12 T.C. 1146 (1949)

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To qualify for tax exemption under Section 3798(b) of the Internal Revenue Code, depositors of an insolvent bank must receive a lien on the bank's subsequent earnings *solely* in lieu of their claims, and the bank must demonstrate that taxation would diminish assets needed to pay those claims.

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Summary

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New Brunswick Trust Co. sought a tax exemption under Section 3798(b) of the Internal Revenue Code, arguing that it had been released from liability to depositors who accepted preferred stock in lieu of their claims. The Tax Court denied the exemption, holding that the depositors did not receive a true lien on the bank's future earnings because the bank had discretion over using earnings. Moreover, the depositors also received a controlling interest in the bank's common stock, so the preferred stock was not received *solely* in lieu of their claims. Therefore, the bank did not meet the requirements for tax exemption under the statute.

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Facts

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New Brunswick Trust Co. closed in 1933 due to insolvency. A reorganization plan, sanctioned by the New Jersey Banking Commissioner, was created to allow the bank to reopen. Depositors received preferred stock for 50% of their claims. The preferred stock had cumulative dividends and was to be retired at a premium. Depositors also received 51% of the common stock, giving them a controlling interest in the reorganized bank. The preferred stock certificates stated that dividends on common stock could be paid only after all preferred stock was retired with cumulative dividends. The bank reopened in December 1933. By 1941, remaining unsecured deposits were liquidated from old assets. As of 1945, the bank had not yet earned enough to redeem the preferred stock.

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Procedural History

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The Commissioner of Internal Revenue determined a deficiency in New Brunswick Trust Co.’s income tax and declared value excess profits tax for 1945. The bank petitioned the Tax Court, arguing it was exempt from taxation under Section 3798(b) of the Internal Revenue Code.

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Issue(s)

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1. Whether the redemption provision in the preferred stock certificates granted depositors an equitable lien on the bank’s future earnings.

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2. Whether the preferred stock was accepted by the depositors

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