Federal Income Taxation: Case Notes

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Federal Income Taxation—The Effect of Family Hostility upon the Attribution Rules in the "Essentially Equivalent to a Dividend Test"—Robin Haft Trust v. Commissioner, 510 F.2d 43 (1st Cir. 1975).

In 1965, the Haft-Gaines Company, a family-owned corporation, had 100,000 of its 500,000 shares of outstanding common stock held in trust in equal shares for the four children of Burt and Marcia Haft. In 1967, Burt and Marcia Haft were granted a divorce and as part of the settlement, the stock held in trust for the children was redeemed for $200,000 by the Haft-Gaines Company. For the taxable year 1967, each trust reported receipt of $50,000 as a long-term capital gain. The Commissioner assessed deficiencies against each trust after determining that the sales of stock were "essentially equivalent to a dividend" and therefore taxable as receipt of ordinary income. The four trusts petitioned the Tax Court, and the cases were consolidated and heard as Robin Haft Trust.

I. THE TAX COURT

In the Tax Court, the taxpayer-trusts claimed that the redemptions met the "not essentially equivalent to a dividend" test of § 302(b)(1) of the Internal Revenue Code of 1954 and that the transaction qualified for exchange treatment. Thus, reasoned the taxpayers, they should be taxed at the capital gains rate rather than at the

1 25,000 shares were held in each of four trusts bearing the beneficiary's name: Robin Haft Trust, Wendy Laura Haft Trust, Lisa Ann Haft Trust, and Daniel Foster Haft Trust.

2 When a corporation makes a distribution that is a dividend, it is taxable to the recipient as a part of gross income. A loophole would be available if the corporation could simply issue more stock to distribute its profits and then redeem this stock from the same shareholders at the lower capital gains rate. The 1921 Revenue Act prevented such a scheme by providing that redemptions that were "essentially equivalent to the distribution of a taxable dividend" be taxed at ordinary rates. This test has been retained since 1921 and today is contained in Int. Rev. Code of 1954 § 302(b)(1) [hereinafter cited as Code] (see n. 4 infra). If after the redemption a shareholder owns substantially the same proportion of stock in relation to the other shareholders, the redemption is considered "equivalent to a dividend" and taxed at the ordinary rate. If, however, the shareholder has substantially reduced his holdings in the company in relation to other shareholders, the redemption is considered a "sale" and taxed at the lower capital gains rate.

3 61 T.C. 398 (1973), vacated, 510 F.2d 43 (1st Cir. 1975).

4 Code, § 302 provides:

(a) General Rule.—If a corporation redeems its stock . . . and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) Redemptions Treated as Exchanges.—

(1) Redemptions not equivalent to dividends.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.
ordinary income rate applicable if the distribution were deemed a "dividend." The Commissioner, on the other hand, argued that the taxpayer-trusts did not qualify for exchange treatment under § 302(b)(1). After properly applying the attribution rules of § 318, the transaction did not fit within § 302(b)(1) and therefore the amount received from the redemption should be taxed at ordinary rates.

In the Haft-Gaines Company, the children's father, Burt Haft, directly owned 100,000 shares. He owned another 33,333 shares representing his beneficial interest in a trust. According to the attribution rules of § 318, the 133,333 shares actually and constructively owned by Burt Haft are constructively owned by each of the four trusts that name one of his children as a beneficiary. First, the 33,333 shares held in trust for Burt Haft are attributed to him;

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5 Taxpayers alternatively argued that they qualified for exchange treatment under Code § 302(b)(3). Section 302(b)(3) requires a "complete redemption of all of the stock of the corporation owned by the shareholder." Taxpayers could have met this test except that they failed to file the form required by Code § 302(c)(2)(A)(iii). For this reason the Tax Court refused to allow exchange treatment as a "complete redemption" under the test of § 302(b)(3).

6 Code § 302(c)(1) provides that "section 318(a) shall apply in determining the ownership of stock for purposes of this section." The attribution rules of § 318 were added to the Code in 1954 to prevent abuse of the sections of the Code providing for exchange treatment of closely-held corporations. But for the attribution rules, a shareholder could qualify for exchange treatment and be taxed at the capital gains rate by redeeming all of his personally held shares while continuing to exercise control over the corporation through shares owned by other family members. In H.R. Rep. No. 1337, 83d Cong., 2d Sess. 36 (1954), the Committee on Ways and Means described its purpose in enacting the attribution rules: "to prevent tax avoidance, but at the same time to provide definitive rules for the guidance of taxpayers, your committee has provided precise standards whereby under specific circumstances, a shareholder may be considered as owning stock held by members of his immediate family (or by partnerships, corporations, or trusts which he controls)." See nn. 9, 10, 11, 15.

