10 T.C. 708 (1948)

A corporate restructuring does not qualify as a tax-free reorganization under Section 112(g)(1)(D) of the Internal Revenue Code if the transferee corporation is formed solely to liquidate assets and does not continue the transferor's business operations.

Summary

Standard Rice Co. (Rice) liquidated and distributed cash and mill interests to its shareholders. The shareholders then formed Standard Realization Co. (Standard) solely to sell the mills. Standard quickly sold the mills and dissolved. The Commissioner argued this was a tax-free reorganization, requiring Standard to use Rice's basis in the mills. The Tax Court disagreed, holding that because Standard was formed solely to liquidate assets and did not continue Rice's business, the transaction did not qualify as a reorganization. Standard was entitled to use the fair market value of the mills at the time of transfer as its basis.

Facts

Standard Rice Co. (Rice) owned and operated several rice mills. After experiencing financial difficulties and the death of its experienced manager, Rice decided to liquidate. Rice distributed cash and undivided interests in three mills to its shareholders as a liquidating dividend. The Rice shareholders then formed Standard Realization Co. (Standard) for the sole purpose of selling the mills. Rice shareholders received stock in Standard equal to their ownership in Rice. Standard sold the mills within a few months and then dissolved. There were no pending negotiations for the sale of the mills at the time of the transfer to Standard.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in Standard's income tax, arguing that Standard acquired the mills in a reorganization and should use Rice's basis. Standard petitioned the Tax Court, arguing there was no reorganization.

Issue(s)

1. Whether the transfer of assets from Rice to Standard, through the shareholders, constituted a tax-free reorganization under Section 112(g)(1)(D) of the Internal Revenue Code.
2. What is Standard's basis in the mills for computing gain or loss on the sale of the mills?

Holding

1. No, because Standard was not created to carry on any part of Rice's corporate business, but solely for the purpose of selling assets.

2. Standard’s bases for computing gain or loss on the sale of the mills are the bases of the transferor shareholders, because there was no reorganization.

Court’s Reasoning

The court reasoned that while the literal requirements of Section 112(g)(1)(D) were met (transfer of assets, shareholder control), the substance of the transaction lacked a key element of a reorganization: the continuation of a business enterprise. The court emphasized that Standard was formed solely to liquidate the mills, not to operate them as a going concern. The court distinguished this case from others where a liquidation was part of a broader reorganization plan that included the continuation of the transferor’s business. The court quoted *Gregory v. Helvering, 293 U.S. 465* stating that to warrant application of 112(g)(1)(D) there must be a transfer made “in pursuance of a plan of reorganization of corporate business; and not a transfer of assets by one corporation to another in pursuance of a plan having no relation to the business of either.” Because Standard was formed for the sole purpose of liquidating assets, the court held it was entitled to use the fair market value of the mills at the time of transfer, resulting in no taxable gain.

Practical Implications

This case clarifies that a mere transfer of assets followed by shareholder control is insufficient for a tax-free reorganization. A key factor is whether the transferee corporation continues the business operations of the transferor. This decision provides guidance on the “continuity of business enterprise” requirement in corporate reorganizations. Legal practitioners must carefully consider the transferee’s intended activities to determine whether a transaction qualifies as a tax-free reorganization or a taxable liquidation. Later cases have cited *Standard Realization* to emphasize that the transferee must actively engage in the transferor’s business, not merely liquidate its assets. This principle is essential when structuring corporate transactions and advising clients on tax implications.

