

7 T.C. 1014 (1946)

A corporate reorganization can still qualify as an exchange solely for voting stock, even if the transferor corporation's cash is used to satisfy the interests of dissenting equity holders, as long as the acquiring corporation provides only stock for the acquired assets.

Summary

Westfir Lumber Co. sought to use the basis of its predecessor, Western Lumber Co., for depreciation and invested capital purposes, arguing that the acquisition of Western's assets was a tax-free reorganization. The Tax Court addressed whether the acquisition of assets qualified as a reorganization under Section 112(g)(1)(B) of the Revenue Act of 1936, where some cash of the transferor corporation was used to pay off non-assenting bondholders. The court held that the transaction qualified as a reorganization because the acquiring corporation only used its stock to acquire the assets, and the cash used was already part of the transferor's assets.

Facts

Western Lumber Co. was in financial distress, having defaulted on its bonds and debentures. A bondholders' protective committee formed a plan of reorganization involving a new corporation (Westfir Lumber Co.) acquiring Western's assets. Westfir would issue stock to the depositing bondholders and debenture holders. Some bondholders did not participate in the exchange. Westfir acquired Western's assets, including cash, and used a portion of Western's existing cash to pay off the non-depositing bondholders.

Procedural History

Westfir Lumber Co. petitioned the Tax Court, contesting the Commissioner's determination of deficiencies in income and excess profits tax. The central issue was whether the acquisition of Western's assets qualified as a reorganization, thus allowing Westfir to use Western's basis in those assets.

Issue(s)

Whether the acquisition by Westfir of substantially all the properties of Western constituted a reorganization under Section 112(g)(1)(B) of the Revenue Act of 1936, as amended, when a portion of the transferor's (Western's) cash was used to pay off dissenting bondholders.

Holding

Yes, because Westfir acquired substantially all of Western's assets solely in exchange for its voting stock. The fact that a portion of Western's cash was used to pay off non-assenting bondholders did not disqualify the transaction as a

reorganization, since the cash was already part of Western's assets.

Court's Reasoning

The Tax Court distinguished the case from situations where the acquiring corporation uses its own funds or borrowed funds to purchase assets in addition to issuing stock, which would violate the "solely for voting stock" requirement. Here, Westfir used only Western's existing cash to satisfy the dissenting bondholders' claims. The court emphasized that the acquiring corporation never purchased any asset but used its stocks, the use of cash by the transferor was immaterial to the exchange. The court reasoned that the transaction's tax consequences should not hinge on the trivial detail of whether the cash was distributed before or after the asset transfer. The court stated, "The assets actually acquired were acquired solely for stock." Additionally, the court determined that the assumption of Western's liabilities by Westfir should be disregarded, as provided by the statute.

Practical Implications

This case clarifies that the "solely for voting stock" requirement in a reorganization does not necessarily prevent the use of the transferor corporation's own cash to satisfy dissenting shareholders. Attorneys structuring reorganizations can rely on this ruling to ensure that the use of the target company's cash for dissenters does not automatically disqualify the transaction from tax-free treatment. This ruling provides flexibility in structuring reorganizations, particularly in situations involving dissenting shareholders or creditors. Later cases may distinguish this ruling based on the source of the cash used to pay off dissenters, reinforcing the principle that the acquiring corporation should only use its voting stock for the acquisition.