14 T.C. 263 (1950)

A transaction where property is transferred to a corporation solely in exchange for stock, and the transferors control the corporation immediately after the exchange, can qualify as a tax-free reorganization, with the stock basis carried over from the transferors.

Summary

ACF-Brill Motors sought to deduct certain expenses and challenged the IRS's determination of its invested capital basis. The Tax Court addressed whether a corporate reorganization was tax-free, impacting the basis of stock held by ACF-Brill. The court held that the initial stock acquisitions by American Car & Foundry and J.G. Brill were separate from the later formation of ACF-Brill, but the subsequent stock exchanges qualified as a tax-free reorganization. The court also addressed the deductibility of Pennsylvania and California state taxes, finding some deductible in 1943 and others not.

Facts

American Car & Foundry Co. and J.G. Brill Co. sought to consolidate bus manufacturing interests by acquiring Hall-Scott Motor Car Co. and Fageol Motors Co. Initially, American Car & Foundry and Brill directly purchased stock in Hall-Scott. Subsequently, they formed American Car & Foundry Motors Co. (ACF-Brill's predecessor). The shareholders of Hall-Scott and Fageol Ohio exchanged their shares for stock in the newly formed American Car & Foundry Motors Co. ACF-Brill later claimed certain deductions for Pennsylvania and California state taxes.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in ACF-Brill's excess profits tax for 1943. ACF-Brill contested certain adjustments, leading to a Tax Court case. The Tax Court addressed several issues related to the computation of consolidated invested capital and the deductibility of state taxes.

Issue(s)

1. Whether ACF-Brill's predecessor held the stock of Hall-Scott Motor Car Co. and Fageol Motors Co. with an "other than cost basis" as prescribed by Regulations 110, section 33.31 (c) (2) (iv) (F)?
2. Whether ACF-Brill is entitled to accrue and deduct on its 1943 consolidated tax return $17,896.84 for Pennsylvania income and franchise taxes of ACF Motors Co.?
3. Whether ACF-Brill is entitled to an additional deduction for 1943 of $34,169.55 for California franchise tax based on the 1942 income of its subsidiary, Hall-Scott Motor Car Co.?
4. Whether ACF-Brill should be permitted to deduct for the taxable year 1943 an

© 2025 SCOTUSreports.com. All rights reserved.

amount paid by Hall-Scott Motor Car Co. for California franchise tax based on 1943 income of that subsidiary?

Holding

1. Yes, because the stock exchanges qualified as a tax-free transaction under section 203(b)(4) of the Revenue Act of 1926, thus mandating the use of the transferor's basis.
2. Yes, because all the events fixing the liability for the Pennsylvania taxes had occurred, and the amount was determinable in 1943.
3. Yes, because there was no evidence of a protest against the additional tax assessment made by California.
4. No, because the franchise tax for the privilege of doing business in 1944, measured by 1943 income, accrued and was deductible in 1944, not 1943.

Court's Reasoning

The court reasoned that while the initial stock purchases by American Car & Foundry and J.G. Brill were independent transactions, the subsequent exchanges of stock in Hall-Scott and Fageol Ohio for stock in the newly formed American Car & Foundry Motors Co. met the requirements of a tax-free reorganization under section 203(b)(4) of the Revenue Act of 1926. The court emphasized that after the exchange, the transferors were in control of the corporation, and the stock received was proportionate to their prior interests. Regarding the Pennsylvania taxes, the court applied the "all events test" established in *Dixie Pine Products Co. v. Commissioner*, finding that because the liability was fixed and determinable in 1943, the deduction was proper in that year. For the California taxes based on 1942 income, the court noted the lack of protest and allowed the deduction. Citing *Central Investment Corporation*, the court disallowed the deduction for California franchise taxes based on 1943 income, as that tax accrued in 1944.

Practical Implications

This case illustrates the importance of complying with the technical requirements for tax-free corporate reorganizations under section 368 of the Internal Revenue Code (which evolved from section 203(b)(4) of the Revenue Act of 1926). It demonstrates that even if the ultimate goal is a reorganization, preliminary steps, if considered independent transactions, can impact the tax basis of acquired assets. The case also reinforces the "all events test" for accrual-basis taxpayers, clarifying when state tax liabilities can be deducted for federal income tax purposes. Taxpayers and practitioners should carefully examine all steps in a reorganization plan and ensure that state tax liabilities are properly accrued and deducted to avoid potential tax deficiencies and penalties. Later cases cite this case for its explanation of step transactions and the application of the all-events test.

© 2025 SCOTUSreports.com. All rights reserved.