Tower Building Corporation v. Commissioner, 6 T.C. 125 (1946)

When a corporate reorganization under Section 77B of the National Bankruptcy Act is completed before September 22, 1938, and a final decree entered, Section 270 of the Act does not apply to reduce the basis of the corporation's property for depreciation purposes; furthermore, the exchange of new stock for old debt in a 77B reorganization does not constitute a cancellation of indebtedness requiring a reduction in basis.

Summary

Tower Building Corporation sought a determination of its basis for depreciation after a reorganization under Section 77B of the National Bankruptcy Act. The Tax Court addressed whether Section 270 of the Act, which requires a reduction in the basis of property by the amount of indebtedness canceled in a bankruptcy proceeding, applied to the corporation's reorganization. The court held that because the reorganization was effectively completed before September 22, 1938, and a final decree was entered, Section 270 did not apply. Additionally, the court found that the exchange of new stock for old debt did not constitute a cancellation of indebtedness.

Facts

Tower Building Corporation underwent a reorganization under Section 77B of the National Bankruptcy Act. The plan of reorganization was confirmed on November 25, 1935. On June 4, 1936, the court approved the final report and account of the trustee, discharging the trustee and canceling his bond. A special master was appointed to investigate the conduct of a bondholder, but his report was never filed. The corporation continued to operate its property and business without court supervision after July 1, 1936. The Commissioner argued that the corporation's basis in its property should be reduced due to the cancellation of indebtedness during the reorganization.

Procedural History

The Commissioner determined a deficiency in Tower Building Corporation's income tax. Tower Building Corporation petitioned the Tax Court for a redetermination of the deficiency, contesting the Commissioner's adjustment to its basis for depreciation.

Issue(s)

1. Whether the order of June 4, 1936, approving the final account of the trustee and discharging him, constituted a "final judgment or decree" within the meaning of Section 113(b)(4) of the Internal Revenue Code, thus precluding the application of Section 270 of the National Bankruptcy Act.
2. Assuming that no final judgment or decree was entered before September 22, 1938, whether the exchange of new stock for old debt constituted a cancellation or

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reduction of indebtedness under Section 270 of the National Bankruptcy Act.

Holding

1. Yes, because the plan of reorganization was fully consummated and completed before July 1, 1936, and Section 270 is not to be given retroactive effect so as to cover the reorganization of petitioner which occurred some two years prior to the enactment of the Chandler amendment to the Bankruptcy Act.
2. No, because the exchange of petitioner's new stock for its first and second mortgage bonds, unsecured claims, and old stock in accordance with the plan approved in the 77B proceeding did not amount to a cancellation or reduction of indebtedness under Section 270 of the Bankruptcy Act, as amended.

Court's Reasoning

The court reasoned that the reorganization had been effectively completed before the enactment of the Chandler Act (which included Section 270) on September 22, 1938. The court emphasized that the order of June 4, 1936, was the functional equivalent of a final decree, as it discharged the trustee and ended court supervision of the corporation's operations. Citing *Claridge Apartments Co. v. Commissioner*, the court refused to apply Section 270 retroactively to disturb tax consequences already settled. The court also held that even if a final decree hadn't been entered before September 22, 1938, the exchange of new stock for old debt did not constitute a cancellation or reduction of indebtedness, relying on its prior holding in *Motor Mart Trust*. The court distinguished a cancellation of debt from a substitution of equity for debt.

Practical Implications

This case clarifies the application of Section 270 of the National Bankruptcy Act in the context of corporate reorganizations under Section 77B. It establishes that if a reorganization is substantially completed before September 22, 1938, and a final decree (or its functional equivalent) is entered, Section 270 does not apply to reduce the basis of the corporation's assets for depreciation purposes. Furthermore, the case reinforces that the exchange of stock for debt in a reorganization does not automatically trigger a reduction in basis under Section 270. Attorneys and accountants should carefully examine the timing of reorganization events and the nature of debt restructuring when determining the tax consequences of bankruptcy reorganizations. This case underscores the importance of substance over form in determining whether a

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