1 T.C. 406 (1943)

When a corporation acquires assets of another entity in a reorganization, the acquiring corporation is entitled to use the transferor's basis in those assets for calculating gain or loss upon their later disposition.

Summary

Bankers Farm Mortgage Co. (BFM) acquired assets from an insolvent joint stock land bank. BFM was formed by the bank's bondholders to acquire the bank's assets and continue their liquidation. BFM acquired a significant majority of the bank's bonds and then purchased the bank's assets at a receiver's sale, crediting its bond holdings toward the purchase price. The Tax Court held that this transaction constituted a tax-free reorganization under Section 112(i) of the Revenue Act of 1932. As a result, BFM was entitled to use the land bank's basis in the assets when calculating its gain or loss on their subsequent sale, pursuant to Section 113(a)(7) of the same act. The court followed the Supreme Court's decision in *Palm Springs Holding Corporation v. Commissioner*.

Facts

Bankers Joint Stock Land Bank of Milwaukee became insolvent and was placed in receivership.

A bondholders' protective committee was formed, representing a substantial portion of the bank's bondholders.

BFM was organized by a group of bondholders as part of a plan to acquire the bank's assets.

BFM acquired a large percentage of the bank's outstanding bonds in exchange for its stock or for cash.

BFM negotiated with the Federal Farm Loan Board to purchase the bank's assets from the receiver.

The receiver sold the assets at a public sale to BFM, which bid an upset price, crediting its bond holdings toward the payment.

BFM continued to liquidate the assets it acquired from the bank.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in BFM's income and excess profits taxes for several years, arguing that BFM used an incorrect basis for computing gain or loss on the disposition of assets.

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BFM petitioned the Tax Court, claiming it was entitled to use the transferor's basis because the asset acquisition was a nontaxable reorganization.

Issue(s)

Whether the acquisition of assets by BFM from the insolvent land bank constituted a reorganization under Section 112(i) of the Revenue Act of 1932.

Whether BFM was entitled to use the land bank's basis in the acquired assets when computing gain or loss on their disposition, pursuant to Section 113(a)(7) of the Revenue Act of 1932.

Holding

Yes, because the transaction met the requirements of a reorganization under Section 112(i) as construed by the Supreme Court in *Palm Springs Holding Corp.*

Yes, because Section 113(a)(7) allows the acquiring corporation in a reorganization to use the transferor's basis in the acquired assets.

Court's Reasoning

The court relied heavily on the Supreme Court's decision in *Palm Springs Holding Corporation v. Commissioner*, finding the facts to be essentially similar. The court rejected the Commissioner's argument that the land bank should be considered a government instrumentality, noting that joint stock land banks are privately owned corporations operated for profit, citing *Federal Land Bank v. Priddy, 295 U.S. 229*. The court emphasized that BFM, as the holder of a substantial majority of the land bank's bonds prior to the acquisition, had a significant equitable interest in the bank's assets. Post-acquisition, BFM had 100% ownership. The court also found that BFM continued the land bank's business of liquidating assets, indicating a continuity of business enterprise. The court stated, "Joint stock land banks are subject to tax upon their earnings as other corporations."

Practical Implications

This case clarifies the application of reorganization provisions to situations involving insolvent entities and bondholder-led acquisitions.

It reinforces the principle that the acquiring corporation in a valid reorganization can use the transferor's basis in assets, even when the acquisition involves the purchase of assets at a receiver's sale.

The case is also important for distinguishing between government instrumentalities and privately-owned joint stock land banks, particularly in the context of tax law.

This ruling highlights the importance of continuity of interest and continuity of

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business enterprise when determining whether a transaction qualifies as a reorganization for tax purposes. Subsequent cases have cited *Bankers Farm Mortgage* for its application of the *Palm Springs Holding* doctrine and its emphasis on the purpose and continuity of the business.

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