14 T.C. 1425 (1950)

When property is exchanged for stock in a corporate transaction, the property's basis for determining loss upon sale or exchange is included in equity invested capital, even if the stock is immediately sold to underwriters pursuant to a prearranged plan.

Summary

Black Hills Power & Light Co. sought to increase its equity invested capital for excess profits tax purposes based on the value of property it received from General Public Utilities, Inc. (General) in exchange for stock. The Commissioner argued that the equity invested capital should be based on the price paid by the underwriters who immediately purchased the stock from General. The Tax Court held that because property was actually paid in for stock, the basis of that property should be included in equity invested capital, and determined the value of the property to be $2,280,000.

Facts

General, a subsidiary of Community Power & Light Co., was required to divest itself of its South Dakota business operations. To accomplish this, Black Hills Power & Light Co. (Petitioner) was incorporated. Petitioner agreed to acquire General's South Dakota properties in exchange for cash, assumption of liabilities, and the issuance of 8,500 shares of preferred stock and 92,650 shares of common stock. An Underwriting Agreement was made with Dillon, Read & Co., where Petitioner sold the underwriters 7,350 shares of its common stock, and General sold the underwriters the remaining shares of preferred and common stock received from Petitioner. The underwriters then offered the stock to the public at a higher price.

Procedural History

Black Hills Power & Light Co. claimed an excess profits credit based on an invested capital that included amounts for the preferred and common stock issued for property. The Commissioner determined a deficiency, arguing for a lower valuation of the stock. The case was then brought before the Tax Court.

Issue(s)

1. Whether the equity invested capital should be determined by the cash paid by the underwriters for the stock, rather than by the value of the property received from General in exchange for the stock.
2. What was the fair market value of the preferred and common stock issued to General in exchange for the South Dakota properties?

Holding

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1. No, because General actually transferred property to the petitioner for the stock in question, and became the owner of that stock.
2. The Court determined the basis of the property paid in by General for the 8,500 shares of preferred and the 92,650 shares of common was $2,280,000, after consideration of all evidence.

Court’s Reasoning

The court rejected the Commissioner’s argument that the transactions were an integral plan to be viewed as a single event. The court found that General actually transferred property to the Petitioner for stock and became the owner of that stock, before selling to the underwriters. The court stated,

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