14 T.C. 81 (1950)

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For a statutory merger to qualify as a tax-free reorganization under Section 112(g)(1)(A) of the Internal Revenue Code, the transaction must satisfy the "continuity of interest" doctrine, requiring the transferor corporation's shareholders to retain a substantial proprietary interest in the acquiring corporation.

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Summary

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Southwest Natural Gas Co. acquired Peoples Gas & Fuel Corporation in a statutory merger. The Tax Court addressed whether this merger qualified as a tax-free reorganization under Section 112(g)(1)(A) of the Internal Revenue Code. Peoples' shareholders received a combination of Southwest's stock, bonds, and cash. The court held that the transaction did not qualify as a tax-free reorganization because the equity received by Peoples' shareholders did not represent a substantial portion of the value of the transferred assets, thus failing the "continuity of interest" test.

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Facts

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Southwest Natural Gas Co. (Southwest) and Peoples Gas & Fuel Corporation (Peoples) were both utility companies. Southwest acquired all of Peoples' assets in a statutory merger under Delaware law. In exchange, Peoples' shareholders received: (1) 16.4% of Southwest's common stock (valued at $5,592.50), (2) Southwest's bonds, (3) cash, and (4) assumption of Peoples' liabilities. The total consideration was $663,393.01. The same group of people owned approximately 85% of Southwest's common stock and 35% of Peoples' common stock. After the transaction, these individuals continued in active control of the merged business enterprise.

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Procedural History

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The Commissioner of Internal Revenue determined that the merger did not constitute a tax-free reorganization. The Commissioner asserted deficiencies in Southwest's income tax, declared value excess profits tax, and excess profits tax for the years 1941 and 1942. Southwest petitioned the Tax Court for review.

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Issue(s)

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Whether the statutory merger of Peoples into Southwest constituted a "reorganization" within the meaning of Section 112(g)(1)(A) of the Internal Revenue Code, considering the "continuity of interest" doctrine.

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Holding

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No, because the value of the Southwest stock received by Peoples' shareholders represented an insubstantial portion of the total consideration, thus failing the

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