19 T.C. 1123 (1953)

The dissolution of a corporation and the subsequent formation of a new corporation are considered separate transactions for tax purposes when they are not part of a preconceived plan, resulting in the earned surplus of the original corporation becoming paid-in surplus of the new corporation.

Summary

In 1927, Sherman Lumber Company, an Alabama corporation, was dissolved to avoid state taxes. Nine months later, Sherman & Sons, Inc., a Florida corporation, was formed by the former majority stockholder (Sherman) to give his family interests in the properties. Assets from the dissolved company and other assets were transferred to the new corporation. The Tax Court addressed whether this constituted a tax-free reorganization, impacting the taxability of a distribution to Katherine S. Mathis in 1945. The court held that the dissolution and subsequent incorporation were independent transactions, meaning the surplus of the old company became paid-in surplus of the new one, affecting dividend taxation.

Facts

Sherman-Spann Lumber Company was formed in 1914, later becoming Sherman Lumber Company ("the Company"), with W.C. Sherman as the majority stockholder. By 1927, the Company's activities were mainly a retail lumber business and stock holdings in Florida companies. In September 1927, the Company dissolved to avoid Alabama state taxes, distributing assets to directors as trustees. In May 1928, Sherman formed Sherman & Sons, Inc. ("the Corporation") in Florida, transferring assets held by the trustees, as well as other assets, in exchange for stock issued to Sherman and his family members. The Company's closing balances became the Corporation's opening balances.

Procedural History

The Commissioner of Internal Revenue determined that the 1927-1928 transactions constituted a tax-free reorganization, resulting in a deficiency assessment against the Mathises for the 1945 tax year. The Tax Court was petitioned to determine whether a distribution received by Katherine S. Mathis from the Corporation in 1945 was fully taxable as a dividend.

Issue(s)

Whether the dissolution of Sherman Lumber Company and the subsequent formation of Sherman & Sons, Inc. constituted a tax-free reorganization under Section 112(i)(1)(B) or (D) of the Revenue Act of 1928.

Holding

No, because the dissolution of the Company and the formation of the Corporation were separate and independent transactions, not part of one overall plan.

Court's Reasoning

The court reasoned that the dissolution of the Company in 1927 was solely to avoid Alabama taxes, with no immediate plans for a new corporation. The new Corporation was formed nine months later, primarily to distribute interests in the property to Sherman's family. The court emphasized the lack of a preconceived plan for reorganization at the time of dissolution. The court distinguished this case from *Morley Cypress Trust, Schedule "B"*, where a liquidation was deemed a reorganization because the corporation was still in the process of liquidating when a new corporation was formed to handle remaining assets. Here, the court found that Sherman had effectively received and controlled the assets of the dissolved company. The Tax Court stated:

