9 T.C. 468 (1947)

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When creditors exchange debt (judgment claims) for stock in a debtor corporation and, after the exchange, control the corporation, no gain or loss is recognized under Section 112(b)(5) of the Internal Revenue Code.

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Summary

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In *Duncan v. Commissioner*, the Tax Court held that the exchange of judgment claims for stock in a debtor corporation qualified for non-recognition of gain under Section 112(b)(5) of the Internal Revenue Code. The petitioners, creditors holding judgment claims against May Oil Burner Corporation, received stock in the corporation in proportion to their claims. Immediately after the exchange, the petitioners controlled the corporation. The court reasoned that this transaction was akin to a reorganization where debt is exchanged for equity, thus deferring recognition of gain or loss.

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Facts

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The petitioners held promissory notes of May Oil Burner Corporation totaling $250,000. A.E. Duncan also loaned the corporation $20,000. Unable to pay the notes, the corporation faced unsuccessful recapitalization efforts and a dismissed bankruptcy petition. The petitioners obtained judgments on their notes totaling $270,000. An arbitration agreement led to the corporation amending its charter and issuing 270,000 shares of stock to the petitioners in settlement of the judgment claims, proportional to their holdings. The petitioners then owned 81.84% of the corporation’s stock.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in the petitioners' 1941 income tax, arguing that the receipt of stock in satisfaction of the judgment constituted a taxable gain. The petitioners appealed to the Tax Court, contending that the transaction fell under the non-recognition provisions of Section 112(b)(5) of the Internal Revenue Code.

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Issue(s)

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Whether the surrender of judgment claims to a debtor corporation in exchange for stock, resulting in the creditors controlling the corporation, constitutes a transfer in exchange within the meaning of Section 112(b)(5) of the Internal Revenue Code, thus qualifying for non-recognition of gain or loss.

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Holding

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Yes, because the surrender of judgment claims for stock, resulting in the creditors' control of the debtor corporation, is a transfer in exchange within the meaning of Section 112(b)(5), allowing for non-recognition of gain or loss.

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Court's Reasoning

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The Tax Court reasoned that the transaction was similar to a reorganization, where creditors exchange debt for a continuing equity interest in the corporation. The court distinguished cases like *Hale v. Helvering*, which held that settling a debt for cash less than its face value is not a

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