13 T.C. 919 (1949)

r
r

A corporate reorganization can be tax-free under Section 112(g)(1)(D) of the Internal Revenue Code if the transferor corporation's shareholders control the transferee corporation immediately after the transfer, even if not all of the transferor's original shareholders participate in the new entity, provided the participating shareholders own at least 80% of the transferee's voting stock.

r
r

Summary

r

Reilly Oil Co. (petitioner) disputed the Commissioner's determination that its acquisition of oil properties from its predecessor was a tax-free reorganization. The Commissioner argued that Reilly Oil Co. must use its predecessor's cost basis for depletion deductions, resulting in a smaller deduction than if it used its own cost basis. Reilly Oil Co. contended that the acquisition was taxable, entitling it to a higher cost basis and larger depletion deductions. The Tax Court held that the acquisition was a tax-free reorganization under Section 112(g)(1)(D), so Reilly Oil Co. had to use its predecessor's basis. The key was that the shareholders of the predecessor who participated in the new company owned 100% of the new company's stock, even though it was only 68.93% of the original shareholders.

r
r

Facts

r

Trapshooter Reilly Oil & Royalties Co. (predecessor) underwent bankruptcy reorganization. As part of the reorganization plan, a new corporation, Reilly Oil Co. (petitioner), was formed. The bankruptcy court approved a plan where some of the predecessor's assets were sold to pay off creditors and redeem stock/unit holdings. The remaining assets were transferred to Reilly Oil Co. In exchange, Reilly Oil Co. issued stock to those shareholders and unit holders of the predecessor who elected to receive stock in the new company. Approximately 68.93% of the predecessor's shareholders participated in the new corporation, owning 100% of its stock. The Commissioner determined that the transfer was a tax-free reorganization, requiring Reilly Oil Co. to use the predecessor's lower cost basis for calculating depletion.

© 2025 SCOTUSreports.com. All rights reserved.

r
r

Procedural History

r

The Commissioner assessed deficiencies in Reilly Oil Co.’s income and excess profits taxes for 1943 and 1944, based on the determination that the company acquired its oil properties in a non-taxable reorganization and therefore had to use the predecessor’s cost basis. Reilly Oil Co. petitioned the Tax Court, arguing that the acquisition was a taxable transaction and that it was entitled to use its own cost basis, resulting in larger depletion deductions. The Tax Court upheld the Commissioner’s determination.

r
r

Issue(s)

r

Whether the transfer of assets from the predecessor corporation to Reilly Oil Co. constituted a tax-free reorganization under Section 112(g)(1)(D) of the Internal Revenue Code, requiring Reilly Oil Co. to use the predecessor’s cost basis for depletion deductions.

r
r

Holding

r

Yes, because after the transfer, the transferor’s shareholders (specifically, those who elected to participate in the new entity) controlled the corporation to which the assets were transferred (Reilly Oil Co.) within the meaning of Section 112(h), even though not all original shareholders participated, as long as the participating shareholders owned at least 80% of the transferee’s voting stock.

r
r

Court’s Reasoning

r

The Tax Court determined that the transfer did not qualify as a reorganization under

© 2025 SCOTUSreports.com. All rights reserved.

Section 112(g)(1)(C) because Reilly Oil Co. did not acquire substantially all of the predecessor's properties. However, the court found that the transfer met the requirements of Section 112(g)(1)(D), which defines a reorganization as a transfer of assets from one corporation to another if, immediately after the transfer, the transferor or its shareholders control the transferee. Control is defined in Section 112(h) as owning at least 80% of the voting stock. The court reasoned that even though only 68.93% of the predecessor's shareholders participated in the new corporation, they owned 100% of Reilly Oil Co.'s stock. The court cited *Toklan Royalty Corporation v. Jones*, which held that a reorganization was tax-free even though only 75.5% of the transferor's stockholders continued their interest in the successor corporation, because those stockholders owned all of the stock of the transferee corporation. The court rejected Reilly Oil Co.'s argument that

© 2025 SCOTUSreports.com. All rights reserved.