7 Code § 302(d) provides:

"If a corporation redeems its stock . . ., and if subsection (a) of this section does not apply, such redemption shall be treated as a distribution of property to which section 301 applies."

Code, § 301 provides:

(a) . . . a distribution of property . . . made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

(c) Amount Taxable.—In the case of a distribution to which subsection (a) applies—

(1) Amount constituting a dividend.—That portion of the distribution which is a dividend . . . shall be included in gross income.

8 Another 100,000 shares were owned by Burt Haft's brother, Richard Haft: 100,000 by Jack Gaines, brother-in-law to Burt Haft; and, 100,000 by the Abraham Haft Trust in which Burt Haft, Richard Haft, and their sister, Norma Gaines each has a 1/3 interest as beneficiary. See Robin Haft Trust, 61 T.C. 398, 400 (1973).

9 Code, § 318(a)(2)(B)(i) provides:

"Stock owned, directly or indirectly, by or for a trust . . . shall be considered as
second, the 100,000 shares owned directly by Burt Haft and the 33,333 shares attributed to Burt Haft are attributed to each child; third, from each child the 133,333 shares are attributed to the respective trust in which the child is named as beneficiary. Therefore, before the redemption, each trust not only directly owned its 25,000 shares, but also indirectly owned 133,000 additional shares under the attribution rules. Thus the percentage of ownership of each trust before the redemption of its 25,000 shares was 31.7% (158,333 of 500,000 shares), while the percentage of ownership after the redemption was 32.3% (133,000 of 400,000 shares). Based upon this fact, the Commissioner argued that each trust had experienced a slight increase in proportionate interest and that this increase would not meet the meaningful reduction test developed under the Supreme Court decision of United States v. Davis.

Taxpayers relied upon Estate of Arthur H. Squier to rebut the Commissioner's argument. In Squier the Tax Court recognized an exception to the usual effect of the attribution rules upon § 302(b)(1) if hostility exists between the redeeming shareholder and those from whom the stock would normally be attributed. Although the attribution rules were applied in that case, the hostility between the executor of the estate and the estate beneficiaries was one of the factors that convinced the court that the redemption was "not essentially equivalent to a dividend." In Squier the actual and constructive ownership of the estate was 63% before the distribution and 57% afterward. Normally, this slight change would be considered as "essentially equivalent to a dividend." Disregarding the attribution rules however, actual ownership of stock by the estate declined from 50.49% before the redemption to 41.27% afterward, causing the estate to

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owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust.

16 Code, § 318(a)(3)(A) provides: "Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as owned by the partnership or estate."


loose its actual majority voting power. The court described the non-dividend equivalency requirement as one involving a "substantial dislocation of relative stockholdings" or a "significant change in control." Although Squier was decided for the taxpayer only "after taking the entire record into account," the estate's loss of the majority vote was viewed as a "significant change in control" since the estate beneficiaries, who would normally be expected to vote in concert with the estate, had taken a hostile attitude toward the executor.8

Taxpayers in Robin Haft Trust argued that, as in Squier, family estrangement had caused a crucial reduction in each trust's control since actual stock ownership had been completely terminated. The trusts claimed that the constructive ownership should be considered inconsequential due to the fact that the divorce and separation of the Haft and Foster families had eliminated any effective control that the trusts might have had over Burt Haft's stock.9 The Tax Court, however, ruled that Squier was inconsistent with the holding in United States v. Davis and rejected the "family hostility" argument.2

In Davis, the controlling shareholder issued and purchased 1000 shares of preferred stock in order to qualify the corporation for a bank loan. After the loan had been repaid, Davis, who now directly or constructively owned all of the stock, redeemed the 1000 preferred shares and reported a capital gain. Prior to Davis several circuits had developed what was described as a "flexible net effect" test, whereby a valid business purpose was given great weight in qualifying a redemption under § 302(b)(1).21 Davis argued that since qualifying the company for a loan is essentially a legitimate business purpose, this purpose made the redemption "not essentially equivalent to a dividend." The Supreme Court rejected this argument and held that the business purpose or motive behind a redemption was irrelevant in determining dividend equivalency—only the net effect of the transac-

