10 T.C. 1080 (1948)

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A corporate reorganization qualifies for tax-free treatment only if it serves a legitimate business purpose and is not solely a device for distributing corporate earnings to shareholders while avoiding dividend taxation.

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Summary

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John D. Lewis, Inc. transferred its operating assets to a newly formed entity, John D. Lewis Co., in exchange for the new company's stock and assumption of liabilities. The old company then liquidated, distributing cash, securities, and the new company's stock to its shareholders. The Tax Court, on remand from the First Circuit, addressed whether a valid business purpose existed for the transfer. The court held that the transaction constituted a valid reorganization under Section 112(g)(1)(D) because the transfer was undertaken for reasons germane to the continuance of the corporate business, despite the shareholders' tax motives, and the distribution had the effect of a taxable dividend under Section 112(c)(2).

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Facts

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John D. Lewis, Inc. engaged in manufacturing synthetic resins and chemicals. In 1941, it sold two branches of its business. On December 27, 1941, the board voted to transfer its remaining operating assets to a new corporation, John D. Lewis Co., in exchange for all of the new company's stock and assumption of the old company's liabilities. The old company then changed its name to Traverse Street Corporation and liquidated, distributing its remaining assets, including the new company's stock, to its shareholders.

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Procedural History

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The Tax Court initially ruled the distribution was part of a reorganization and taxable as a dividend. The First Circuit vacated and remanded, requiring a finding on whether a business purpose existed for the transfer. On remand, the Tax Court made supplemental findings of fact and reaffirmed its original decision.

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Issue(s)

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Whether the transfer of operating assets from John D. Lewis, Inc. to John D. Lewis Co. constituted a tax-free corporate reorganization under Section 112(g)(1)(D) of the Internal Revenue Code, given the subsequent liquidation of the old company and distribution of assets to its shareholders.

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Holding

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Yes, because the transfer of assets was undertaken for reasons germane to the continuance of the corporate business, satisfying the "business purpose" requirement, even though the shareholders also sought to minimize taxes. The distribution to the A stockholders pursuant thereto had the effect of the distribution of a taxable dividend under section 112 (c)(2).

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Court's Reasoning

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The Tax Court emphasized that the

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