and John chose this form of transaction for legitimate economic reasons.\textsuperscript{118} By freely entering into a transaction for which she had a legitimate business purpose, Joann acted sufficiently as the "owner" of the stock. Therefore, she should not be

\begin{footnotesize}
\begin{enumerate}
\item See supra note 49 and accompanying text.
\item See supra notes 50–62 and accompanying text.
\item See Charles I. Kingson, The Deep Structure of Taxation: Dividend Distributions, 85 YALE L.J. 861, 883 (1976). Kingson identifies the primary source of this theory as Commissioner v. Court Holding Co., 324 U.S. 331 (1945), which found that a sale of an apartment building was conducted by a corporation rather than its shareholders since the negotiations leading up to this sale were conducted solely on the corporation's behalf.
\item Kingson, supra note 113, at 884. Although I.R.C. § 336(a) has overruled the result in Court Holding Co., the case still represents the general principle of form versus substance. See BITTKER & EUSTICE, supra note 33, ¶ 11.07 at 11-31 n.83.
\item See supra notes 38–41 and accompanying text.
\item See supra note 39 and accompanying text.
\item The IRS applied such a fact-specific analysis. It noted: "In the present case, Ex-Wife agreed to immediately transfer the stock to the corporation. Thus, by agreeing to immediately redeem the stock, the wife exercised a form of 'ownership' and under Q&A-9, became the party responsible for the tax consequences . . . ." Priv. Ltr. Rul. 90-46-004 (July 20, 1990).
\item See supra note 10. Even if this were a contested issue, the court did not consider the negotiation substance of the Arneses' transaction in its decision.
\end{enumerate}
\end{footnotesize}
able now to disavow the form of this transaction and thereby escape the
tax consequences. In *Schroeder v. Commissioner*, the Ninth Circuit
held that the shareholder had business reasons for choosing the form of
his transaction, and he therefore could not argue subsequently that he
was "immunized from tax because the transaction was really something
which never occurred." The court should not have allowed Joann to
receive the favorable post-transaction restructuring which it proscribed in
*Schroeder*.

Clearly the *Ames* decision has the practical effect of producing
unpredictability in divorce settlements involving closely held
corporations. Practitioners representing spouses who have had their
interests in a corporation redeemed pursuant to a divorce settlement will
certainly attempt to characterize the redemption as made "on behalf of"
the unredeemed spouse. Moreover, spouses in other jurisdictions must
now wonder if their jurisdiction will follow *Ames*. Thus, *Ames*
not only casts uncertainty upon past settlements but also frustrates the tax
planning aspects of section 1041.

Finally, the court’s disruption of the form of the Arneses’ transaction
produced highly inequitable results. Joann, who received a large cash
consideration for her stock, took this payment tax-free, whereas John, the
passive party in this transaction who received no economic gain, must
struggle with this heavy tax burden.

**VII. IDEALLY, WHAT TRANSACTIONS SHOULD REGULATION
SECTION 1.1041-1T(C), A-9 COVER?**

The source of the Ninth Circuit’s error in *Ames* lies not in its
definition of "on behalf of" as found in section 1.1041-1T(c), A-9, but
rather in its application of that definition to the Arneses’ particular
transaction. In fact, the Ninth Circuit produced a reasonable, if

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119. 831 F.2d 856 (9th Cir. 1987).
120. Id. at 859.
121. After *Ames*, spouses who received additional compensation in return for bearing the
anticipated tax burden of appreciated stock which is redeemed, see *supra* note 10, may now be able
to claim a refund pursuant to section 1.1041-1T, A-9, thereby receiving a windfall similar to Joann’s.
122. *See supra* notes 30–31 and accompanying text.
123. *See supra* note 22 and accompanying text. The *Ames* decision infers that John will bear the
tax burden.
somewhat incomplete, definition of this phrase. Temporary Treasury Regulation § 1.1041-1T(c), A-9 should be interpreted to extend non-recognition treatment to transfers to third parties which produce the type of economic benefit associated with constructive dividend taxation, whether this is through relief of a primary obligation or actual receipt of property. Another justifiable basis for shifting the tax burden through this regulation would be when the negotiations surrounding the disposition of the property identify one spouse as the clear owner.

