S.J. Braun, Inc. v. Commissioner, 4 T.C. 422 (1945)

In determining equity invested capital for tax purposes after a corporate reorganization, the basis of property acquired is the transferor's basis if, immediately after the transfer, the transferors retain a 50% or greater interest or control in the property.

Summary

S.J. Braun, Inc. disputed the Commissioner's calculation of its equity invested capital following a 1926 recapitalization. The company argued that the fair market value of stock issued for property, including patents and real estate, should be included in equity invested capital. The Tax Court held that the basis of the patents was the transferor's basis because the transferors retained a 50% or greater interest in the property after the reorganization. The court determined the transferor's basis based on available evidence, applying the Cohan rule where necessary.

Facts

S.J. Braun, Inc. underwent a recapitalization in 1926. As part of the recapitalization, the company issued Class A and Class B stock to various parties, including the Brauns, National Chemical Company, Keeps, and Davis, in exchange for property including real estate and patents. Ford, Bacon & Davis, Inc. and its associates paid cash for stock. The company included the value of the cash, old stock, land, intangibles and goodwill in its reported equity invested capital. The Commissioner disallowed a portion of this calculation related to intangibles.

Procedural History

S.J. Braun, Inc. petitioned the Tax Court to review the Commissioner's determination of a deficiency in its tax liability. The dispute centered on the amount includible in equity invested capital as a result of the 1926 recapitalization.

Issue(s)

1. Whether the basis of patents transferred to S.J. Braun, Inc. as part of a corporate recapitalization should be determined by the cost to the corporation or the transferor's basis, under Section 113(a)(7) of the Internal Revenue Code.

Holding

1. No, the basis of the patents should be determined by the transferor's basis because immediately after the transfer, the transferors retained an interest or control of 50% or more in the property.

Court's Reasoning

The court reasoned that the 1926 recapitalization qualified as a reorganization. Section 113(a)(7) of the Internal Revenue Code dictates that if property is acquired by a corporation in connection with a reorganization, and immediately after the transfer an interest or control of 50% or more remains in the same persons, then the basis of the property is the same as it would be in the hands of the transferor. The court found that the Brauns, National Chemical, Keeps, and Davis retained a 50% interest in the patents after the transfer. The court then determined the transferor's basis in the patents. As to patents from Keeps, the court applied *Cohan v. Commissioner, 39 F.2d 540*, to determine a reasonable basis of $2,000. As to patents from the Brauns, the court determined the basis to be $10,000. As to Davis, the court found that the patents had no basis to him, as they were likely created as an employee of the petitioner.

Practical Implications

This case clarifies how to determine the basis of property acquired in a corporate reorganization for purposes of calculating equity invested capital. It highlights the importance of determining whether the transferors retain a 50% or greater interest or control in the property after the transfer. It also demonstrates the application of the Cohan rule when precise evidence of basis is lacking. The case is significant for tax practitioners dealing with corporate reorganizations and the determination of asset basis for tax purposes. Later cases would rely on this precedent when assessing whether a transferor retained sufficient control to invoke the carryover basis rules.