5 T.C. 665 (1945)

When an old company liquidates and its assets are acquired by a new corporation in exchange for stock and debentures distributed to the old stockholders, the transaction constitutes a reorganization under Section 112 of the Internal Revenue Code, regardless of the stockholders' personal motives; therefore, the new corporation's basis for depreciation is the same as the old company's.

Summary

National Typesetting Co. liquidated, and its assets were transferred to a newly formed National Typesetting Corporation. The new corporation issued stock and debentures to the old company's stockholders. The Tax Court addressed whether this constituted a tax-free reorganization or a taxable liquidation. The court held it was a reorganization, emphasizing the integrated nature of the transaction. The transfer of assets from the old company to the new one, with the old stockholders maintaining control, met the criteria for a reorganization under Section 112. Consequently, the new corporation had to use the old company's basis for depreciation, and an individual stockholder could not claim a capital loss.

Facts

National Typesetting Co. was originally owned by four individuals. After two owners died, the remaining two, Survaunt and Hartwell, bought the deceased owners' shares. Upon Hartwell's death, his estate and Survaunt faced difficulty paying off promissory notes related to the previous stock purchase. To address this, they formed a plan to liquidate the old company and transfer its assets to a new corporation, National Typesetting Corporation, in exchange for stock and debentures. The primary motivation was to use the new corporation's assets to satisfy Survaunt and Hartwell's personal debts.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Survaunt's individual income tax and in the National Typesetting Corporation's corporate income tax. Survaunt had claimed a loss on the liquidation of the old company, and the corporation had taken a new, higher basis for depreciation. The Tax Court consolidated the cases. The Tax Court ruled in favor of the Commissioner, determining that the transaction constituted a reorganization, thus disallowing Survaunt's loss and requiring the corporation to use the old company's depreciation basis.

Issue(s)

1. Whether the liquidation of the old company and the transfer of its assets to the new corporation constituted a reorganization under Section 112 of the Internal Revenue Code.

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2. Whether, if a reorganization occurred, the new corporation was required to use the old company's basis for depreciation of the transferred assets.
3. Whether, if a reorganization occurred, Survaunt was entitled to claim a capital loss on the liquidation of the old company.

Holding

1. Yes, because the steps were integrated, resulting in a transfer of assets from one corporation to another, with the shareholders of the transferor maintaining control of the transferee.
2. Yes, because Section 113(a)(7) of the Internal Revenue Code requires the new corporation to use the transferor's basis in a reorganization.
3. No, because Section 112(e) of the Internal Revenue Code disallows the recognition of loss in a reorganization.

Court's Reasoning

The court reasoned that the liquidation of the old company and the formation of the new corporation were part of an integrated transaction designed to continue the same business under a new corporate structure. The court emphasized that the transfer of assets from the old company to the new company, coupled with the old stockholders maintaining control, satisfied the requirements of Section 112(g)(1)(D) of the Internal Revenue Code, which defines a reorganization as "a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders… is in control of the corporation to which the assets are transferred." The court stated, "That there was a 'reorganization' here and not a mere liquidation of the old company seems obvious if we follow the well beaten path through the reorganization wilderness that requires all parts of the transaction to be considered together rather than separately." The court dismissed arguments that the stockholders had personal reasons for the arrangement, stating that this did not change the outcome. The court applied Section 113(a)(7) to determine the basis of the assets transferred and Section 112(e) to determine if any loss should be recognized.

Practical Implications

This case illustrates the importance of analyzing a series of related transactions as a whole to determine their tax consequences. It clarifies that the presence of a shareholder's personal motive does not necessarily disqualify a transaction from being considered a reorganization. The case reinforces that substance over form is a guiding principle in tax law. Attorneys must carefully consider whether a transaction qualifies as a reorganization under Section 112, as this determination significantly impacts the basis of assets and the recognition of gains or losses. Later cases have cited *Survaunt* for the principle that a series of steps can be integrated to determine if a reorganization exists, even if the plan is unwritten.

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