17 T.C. 471 (1951)

Exchanges of stock and securities for other securities, pursuant to a plan of corporate reorganization, are tax-free under Section 112(b)(3) of the Internal Revenue Code if the reorganization has a valid business purpose and is not merely a disguised dividend distribution.

Summary

Wolf Envelope Company underwent a reorganization where debenture shares and Class A stock were exchanged for debenture bonds. The Tax Court addressed whether this exchange was a tax-free reorganization or a taxable dividend distribution. The court held that the exchange qualified as a tax-free recapitalization because it had a valid business purpose: to shift voting control to active managers and simplify the capital structure. This purpose distinguished the case from transactions that are merely disguised dividend distributions with no real business objective. The court found the exchange served a valid business purpose and therefore qualified as a tax-free reorganization.

Facts

The Wolf Envelope Company had a complex capital structure, including debenture shares, Class A common stock (held mostly by inactive shareholders), and Class B common stock (held by active managers). The Class A stock had a fixed cumulative dividend and a set liquidating value. The Class B stock had rights to further earnings. Disagreements arose between Class A and Class B shareholders. To resolve these, the company adopted a plan to issue new debenture bonds in exchange for Class A stock and existing debentures. New common stock was issued to Class B holders, giving them voting control.

Procedural History

The Commissioner of Internal Revenue determined deficiencies against Wolf Envelope Co. and its shareholders, arguing that the exchange of stock and securities for debenture bonds constituted a taxable dividend. The Tax Court disagreed, holding that the exchange qualified as a tax-free reorganization under Section 112(b)(3) of the Internal Revenue Code.

Issue(s)

1. Whether the exchange of debenture shares and Class A stock for debenture bonds constitutes a tax-free reorganization under Section 112(b)(3) of the Internal Revenue Code.
2. Whether the exchange was essentially equivalent to the distribution of a taxable dividend under Section 115(g)(1) of the Internal Revenue Code.

Holding

© 2025 SCOTUSreports.com. All rights reserved.

1. Yes, because the exchange was part of a plan of reorganization with a valid business purpose.
2. No, because the exchange served a valid business purpose beyond merely distributing earnings.

Court’s Reasoning

The court reasoned that the exchange was a

© 2025 SCOTUSreports.com. All rights reserved.