17 Id. at 956.
18 Id. Other factors taken into account include the existence of a large unrelated minority interest which rose from 37% to 43% as a result of the redemption, a good record of dividend payments, and sharp cleavage between the executor and members of the Squier family.
19 The divorce proceedings resulted in an unfriendly and complete separation of all financial interest of the Haft and Foster families. Marcia (Foster) Haft remarried and moved with the four children to New York. Burt Haft did not see his children during the six months before the divorce and not for several years thereafter. See 61 T.C. 398, 399-400 (1973).
21 See, e.g., Ballenger v. United States, 301 F.2d 192 (4th Cir. 1962); United States v. Fewell, 255 F.2d 496 (5th Cir. 1958); Davis v. United States, 408 F.2d 1139 (6th Cir. 1969); Heman v. Comm'r 283 F.2d 227 (8th Cir. 1960); Kerr v. Comm'r, 326 F.2d 225 (9th Cir. 1964); Comm'r v. Berenbaum, 369 F.2d 337 (10th Cir. 1966).
tion should be considered. According to the Court: “To qualify for preferred treatment under [302(b)(1)], a redemption must result in a meaningful reduction of the shareholder’s proportionate interest . . . .” Since the taxpayer in Davis directly or constructively owned 100% of the stock after application of the attribution rules, the redemption could not reduce his proportionate interest. Thus, reasoned the Court, there could be no “meaningful reduction.”

In Davis the taxpayer further argued that he should not be considered the sole shareholder since §318 was not intended by Congress to apply to §302(b)(1). The Supreme Court also rejected this argument and stated:

the attribution rules of §318(a) do apply [to §302(b)(1)]; and, for purposes of deciding whether a distribution is “not essentially equivalent to a dividend” under §302(b)(1), taxpayer must be deemed the owner of all 1,000 shares of the company’s common stock.

Focusing upon the “must be deemed” language in Davis, the Tax Court in Robin Haft Trust felt that the attribution rules should be applied to all §302(b)(1) cases without exception. The Tax Court concluded:

By the terms of the statute [§302(b)(1)], the attribution rules are applicable irrespective of the personal relationships which exist among the members of a family, and an interpretation of the statute which made their applicability depend upon whether there was discord among the members of a family—or the extent of any such discord—would frustrate the legislative objective and would be clearly inconsistent with the language and rationale of Davis.

Therefore, without the use of the “family hostility” exception, the Robin Haft trusts failed to meet the test of §302(b)(1) and were not entitled to exchange treatment.

23 Id.
24 There has been a question whether §318 was intended by Congress to apply only to §§302(b)(2) and (3) or whether §302(b)(1) was also to be included. The debate was over language in §302(c) [see n.6, supra] which makes the attribution rules applicable “in determining ownership of stock.” Since only §§302(b)(2) and (3) specifically refer to ownership of stock, it was argued that attribution should apply only to these two sections. See Cohen, Redemptions of Stock Under the Internal Revenue Code of 1954, 103 U. PA. L. REV. 739, 759 (1955). But Davis points out at 306: “[T]he other courts of appeals, a long-standing treasury regulation, and the opinion of the leading commentators” are all opposed to this view and would apply the attribution rules to §302(b)(1).
25 397 U.S. at 307.
27 Id. at 403, referring to H. REP. NO. 1337, 83d Cong., 2d Sess. A96 (1954).
II. The Court of Appeals Decision

Taxpayers appealed to the First Circuit Court of Appeals challenging the Tax Court’s interpretation of *Davis* as applied to the Robin Haft trusts. The First Circuit rejected the Tax Court’s view that *Davis* precludes a “family hostility” exception to § 302(b)(1) and noted that

in fact the court in *Squier* did apply the [§ 318 attribution] rules though it concluded on balance that the redemption before it was not essentially equivalent to a dividend. Taxpayers here argue not that the rules are inapplicable, but that they are not in themselves determinative.

The Tax Court decision was vacated and the case remanded for a determination of whether the family discord was so serious as to mitigate the effect of the attribution rules.

