9 T.C. 1039 (1947)

The basis of assets acquired in a bank merger for equity invested capital purposes is the acquiring bank's cost when there is a lack of continuity of interest or control; also, a bank is not entitled to an allowance for new capital if the increase in inadmissible assets exceeds the amount of new capital; and income derived from transactions with the Commodity Credit Corporation is not tax-exempt unless explicitly stated in the authorizing statute.

Summary

Republic National Bank acquired assets from North Texas National Bank in a merger. The Tax Court addressed three issues: (1) determining the basis of the acquired assets for equity invested capital purposes, (2) whether the bank was entitled to an allowance for new capital, and (3) whether income from Commodity Credit Corporation transactions was tax-exempt. The court held that Republic's basis was its cost because there was a lack of continuity of interest. It further determined that no allowance for new capital was permitted because inadmissible assets increased by more than the new capital. Finally, the court ruled the income from Commodity Credit Corporation transactions was taxable because the relevant statute did not explicitly exempt it.

Facts

In 1929, Republic National Bank (Republic) acquired all assets and assumed all liabilities of North Texas National Bank (North Texas) in a merger, paying $750,000 in cash and issuing 25,000 shares of its stock. Negotiations started early in 1929, with Republic receiving North Texas's assets in October 1929. The formal merger agreement, executed on October 14, was subject to stockholder ratification and approval by the Comptroller of the Currency. Stockholder approval occurred on December 26, 1929, and Comptroller approval on December 28, 1929. Republic National Co., a corporation with shares held in trust for Republic's stockholders, purchased North Texas stock to facilitate the merger, later selling those shares to North Texas directors. In 1941, Republic increased its capital by selling new stock for cash. Republic also engaged in cotton loan programs with the Commodity Credit Corporation, earning income from these transactions.

Procedural History

The Commissioner of Internal Revenue assessed income tax, declared value excess profits tax, and excess profits tax deficiencies against Republic for the years 1940, 1941, and 1942. Republic contested certain adjustments, leading to a trial before the United States Tax Court.

Issue(s)

1. Whether, for equity invested capital purposes in 1940, 1941, and 1942, Republic's

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basis for assets acquired from North Texas is Republic's cost or the basis of the assets in the hands of North Texas.

2. Whether, in determining Republic's equity invested capital for 1941 and 1942, Republic is entitled to an allowance for new capital under Section 718(a)(6) of the Internal Revenue Code.

3. Whether the amounts received by Republic in 1940 and 1941 in transactions with the Commodity Credit Corporation constitute taxable or exempt income.

Holding

1. No, Republic's basis is its cost because the merger did not become effective until December 28, 1929, lacking the necessary continuity of control to apply Section 113(a)(7) of the Internal Revenue Code.

2. No, Republic is not entitled to an allowance for new capital because the increase in inadmissible assets on October 16, 1941, exceeded the amount of new capital.

3. No, the income received from the Commodity Credit Corporation transactions was not tax-exempt because the cotton producers' notes and purchase contracts were not the types of obligations Congress intended to exempt under Section 5 of the Act of March 8, 1938.

Court's Reasoning

Regarding the basis of the acquired assets, the court emphasized that the merger agreement explicitly required ratification by stockholders and approval by the Comptroller of the Currency, which did not occur until December 28, 1929. The court rejected the Commissioner's argument that the merger was effective in October 1929 upon physical delivery of assets, stating that federal banking laws governed the merger's effective date. Because the merger was not effective until late December there was not the necessary "continuity of control to make section 113 (a) (7) applicable."

On the new capital issue, the court interpreted Section 718(a)(6)(D) to mean that the amount of inadmissible assets cannot increase by more than the amount of new capital for the taxpayer to qualify for the allowance. The court held that "the term 'amount computed under section 720 (b) with respect to inadmissible assets held on such day,' appearing in section 718(a)(6)(D), means simply the mathematical sum of the adjusted bases of the inadmissible assets."

Concerning the Commodity Credit Corporation transactions, the court found that the cotton producers' notes and purchase contracts did not qualify as tax-exempt obligations under Section 5 of the Act of March 8, 1938. The court reasoned that the terms used are "Bonds, notes, debentures, and other similar obligations issued by the Commodity Credit Corporation." The court further explained that under Section

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4 of the Act “the obligations were to be in such forms and denominations, to have such maturities, to bear such rates of interest, to be subject to such terms and conditions, and to be issued in such manner and sold at such prices as might be prescribed by the Commodity Credit Corporation with the approval of the Secretary of the Treasury. They were to be fully and unconditionally guaranteed by the United States, and the guaranty was to be expressed on their face.” The cotton producers’ notes and the purchase contracts simply did not fit these parameters.

Practical Implications

This case clarifies the requirements for establishing continuity of interest in corporate reorganizations for tax purposes, emphasizing that formal approvals required by law are critical in determining the effective date of a merger. It also provides guidance on the limitations of the new capital allowance under Section 718(a)(6) of the Internal Revenue Code, demonstrating that an increase in inadmissible assets can negate the benefits of increased capital. Finally, it underscores the principle that tax exemptions must be explicitly stated in the relevant statutes and should not be broadly inferred, particularly in cases involving government agencies.

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