17 T.C. 1253 (1952)

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For a corporate reorganization to be considered tax-free under Section 112(g) of the 1936 Revenue Act, the transferor corporation or its shareholders must maintain control (at least 80% ownership) of the transferee corporation ‘immediately after the transfer’ of assets, but subsequent events like planned public stock offerings don’t necessarily negate that initial control if they are not inextricably linked to the reorganization itself.

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Summary

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Scientific Instrument Company (old) transferred its assets to a newly formed corporation, Scientific Instrument Company (new), in exchange for stock and warrants. The Tax Court addressed whether this transfer qualified as a tax-free reorganization. The court held that the transfer was a tax-free reorganization because the old company’s shareholders had control of the new company immediately after the transfer. The court reasoned that the planned sale of stock to the public to raise capital was a separate transaction that did not negate the initial control established at the time of the asset transfer, because there was no assurance the offering would occur, nor requirement for the old company to relinquish control.

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Facts

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Scientific Instrument Company (old) faced the expiration of its corporate charter. Its stockholders agreed to a plan in which a new corporation (Scientific Instrument Company) would be formed. The old company would transfer substantially all of its assets to the new company in exchange for 75,000 shares of the new company’s stock and warrants. The new company planned to sell additional shares to the public to raise working capital. The agreement stipulated that the old company’s stockholders would sell a portion of their new shares to Securities Investment Corporation. The asset transfer occurred on December 30, 1936, and the old company was dissolved the next day.

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Procedural History

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The Commissioner of Internal Revenue determined deficiencies in the new company's income tax, declared value excess-profits tax, and excess profits tax. The company argued that the asset transfer was not a tax-free reorganization, entitling it to a stepped-up basis in the assets. The Tax Court ruled in favor of the Commissioner, finding that the transfer qualified as a tax-free reorganization.

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Issue(s)

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Whether the transfer of assets from the old Scientific Instrument Company to the new Scientific Instrument Company qualified as a tax-free reorganization under Section 112(g) of the Revenue Act of 1936, considering the planned sale of stock to the public and the agreement for the old company's shareholders to sell shares to Securities Investment Corporation.

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Holding

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Yes, because the old company's shareholders had control of the new company "immediately after the transfer" of assets, and the subsequent planned sale of stock to the public was a separate transaction that did not necessarily negate that initial control.

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Court's Reasoning

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The court reasoned that the old company effectively owned 75,000 shares of the new company's stock as of December 30, 1936, regardless of when the stock certificate was physically issued. This constituted 100% control of the new company at the time of transfer. The court then addressed whether the planned sale of stock to the public

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should be considered an integral part of the reorganization plan, which would dilute the old company's control below the required 80%. The court determined that the sale of stock to the public was a separate step. The court emphasized that there was no guarantee the additional shares would be purchased, and no requirement that the old company relinquish control. As the court stated: "The core steps of the plan, as we view it, were the formation of the new corporation and the transfer to it of the assets of the old, thus insuring continuity of operations… These steps, so far as we can see, could stand alone. Their effectiveness did not depend on new capital." The court distinguished cases where divestiture of control was a required, integral step of the reorganization plan.

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Practical Implications

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This case provides guidance on the

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