5 T.C. 1265 (1945)

When a corporation acquires assets in exchange for stock, the basis of those assets for determining equity invested capital is generally the cost of the assets at the time of acquisition, which is the fair market value of the stock issued.

Summary

The Maltine Co. sought to include the value of assets acquired from a predecessor company in its equity invested capital for excess profits tax purposes. The assets were acquired in 1898 in exchange for the issuance of Maltine Co.'s stock. The Commissioner argued that Maltine Co. was limited to the predecessor's invested capital. The Tax Court held that Maltine Co. could include the assets at their cost (fair market value at the time of acquisition). It determined the fair market value of the tangible and intangible assets and found that a prior Board of Tax Appeals decision was not res judicata. The court also refused to consider issues not raised in the deficiency notice or pleadings.

Facts

In 1898, The Maltine Co. (petitioner) was formed with a capital of $1,000,000. It acquired the assets of The Maltine Manufacturing Co., a company with a capital of $100,000, in exchange for all of its stock. The stockholders were substantially the same. The manufacturing company had been successful, paying dividends for six years equal to a 100% return on the original investment. The manufacturing company's charter limited its activities to manufacturing and selling a specific medical preparation in New York City. The Maltine Co.'s purpose was broader – making and selling medicinal and food products generally.

Procedural History

The Commissioner determined a deficiency in Maltine Co.'s excess profits tax for 1942, arguing that it was limited to the invested capital of its predecessor. Maltine Co. petitioned the Tax Court, claiming it was entitled to an equity invested capital credit based on the cost of the assets acquired in 1898. A prior Board of Tax Appeals decision involving the same company was introduced as evidence, with Maltine Co. arguing res judicata. The Tax Court ruled against the Commissioner, determining the value of the assets, and ordering a recomputation under Rule 50.

Issue(s)

1. Whether a prior decision of the Board of Tax Appeals regarding the same company for different tax years is res judicata on the present issues.
2. Whether Maltine Co. is entitled to include the cost of intangible assets acquired from Maltine Manufacturing Co. in 1898 in its equity invested capital.
3. If so, what was the cost (fair market value) of those intangible assets at the time of acquisition?

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Holding

1. No, because the issues and applicable tax statutes are different.
2. Yes, because section 718(a)(2) of the Internal Revenue Code allows inclusion of property acquired for stock at its unadjusted basis for determining loss, which is cost.
3. The fair market value of the intangible assets (patents, trademarks, and goodwill) was $866,000.

Court’s Reasoning

The court distinguished the prior Board of Tax Appeals decision, noting that it addressed a different issue under a different statute. The present case concerned whether the 1898 transaction should be disregarded for computing invested capital, which was not previously litigated. Regarding the asset basis, the court applied section 718(a)(2) of the Internal Revenue Code, stating that property acquired for stock is included in equity invested capital at its unadjusted basis for determining loss upon a sale or exchange. Section 113(a) defines the basis as the cost of the property. The court reasoned that the statute was precise and unambiguous, and to hold otherwise would be to create an exception not found in the statute. Regarding valuation, the court relied on the company’s earnings record, dividend history, stock sales, and expert testimony to determine the fair market value of the intangible assets. The court quoted section 35.718-1 of Regulations 112 that if stock had no established market value at the time of the exchange, the fair market value of the assets of the company at that time should be determined. Finally, the court refused to consider the argument suggested in the brief that petitioner had not proved there were not other adjustments in reduction of invested capital because no other factors were mentioned in connection with the case except those which we have discussed above, stating “There is nothing in the deficiency notice or in the pleadings which would suggest the other questions raised by respondent in his brief, and, therefore, we can not consider them.”

Practical Implications

This case illustrates the principle that the basis of assets acquired for stock is generally their cost at the time of acquisition, even in older transactions. It highlights the importance of proper valuation of both tangible and intangible assets in such situations. The case also underscores the principle that the Tax Court will generally only consider issues raised in the deficiency notice and pleadings. The case demonstrates how a tax-free reorganization concept did not exist at the time, but the transaction was still treated as a sale for fair market value of assets rather than continuing the old basis. Later cases could use this to analyze similar transactions that predate the reorganization provisions of the Internal Revenue Code.

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