In so holding, the First Circuit relied upon the legislative history of § 302(b)(1) as indicative of a congressional intent that the attribution rules be flexibly applied. Until 1954, the “not essentially equivalent to a dividend” test was the only standard available to achieve exchange treatment upon redemption of shares. The House of Representatives proposal in 1954 would have abandoned this uncertain test for the precise standards of § 302(b)(2) and § 302(b)(3). After arguing that eliminating the “essentially equivalent test” would be “unnecessarily restrictive,” the Senate succeeded in preserving the test in the form of § 302(b)(1). The Senate explained that the § 302(b)(1) test would be whether the redemption of the stock could be seen as a “sale.” The Supreme Court in *Davis* interpreted “sale”
to require a "meaningful reduction of the shareholder's proportionate interest." The First Circuit concluded that a test to determine whether a "sale" or a "meaningful reduction of the shareholder's proportionate interest" has occurred "certainly seems to permit, if it does not mandate, an examination of the facts and circumstances to determine the effect of the transaction transcending a mere mechanical application of the attribution rules." The First Circuit found support for this position in Treasury Regulation § 1.302-2(b):

The question whether a distribution in redemption of stock of a shareholder is not essentially equivalent to a dividend under section 302(b)(1) depends upon the facts and circumstances of each case. One of the facts to be considered in making this determination is the constructive stock ownership of such shareholder under section 318(a).

Therefore, concluded the First Circuit, family hostility should be one of the circumstances considered in determining whether there has been a "meaningful reduction of the shareholder's proportionate interest."

III. THE "HOSTILITY" EXCEPTION

A. The Exception Pre-Davis

Since the addition of the attribution rules to the Code in 1954, there has been constant debate over their application to § 302(b)(1). Treasury Regulation § 1.302-2(b) states that the family attribution rules are "one of the facts to be considered" in the § 302(b)(1) test. It is conceivable that a factor such as "family hostility," if also considered in the test, could mitigate the effect of the attribution rules.

The Squier case was the first in which a court recognized the "family hostility" factor and held for the taxpayer. The court in Squier carefully pointed out that it did apply the attribution rules to the redemptions:

Taking the entire record into account we are satisfied that even after applying the attribution rules here the redemptions in controversy were not essentially equivalent to the distribution of a taxable dividend.

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29 510 F.2d 43, 48 (1st Cir. 1975).
30 Id.
31 Id. at 403. 35 T.C. 950, 956 (1961).
However, there is actually no difference in final effect between first applying the attribution rules and later mitigating because of family hostility and first testing for family hostility and then totally disregarding the attribution rules.

In *Bradbury v. Commissioner*, the First Circuit agreed that hostility might have the effect which *Squier* suggested. The court in *Bradbury* noted:

> while these attribution rules are generally applicable to section 302(b)(1) . . . their imposition is not inflexible and if it can be demonstrated that discord exists in a family relationship which would make attribution unwarranted, they will not be applied. Here the record is clear that complete harmony and community of purpose existed between petitioner and her daughter and consequently section 318 applies.

The Fourth Circuit, however, discounted the "family hostility" exception in calling for the strict application § 318 in *Coyle v. United States*. As in *Bradbury* there was no hostility between the shareholders involved in the redemption and the district court had simply failed to apply the attribution rules in its determination. In reversing the District Court for this oversight the court in *Coyle* held:

> The family attribution rules, which are specifically prescribed by the statute, were designed to create predictability for the tax planner and to obviate the necessity of a court's scrutinizing family arrangements to determine whether every family member is in fact a completely independent financial entity. An authoritative study of the subject begins: 'The rules of constructive ownership rest on certain assumptions which are readily supported in the everyday conduct of affairs. * * * Tax administration would be severely handicapped if the rules applied only as presumptions * * *'.

In contrast to the reasoning in *Coyle*, some commentators have argued that the congressional purpose in enacting § 318 was not for administrative convenience but for taxpayer equity. They explain that there is a "presumed community of interest" among the related stockholders described in § 318(a). When "family hostility" destroys this presumed community of interest, the attribution rules should not

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39 298 F.2d 111 (1st Cir. 1962).
40 298 F.2d at 116-17 n. 7.
41 415 F.2d 488 (4th Cir. 1968).
prevent capital gains treatment. Thus it was urged that the constructive ownership rules of § 318 should be used as rebuttable presumptions rather than as automatic, inflexible rules.

