19 T.C. 249 (1952)

A merger with a substantial business purpose does not constitute tax avoidance under Section 129, even if tax benefits are realized; however, a series of transactions designed to exchange stock for property can be treated as a single, indivisible transaction for tax purposes.

Summary

WAGE, Inc. (Petitioner) sought to utilize Revoir Motors, Inc.'s excess profits credit carryover after a merger with Sentinel Broadcasting Company. The Tax Court addressed whether the merger's primary purpose was tax avoidance under Section 129, and whether WAGE could claim a credit for new capital. The court held that the merger had a valid business purpose, thus Section 129 did not apply. However, the court treated the stock exchange and subsequent merger as a single transaction, denying WAGE's claim for new capital credit. Finally, the court held that Sentinel's income should not be included in WAGE's 1943 return because the merger was not final until the FCC approved it.

Facts

Revoir Motors, Inc. (later WAGE, Inc.), primarily an automobile distributor, possessed substantial liquid assets. Sentinel Broadcasting Company, owned primarily by Frank G. Revoir, operated radio station WAGE. Sentinel needed capital for expansion, including upgrades to its broadcast capabilities (5-kilowatt station and FM transmitter) and potential television transmission. Revoir Motors, Inc. recapitalized and agreed to acquire Sentinel's stock in exchange for its own. The agreement was contingent on FCC approval. After FCC approval, Sentinel was merged into WAGE, Inc., which then discontinued the automobile business and focused on radio broadcasting.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in WAGE, Inc.'s excess profits taxes for 1944 and 1945. WAGE, Inc. petitioned the Tax Court, contesting the deficiencies. The Tax Court addressed three issues related to unused excess profits credit carryover, credit for new capital, and the inclusion of Sentinel's income in WAGE's 1943 return.

Issue(s)

1. Whether the merger of Sentinel into WAGE, Inc. had a business purpose, or whether its primary purpose was tax avoidance under Section 129, precluding WAGE from using Revoir Motors, Inc.'s unused excess profits credit carryover.

2. Whether WAGE, Inc. is entitled to a credit for new capital in computing its invested capital credit for 1944 and 1945, based on the acquisition of Sentinel's

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stock in exchange for WAGE stock.

3. Whether WAGE, Inc. erroneously included Sentinel's income from September 1, 1943, through December 31, 1943, in computing its excess profits tax liability for 1943.

Holding

1. No, because the merger served a substantial business purpose by providing Sentinel with needed capital for expansion.

2. No, because the exchange of stock for property was part of a single, indivisible transaction and falls under the limitations of Section 718(a)(6)(A).

3. Yes, because the agreement was subject to FCC approval, and the merger was not final until the certificate was filed with the Secretary of State of New York on December 30, 1943.

Court's Reasoning

Regarding the tax avoidance issue, the court emphasized that Section 129 condemns tax avoidance only when control is acquired with the principal purpose of evading tax. The court found a substantial business purpose in the merger: Sentinel needed capital for upgrades and expansion into FM and potentially television broadcasting, which WAGE, Inc.'s liquid assets could provide. The court referenced *Commodores Point Terminal Corporation, 11 T.C. 411 (1948)*, noting that Section 129 does not disallow deductions where control is acquired for valid business reasons.

On the new capital credit issue, the court applied the "single transaction rule," citing *American Wire Fabrics Corporation, 16 T.C. 607 (1951)* and *Kimbell-Diamond Milling Co., 14 T.C. 74 (1950)*. The court reasoned that the ultimate effect of the transaction was an exchange of stock for property, a reorganization under Section 112(b)(4). Therefore, it was treated as property paid in by a corporation, thus Section 718(a)(6)(A) applied, disallowing the credit.

On the issue of including Sentinel's income, the court relied on *Vallejo Bus Co., 10 T.C. 131 (1948)*. Because the merger agreement was contingent upon FCC approval and the merger was not legally finalized until December 30, 1943, Sentinel's income before that date was not attributable to WAGE, Inc.

Practical Implications

This case clarifies the application of Section 129 in corporate mergers, emphasizing that a legitimate business purpose can shield a transaction from being deemed tax avoidance, even if tax benefits are realized. However, the "single transaction rule" can recharacterize a series of steps into a single transaction, with significant tax implications. Attorneys should carefully analyze the business purpose of mergers

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and be aware of the potential for the IRS to collapse related transactions into a single event. Further, this case underscores the importance of regulatory approvals in determining the effective date of corporate restructurings for tax purposes. This case continues to be relevant when evaluating transactions involving potential tax avoidance, especially in the context of corporate reorganizations and mergers.

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