Elise W. Hill v. Commissioner, 10 T.C. 1090 (1948)

A transfer of assets between corporations constitutes a tax-free reorganization under Section 112(g) of the 1936 Revenue Act if it serves a legitimate business purpose, even if it also results in tax advantages for the shareholders.

Summary

Elise W. Hill received a distribution from Timber Company pursuant to a corporate restructuring. Timber transferred approximately 44% of its assets to Bonners in exchange for all of Bonners' stock. The Tax Court addressed whether this transaction qualified as a tax-free reorganization under Section 112(g) of the Revenue Act of 1936, or whether it should be treated as a taxable distribution. The court held that the transfer qualified as a tax-free reorganization because it served a legitimate business purpose, specifically to alleviate the burden of personal holding company surtax, even though it also benefited the shareholders. The distribution was taxable as a dividend to the extent of the pro rata share in corporate earnings and profits.

Facts

- Timber Company, an investment company, transferred approximately 44% of its assets to Bonners in exchange for all of Bonners' stock.
- The same individuals controlled and operated both Timber and Bonners.
- The investment policy of Bonners was somewhat altered, investing more in government obligations and less in corporate stocks and bonds.
- The restructuring was motivated by changes in tax laws that adversely affected personal holding companies. The easily divisible assets were moved to Bonners, thus relieving them of the personal holding company surtax.
- Elise W. Hill, a Timber Company stockholder, received a distribution as part of this transaction.

Procedural History

The Commissioner of Internal Revenue determined that the distribution received by Hill should be taxed as a dividend. Hill petitioned the Tax Court, arguing that the distribution should be taxed at capital gains rates as a distribution in complete liquidation under Section 115(c) of the Revenue Act of 1936. The Tax Court ruled in favor of the Commissioner, holding that the transaction constituted a tax-free reorganization.

Issue(s)

1. Whether the transfer of assets from Timber to Bonners, followed by a distribution to Timber's shareholders, constituted a tax-free reorganization under Section 112(g)(1)(C) of the Revenue Act of 1936.
2. If the transaction was a reorganization, whether the distribution to Hill should

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be taxed as a dividend to the extent of her pro rata share of the undistributed corporate earnings and profits.

Holding

1. Yes, because the transfer of assets was undertaken for reasons germane to the continuance of the corporate business, and the same persons who controlled Timber controlled Bonners.
2. Yes, because Section 112(c)(2) dictates that if a distribution has the effect of a taxable dividend, it is to be taxed as such to the extent of the distributee's ratable share of undistributed corporate earnings and profits.

Court's Reasoning

The court reasoned that the transaction fell within the definition of a reorganization under Section 112(g)(1)(C) because Timber transferred assets to Bonners, and the same shareholders controlled both corporations immediately after the transfer. The court emphasized that the transfer was undertaken for reasons germane to the continuance of the corporate business, specifically to avoid personal holding company surtax. While the distribution provided a tax benefit to shareholders, the court stated: "It is difficult to find any lack of sound business prudence in such a transaction... the motive behind the transaction is not determinative, but the inquiry, rather, is as to whether what was done is the type of thing with which the reorganization provisions of the statute were concerned." The court distinguished this case from those where new companies were merely used to liquidate assets. The court cited *Gregory v. Helvering*, 293 U.S. 465, and *Bazley v. Commissioner*, 331 U.S. 737, emphasizing that the substance of the transaction, rather than merely its form, should govern. Because Hill received property other than stock in the new corporation, the gain was recognized but taxed as a dividend to the extent of her share of undistributed corporate profits.

Practical Implications

This case clarifies that a corporate restructuring can qualify as a tax-free reorganization even if it is motivated by tax advantages, as long as it also serves a legitimate business purpose. It emphasizes that the

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