A comment published just before the Supreme Court's decision in *Davis* criticized the flexible application of the attribution rules to § 302(b)(1) as an abrogation of the statutory requirement that the percentage of ownership must first be determined under the stock attribution rules; the "dividend equivalency" test is subsequently applied. After a discussion of *Squier, Herbert C. Parker*, and the Sixth Circuit's opinion in *Davis v. United States*, the author concluded:

In the cases above the courts have ignored the statutory scheme. They have exercised discretion as to whether the attribution rules should be applied, which is not discretionary, while they are determining whether the distribution is taxable as a dividend, which is where they are supposed to exercise their judgment.

Wolfburg's criticism of the Sixth Circuit's *Davis* decision was in accord with the later decision of the Supreme Court when it reversed the appellate court's decision. Although the Court in *Davis* held that the attribution rules are to be applied in every determination of "dividend equivalency," the Court did not make clear whether "family hostility" could mitigate the effects of the attribution rules.

**B. The Post-Davis Exception**

No hostility existed between shareholders in the Davis case, and even the Commissioner recognized that a rejection of the business purpose test by the Supreme Court would not necessarily rule out the "family hostility" exception. The holding of the Supreme Court in

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45 Herbert C. Parker, 1961 P-H Tax Ct. Mem. 976. In *Parker*, a family corporation was owned mainly by father and son. After several years of disagreements between the father and son as to management of the business, the father redeemed a portion of his shares. *Parker* followed *Squier* in holding that "[his] transfer of control, preceded by disagreements as to the management of the Company, so affects the total factual picture as to persuade us that, notwithstanding the family relations involved, this redemption of petitioner's stock was not essentially equivalent to a dividend." *Parker* at 983. As in *Squier*, the emphasis was upon the "significant change in control." Even though Parker Sr. still constructively owned 96% of the company's stock after the redemption, his direct holdings dropped from 49.7% to 28.7%.
48 Brief for Appellant at 37, *United States v. Davis*, 397 U.S. 301 (1970). "[I]t has never been suggested except in a case where the family members were hostile to one another that it would be inappropriate to apply the attribution rules . . . . Respondent has neither alleged nor
Davis not only rejected the business purpose test but also addressed itself to the attribution rules. The sweeping nature of the opinion in applying the attribution rules to § 302(b)(1) transactions led several commentators to predict that the “family hostility” exception could no longer be claimed. For example, one report noted: “[t]he tenor of the Court’s opinion in Davis is that § 318 always operates in testing a redemption under § 302(b)(1). It is perilous to assume that any lower court could feel free to find otherwise, for family estrangement or any other reason.”49 Not all, however were convinced that Davis precluded the “family hostility” exception. In outlining the ways in which the § 302(b)(1) requirement could be met after the Davis decision, Bittker and Eustice included the hostility exception noting that it had been weakened but not eliminated by Davis.50

The first test of the effect of Davis upon the family hostility exception came in Robin Haft Trust. The Tax Court read the Davis decision to preclude a “family hostility” exception. Although the Commissioner had not withdrawn his acquiescence in Squier, the Tax Court called for strict application of the attribution rules. It appeared that the matter had finally been settled.

When the case reached the First Circuit, however, that court refused to give such a broad reading to Davis but followed Squier and its own dictum in Bradbury and reversed the Tax Court. Apparently, Davis did nothing to resolve the difference of opinion over the hostility exception. Eventually another Supreme Court decision may be required to settle the controversy.

IV. PROBLEMS INHERENT IN A “FAMILY HOSTILITY” EXCEPTION

The First Circuit remanded Robin Haft Trust to the Tax Court with directions “to reconsider the taxpayer’s claims in the light of the facts and circumstances of the case, including the existence of family discord tending to negate the presumption of continuing control over the corporation despite the redemption.”51 That determination was never made, however, because on July 22, 1975, the remanded case

shown that any hostility existed between him and his wife and children, so that for present purposes, the question of whether a “family hostility” exception exists under section 302(b)(1) is entirely academic.”


51 510 F.2d 43, 48 (1st Cir. 1975).
was settled out of court. The Commissioner conceded that the taxpayers were entitled to the capital gains rate for the redemptions of their stock.

If Robin Haft Trust had actually been heard upon remand, the Tax Court would have had to determine whether there had been sufficient hostility to justify mitigation of the attribution rules. The Tax Court had warned that this would be a difficult task:

If the applicability of the attribution rules depended upon the feeling or attitudes among the members of a family, it would then be necessary to inquire into whether such discord was serious, and whether it would likely impair the ability of one member of the family to influence the conduct of other members.

