12 T.C. 837 (1949)

A transfer of property to a corporation in exchange for stock is a taxable event if the transferors do not own at least 80% of the corporation's stock immediately after the exchange.

Summary

Mojonnier & Sons, Inc. sought to increase its equity invested capital for excess profits tax purposes by valuing assets it received from its founders, F.E. Mojonnier and his wife, at their fair market value at the time of transfer. The IRS argued that the transfer was tax-free under Section 112(b)(5) of the 1928 Revenue Act because the Mojonniers controlled the corporation after the transfer and the assets should retain their original cost basis. The Tax Court disagreed, holding that because the Mojonniers owned less than 80% of the stock after the transfer, it was a taxable exchange, and the corporation could use the fair market value of the assets to calculate its equity invested capital.

Facts

F.E. Mojonnier and his wife operated a greenhouse and produce business.
Prior to incorporating, they promised stock to their son and son-in-law, Harold and Lewis, if they joined the business.
In 1930, Mojonnier & Sons, Inc. was formed. Mojonnier transferred the business assets to the corporation in exchange for stock, with some shares issued to himself, his wife, Harold, Lewis, and another employee, Hills.
After the stock issuance, the Mojonniers owned 1,490 shares out of 2,000, representing 74.5% of the outstanding stock.

Procedural History

Mojonnier & Sons, Inc. sought to increase its equity invested capital for tax years 1942 and 1943, using the fair market value of assets transferred in 1930.
The Commissioner of Internal Revenue determined deficiencies in excess profits tax, arguing for a lower cost basis and asserting estoppel.
The Tax Court reviewed the Commissioner's determination.

Issue(s)

Whether the transfer of assets to Mojonnier & Sons, Inc. in exchange for stock was a tax-free exchange under Section 112(b)(5) of the Revenue Act of 1928, requiring the corporation to use the transferors' basis in the assets.
Whether Mojonnier & Sons, Inc. was estopped from claiming a higher basis for the assets than the transferors' adjusted cost basis due to the transferors not reporting a gain on the transfer in 1930.

Holding

No, because the Mojonniers did not control the corporation immediately after the exchange, owning less than 80% of the outstanding stock. Therefore, the transfer was a taxable exchange.
No, because the transferors acted in good faith, and there was no misrepresentation of facts to justify estoppel.

Court's Reasoning

The court relied on Section 112(b)(5) and 112(j) of the Revenue Act of 1928, which stipulated that no gain or loss shall be recognized if property is transferred to a corporation in exchange for stock, and immediately after the exchange, the transferors control the corporation. "Control" was defined as owning at least 80% of the voting stock and 80% of all other classes of stock.
Because the Mojonniers owned only 74.5% of the stock after the transfer, they did not meet the control requirement. The court rejected the IRS's argument that the stock issued to Harold and Lewis should be considered gifts, finding that the stock issuance was consideration for their past services and a fulfillment of the Mojonniers' promise.
The court distinguished *Wilgard Realty Co. v. Commissioner*, noting that in that case, the transferor could have withheld the stock, while in this case, the stock was issued directly to the family members as part of the initial plan.
Regarding estoppel, the court found no evidence of misrepresentation or intent to mislead. The revenue agent was aware of the details of the incorporation. The court quoted *Florida Machine & Foundry Co. v. Fahs*, stating, "There can be no estoppel against taxpayer for the act of its transferor, who was not in control of taxpayer corporation immediately after the transfer, and who was shown to have acted in good faith."

Practical Implications

This case clarifies the application of Section 112(b)(5) regarding tax-free transfers to controlled corporations. It emphasizes that the 80% control requirement must be strictly met immediately after the exchange.
Attorneys structuring corporate formations must carefully consider the distribution of stock to ensure that transferors maintain the requisite control to avoid triggering a taxable event.
The case illustrates that promises of stock for past services can constitute valid consideration, negating the argument that stock issuances are merely gifts.
The decision limits the application of the estoppel doctrine against corporations based on the actions of their transferors, especially when the transferors lack control and act in good faith. This provides some protection to corporations in subsequent tax disputes when their transferors may have made errors in their initial filings. Later cases and rulings would need to consider any changes to the tax code and regulations regarding corporate formations and control requirements.

