5 T.C. 1 (1945)

When property is transferred to a corporation in exchange for stock, and the transferors are in control of the corporation immediately after the exchange, the transaction is a non-taxable exchange, and the corporation's basis in the property is the same as it would be in the hands of the transferors, subject to adjustments for capital expenditures.

Summary

The Roberts Company sold properties it acquired in 1937 in exchange for its capital stock. The Tax Court addressed the proper basis for calculating gain or loss on these sales. The court held that the 1937 transaction was a non-taxable exchange under Section 112(b)(5) of the Internal Revenue Code, meaning the company's basis in the properties was the same as the transferors' basis. The court reasoned that the transferors, including attorneys with a contingent fee interest, were in control of the corporation immediately after the exchange, satisfying the requirements for a non-taxable transaction.

Facts

Martha E. Roberts died, leaving her estate to her four sons. The estate included Texas lands valued at $5 per acre. Two sons entered into a contingent fee agreement with attorneys, promising 35% of their recovery from the estate. A corporation, The Roberts Company, was formed in 1937 to facilitate the distribution of the estate's assets. The Texas lands were transferred to the corporation in exchange for its stock. The corporation later sold portions of the land in 1939 and 1941, using a basis of $10 per acre to calculate profit.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the company's income tax and declared value excess profits tax for 1939 and 1941. The Commissioner argued that the 1937 transaction was a non-taxable exchange, requiring the company to use the transferors' basis of $5 per acre. The Roberts Company petitioned the Tax Court, arguing the transaction was taxable, entitling it to a $10 per acre basis.

Issue(s)

1. Whether the transfer of Texas lands to The Roberts Company in exchange for stock was a non-taxable exchange under Section 112(b)(5) of the Internal Revenue Code.
2. If the exchange was non-taxable, whether the Roberts Company's basis in the land is the same as the transferors' basis.

Holding

1. Yes, the transfer was a non-taxable exchange because the transferors, including the attorneys with a contingent fee interest, were in control of the corporation immediately after the exchange.
2. Yes, the company's basis is generally the same as the transferors' basis ($5/acre), but with an adjustment to account for the fair market value ($10/acre) of the portion of land attributable to the attorney's fees, as this represented a capital expenditure.

Court's Reasoning

The court relied on Section 112(b)(5) of the Internal Revenue Code, which dictates that no gain or loss is recognized when property is transferred to a corporation in exchange for stock, and the transferors are in control immediately after the exchange. "Control" is defined as owning at least 80% of the voting stock. The court found that the attorneys, holding a contingent fee agreement, had an equitable assignment of a portion of the Texas lands. Because the attorneys received stock in the company, they were considered transferors. Adding the attorneys' stock to that of the Roberts brothers, the transferors controlled more than 80% of the company. The court cited *F. L. G. Straubel, 29 B. T. A. 516*, noting that the word