The First Circuit's response was that the required factual determination would be no great burden upon the courts since the "family hostility" exception had been so rarely invoked; furthermore, courts would be "entitled to view such claims with jaundiced eyes."

Any test for "hostility" would necessarily be subjective and it would involve the testimony of the parties as to their business interests and motives in making the redemption—a motivational inquiry which the Supreme Court sought to eliminate in Davis. Courts would be required to test for "essential equivalence" using not only a quantitative measure of stock ownership but also a qualitative inquiry as to the relationships between stockholders.

A qualitative inquiry as to extent of control between hostile stockholders presents difficult evidentiary problems. Evidence as to the degree and duration of hostility would usually be presented by members of the closely-held corporation—the same parties to whose advantage it would be to establish that hostility did exist. A fight could easily be feigned or exaggerated to meet the degree of hostility required to qualify for the exception, inviting fraud and perjury. The qualitative inquiry adds a confusing collateral issue to the already difficult "essentially equivalent" test. Furthermore, as argued in the Commissioner's brief in Robin Haft Trust, the state of family relationships is so variable that while a hostile attitude can be shown at

52 Robin Haft Trust, #5870-71 T.C., settled July 22, 1975.
53 The settlement decision stated: "Pursuant to agreement of the parties in the above-entitled case, it is ordered and decided: That there is no deficiency in income tax due from, or overpayment due to, the petitioner for the taxable year 1967."
54 61 T.C. 398, 403 (1973).
55 510 F.2d 43, 48.
the time of redemption, the parties may have mended their differences shortly thereafter.  

Another problem with the hostility exception is that there is no accurate measure of the control which one family member may have over another’s stockholdings. In Robin Haft Trust, the Tax Court on remand would first have had to determine whether the relationship to be considered should be that between Burt Haft and his children or between Burt Haft and the trustees. Since the children were ages five, nine, thirteen, and fourteen at the time of the redemption, it is unlikely that they would exert meaningful control over their father’s stock, even if the parties were amicable. The trustees at the time of the redemption were Marcia Haft’s parents and an apparently unrelated, neutral third party. Therefore, because of the unfriendly tone of the divorce, it is unlikely that the trustees would exert any influence over Burt Haft. Finally, if “family hostility” can mitigate the effects of the attribution rules, taxpayers will seek to extend the exception. The rationale for the hostility exception is that it is unfair to penalize a taxpayer by attributing to him a relative’s stock when the presumed “community of interest” does not exist. This reasoning could be applied equally to other situations in which lack of interest, or involvement in the activities of the corporation by the redeeming shareholder indicates that no control would be exerted over the stock held by other family members. If there is justification for a “hostility” exception, there is no reason for not enlarging it to a “no actual control” exception. Several commentators before and after Davis have argued for such a flexible application of § 318 to § 302(b)(1). But a factual determination would be required in every § 302(b)(1) situation as to the extent of the redeeming shareholder’s control over that stock that is to be attributed. The use and possible extension of the hostility exception, therefore, puts an unjustified burden on the courts, which is not counterbalanced by the taxpayer’s claim of “equitable” relief.

57 Brief for Appellee at 19, Robin Haft Trust v. Comm’r, 510 F.2d 43 (1st Cir. 1975).
59 Brief for Appellants at 4, Robin Haft Trust v. Comm’r, 510 F.2d 43 (1st Cir. 1975).
VI. Conclusion

In light of the difficulties involved in a factual determination of "family hostility" and the mandate of the Davis decision that the attribution rules be applied in all § 302(b)(1) cases, it is bewildering that the First Circuit continues to recognize the exception. There is no convincing policy reason that justifies complicating tax law with such a seldom-invoked loophole. The only possible rationale for the exception is the prevention of unfairness to a taxpayer involved in a "family-fight" situation. Yet the Code itself is adequate to prevent such unfair treatment. If the family fight were so serious as to force the taxpayer to sever relations with the corporation, the withdrawal could be complete. Then, the capital gains rate would be available to the taxpayer pursuant to the section which was designed for that purpose—§302(b)(3). As in Robin Haft Trust, it is merely a lack of planning that puts a taxpayer in the position of claiming a "family hostility" exception to § 318. No matter how liberally the courts decide to formulate the "hostility" standards, this exception will never be a reliable means of planning for exchange treatment. Instead, it remains the final argument for those who have failed to effectively utilize the "safe harbors" of § 302. Hopefully, other courts will not follow the First Circuit's view in order to protect careless tax planners.

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