***11 T.C. 656 (1948)***

When a new corporation acquires assets through a reorganization involving a foreclosure and exchange of stock for bonds, the corporation's equity invested capital is based on the fair market value of the stock exchanged and liabilities assumed, not the inflated value of the assets prior to the reorganization.

**Summary**

Victory Glass, Inc. sought to increase its equity invested capital for tax purposes based on a high valuation of assets acquired during a reorganization. The Tax Court determined that Victory Glass's equity invested capital should be calculated based on the fair market value of preferred stock exchanged for bonds of the old company, plus assumed liabilities, rather than the asserted fair market value of the underlying assets. This decision hinged on the fact that the bondholders acted as a conduit in the reorganization, without the intention of contributing capital beyond the value of their exchanged bonds. The court also disallowed depreciation deductions calculated on the inflated asset value.

**Facts**

Victory Glass Co. (the old company) faced financial difficulties, leading to a receivership. Its assets were encumbered by two mortgages securing bond issues. To secure working capital from the Reconstruction Finance Corporation (RFC), a reorganization plan was created. This plan involved foreclosing on the mortgages, selling the old company's assets, forming Victory Glass, Inc. (the new company), and exchanging its preferred stock for the old company's first mortgage bonds. The First Jeannette Bank & Trust Co., as trustee, purchased the assets at a sheriff's sale for a nominal amount ($1), subject to tax liens and execution costs. The trustee then transferred the assets to Victory Glass, Inc., whose preferred stock was exchanged for the bonds.

**Procedural History**

Victory Glass, Inc. calculated its equity invested capital and depreciation deductions based on its perceived fair market value of the assets acquired in the reorganization. The Commissioner of Internal Revenue challenged this valuation, leading to a deficiency assessment for income, declared value excess profits, and excess profits taxes. Victory Glass, Inc. then petitioned the Tax Court to contest the Commissioner's determination.

**Issue(s)**

1. Whether Victory Glass, Inc. could include $77,614.09 in its equity invested capital, representing the difference between the book value and the asserted fair market value of assets acquired from the trustee.
2. Whether Victory Glass, Inc. was entitled to depreciation deductions based on

the inflated fair market value of the acquired assets.

**Holding**

1. No, because Victory Glass, Inc.'s equity invested capital should be based on the fair market value of the preferred stock exchanged for bonds and the liabilities assumed, not the inflated value of the assets.
2. No, because the depreciation deductions must be based on the same cost basis used to calculate equity invested capital.

**Court's Reasoning**

The Tax Court reasoned that the bondholders acted merely as a conduit in the reorganization plan, without the intention of contributing capital beyond the value of their bonds. The court emphasized that the plan required the bondholders to exchange their lien on the assets for preferred stock, and there was no evidence they intended to donate additional value to the new corporation. The court found that the cost to Victory Glass, Inc. of acquiring the assets was the fair market value of the preferred stock issued in exchange for the bonds, plus the liabilities assumed ($31,200 + $6,963.38). The court distinguished *Dill & Collins Co., 18 B.T.A. 638*, noting it applied a different statute. Since the equity invested capital was not based on the higher asset value, the court concluded the depreciation deductions should be calculated using the same, lower cost basis.

**Practical Implications**

This case highlights the importance of accurately determining the cost basis of assets acquired during corporate reorganizations for tax purposes. It clarifies that the equity invested capital cannot be artificially inflated based on a pre-reorganization asset valuation if the transaction's substance indicates that the exchanging parties did not intend a contribution of capital beyond the value of the consideration they received (here, stock). It emphasizes that the intent of parties exchanging property for stock is critical in determining whether they intended to contribute to capital. Later cases applying this ruling would focus on whether the parties involved were acting as conduits or making genuine contributions to capital. It impacts how tax advisors structure corporate reorganizations and how the IRS scrutinizes valuations of assets contributed during these transactions.

 