5 T.C. 814 (1945)

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In a corporate recapitalization, the amount of debt exchanged for stock and other securities only increases equity invested capital to the extent that the debt's basis can be allocated to the stock portion of the exchange; a general benefit to the financial statement is insufficient.

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Summary

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Walsh Holyoke Steam Boiler Works sought to increase its equity invested capital for excess profits tax purposes, arguing that a recapitalization in 1936, where a major stockholder exchanged discounted debt for new stock and bonds, should be included. The Tax Court ruled against Walsh Holyoke, holding that without a clear allocation of the old debt's value between the new stock and new bonds, it could not determine the amount properly attributable to equity invested capital. The court emphasized that a general improvement to the company's balance sheet is not sufficient grounds for increasing equity invested capital; there must be a direct infusion of money or property specifically designated for stock.

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Facts

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Walsh Holyoke Steam Boiler Works was recapitalized in 1936. Vincent Marran, a principal stockholder, purchased the company's outstanding debenture bonds and notes at a significant discount (approximately 20 cents on the dollar). In the recapitalization, Marran exchanged these bonds and notes (totaling $363,758.27, including interest) for 9,394 shares of new no-par-value stock and $65,000 face value of new 5 1/2 percent debenture bonds. The company claimed that the difference between the face value of the debt and the new bonds, $298,758.27, should be added to equity invested capital for excess profits tax purposes.

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Procedural History

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Walsh Holyoke filed its 1941 excess profits tax return, claiming a specific average invested capital and an excess profits tax credit. The Commissioner of Internal Revenue adjusted the equity invested capital by eliminating $298,758.27. Walsh Holyoke petitioned the Tax Court, arguing that the Commissioner's adjustment was erroneous.

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Issue(s)

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Whether the amount of the company's debt surrendered in exchange for stock and bonds during a recapitalization can be included in equity invested capital for excess profits tax purposes, where there is no specific allocation of value between the stock and bonds received in exchange.

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Holding

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No, because the taxpayer failed to demonstrate what portion of the old obligations was exchanged specifically for stock versus bonds, and therefore, what amount qualifies as "money or property paid in for stock" under Section 718 of the Internal Revenue Code.

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Court's Reasoning

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The Tax Court stated that while the recapitalization may have improved the company's financial statement, it does not automatically increase equity invested capital. The court relied on Liberty Mirror Works, 3 T.C. 1018, emphasizing that forgiven debts are not included in equity invested capital unless intended as additional capital contributions. The court acknowledged that the old obligations could be considered

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