Certainly one type of transfer that should be considered as made to a third party "on behalf of" the nontransferring spouse is when the transfer relieves the nontransferring spouse of a primary obligation. Such a transfer provides the nontransferring spouse with a direct benefit which has the ascertainable economic value recognized as sufficient grounds for taxation. An example of such a situation would be where one spouse directly owes money to a creditor and the other spouse transfers appreciated stock directly to the bank in discharge of that spouse's obligation.

Where the transfer to the third party results in a direct receipt of cash by the nontransferring spouse, this should also be considered "on behalf of" the nontransferring spouse. For example, if a divorce settlement provides that one spouse sell property to a third party with the cash proceeds going to the nontransferring spouse, then this transfer should

124. The Ninth Circuit defined "on behalf of" to mean transfers by a spouse to a third party which satisfy an obligation of the nontransferring spouse to that third party. See supra notes 16–17 and accompanying text.

125. Economic benefit is a general characteristic of constructive dividends to unredeemed shareholders. See supra notes 50–63 and accompanying text.

126. Such a result would produce an interpretation of "on behalf of" which would be consistent with not only Old Colony Trust but also with the line of cases involving constructive dividend treatment to unredeemed shareholders in corporate redemptions. See supra notes 47–63 and accompanying text. If the Ameses had structured their property settlement in a manner where John agreed to purchase Joann's stock directly in a cross purchase and then had Moriah step in to redeem Joann's stock, the relief of his primary obligation would properly shift the tax burden of Joann's realized gain to him.

127. See Brief for the Appellant at 17, Ameses v. United States, 981 F.2d 456 (9th Cir. 1992) (No. 91-35752). Conversely, redemptions which do not relieve such a primary obligation, such as the example in the introduction, would be treated as an ordinary sale of stock by the spouse whose stock is redeemed.

128. Consider a non-redemption example: A and B, ex-spouses, own a house. Pursuant to their divorce settlement, A gives B a note for half of the value. Later (within the time limits prescribed by section 1041), A sells the house to a third party and pays off the note to B from the proceeds. B should recognize gain upon this amount, whereas A should receive section 1041 nonrecognition treatment for this portion to B.
shift the tax burden of this sale to the nontransferring spouse, for whose economic benefit it was made.

Besides the controlling principle of economic benefit, the examination of the negotiation substance of a transaction may provide a valid ground for affording nonrecognition treatment to a transferring spouse under section 1.1041-1T, A-9. If the courts look at the substance of a transaction and find that one spouse has acted as the “owner” of property by directing its transfer to a third party, then nonrecognition treatment should be provided to the transferor spouse. This method articulated in Private Letter Ruling 90-46-004 is consistent with the policy of unintrusiveness regarding divorce settlements because it seeks to determine what the spouses decided regarding who would bear the tax responsibility for property. Again, such an inquiry would be driven by the particular facts of a case.

VIII. CONCLUSION

The Arnes decision effectively shifted the tax burden of this transaction from Joann, who received $450,000, to John, who received nothing which would provide grounds for taxation in the ordinary corporate redemption. In doing so, the Ninth Circuit presumed to recast the form of the Arneses’ transaction according to its perception of the substance of the transaction. However, neither the economic reality nor the negotiations of this transaction merit treating it as anything but a sale from a shareholder to a corporation. The court misapplied its own definition of section 1.1041-1T(c), A-9 to the Arneses’ transaction. This regulation should apply only to those transactions in which a spouse’s transfer to a third party produces a direct economic benefit to the nontransferring spouse or where one spouse has clearly exercised control over the disposition of the property.

129. See supra notes 113–14 and accompanying text.
130. See supra notes 115–17 and accompanying text.