13 T.C. 889 (1949)

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A transaction qualifies as a tax-free reorganization under Section 112(b)(10) of the Internal Revenue Code only if there is a continuity of interest on the part of those who were the owners of the enterprise before the reorganization.

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Summary

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Chicago Stadium Corporation (petitioner) acquired assets from an insolvent predecessor, also named Chicago Stadium Corporation (Illinois corporation), through a reorganization plan under Section 77-B of the Bankruptcy Act. The petitioner issued stock and bonds, selling some for cash and exchanging others for the predecessor's bonds. The predecessor's stockholders received nothing. The Tax Court held that the transfer was not a tax-free reorganization under Section 112(b)(10) because there was no continuity of interest from the original owners. The petitioner's basis in the assets was thus its cost, not the predecessor's basis.

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Facts

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The Illinois corporation, which owned and operated the Chicago Stadium, defaulted on its first mortgage bond interest payments in 1932. Receivers were appointed, and the corporation entered reorganization proceedings under Section 77-B of the Bankruptcy Act in 1934. A reorganization plan was proposed, involving the formation of a new corporation (the petitioner) to acquire the assets. Underwriter James Norris agreed to provide $250,000 for taxes, working capital, and reorganization expenses, receiving first mortgage bonds and common stock of the new corporation in return. First mortgage bondholders of the Illinois corporation received second mortgage bonds of the petitioner. Preferred and common stockholders of the Illinois corporation received nothing.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in the petitioner’s excess profits and income taxes for 1944 and 1945. The Commissioner argued that the petitioner’s basis in the assets acquired from the Illinois corporation should be the cost to the petitioner, not the basis in the hands of the Illinois corporation. The Tax Court upheld the Commissioner’s determination, finding that the transaction did not qualify as a tax-free reorganization.

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Issue(s)

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Whether the basis of the petitioner’s assets for depreciation and equity invested capital purposes is the cost of the assets to the petitioner, or whether the petitioner is entitled to use the basis of the prior corporation under Sections 112(b)(10) and 113(a)(22) of the Internal Revenue Code, as amended?

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Holding

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No, because the transaction did not meet the continuity of interest requirement for a tax-free reorganization under Section 112(b)(10) of the Internal Revenue Code. The original owners of the enterprise (the stockholders of the Illinois corporation) did not receive a substantial ownership interest in the new corporation.

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Court’s Reasoning

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The Tax Court reasoned that while the transaction met the literal requirement of exchanging property for stock or securities, it failed the implicit requirement of