Mail Order Publishing Co. v. Commissioner, 30 B.T.A. 19 (1953)

A transferor corporation maintains control in a reorganization under Section 112(i)(1)(B) of the Revenue Act of 1932 if it holds at least 80% of the transferee corporation's voting stock immediately after the transfer, even if it later relinquishes control through subsequent transactions not part of the initial reorganization plan.

Summary

Mail Order Publishing Co. sought to establish its predecessor's basis in certain properties for equity invested capital purposes, arguing a tax-free exchange occurred during reorganization. The Board of Tax Appeals held that the predecessor corporation had sufficient 'control' immediately after the transfer of assets to the newly formed Mail Order Publishing Co., satisfying the requirements for a tax-free reorganization under Section 112(b)(4) of the Revenue Act of 1932. The subsequent sale of stock to the public was not considered part of the reorganization plan, and thus did not negate the initial control. The Board also addressed the deductibility of stock compensation to employees.

Facts

In 1932, a corporation in voluntary receivership transferred properties to Mail Order Publishing Co., a newly formed entity organized by the predecessor's key employees. In return, the predecessor received 300,000 shares of Mail Order Publishing Co. stock, representing all outstanding shares at that time. The receivers granted the employee-organizers an option to purchase these shares. Later, this option was modified and the shares were sold to the public. The Mail Order Publishing Co. later distributed its own capital stock to employees as compensation, based on a percentage of net profits as stipulated in the original court order, valued at par value ($1 per share).

Procedural History

Mail Order Publishing Co. petitioned the Board of Tax Appeals contesting the Commissioner's determination of its equity invested capital and the deductibility of employee compensation. The Commissioner argued the initial transfer wasn't a tax-free reorganization, and the stock compensation should be limited to par value.

Issue(s)

1. Whether the transfer of properties from the predecessor corporation to Mail Order Publishing Co. qualified as a tax-free reorganization under Section 112(b)(4) of the Revenue Act of 1932, thus allowing Mail Order Publishing Co. to take its predecessor's basis in the properties.
2. Whether Mail Order Publishing Co. could deduct the fair market value, rather than the par value, of its own capital stock distributed to employees as compensation.

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Holding

1. Yes, because the predecessor corporation maintained control (ownership of at least 80% of the voting stock) of Mail Order Publishing Co. immediately after the transfer, and the subsequent stock sale to the public was not part of the initial reorganization plan.
2. Yes, because the agreement stipulated the issuance of a number of shares equivalent to a certain percentage of profits, not a fixed monetary payment. The compensation deduction should be based on the fair market value of the stock at the time of distribution.

Court's Reasoning

The Board of Tax Appeals reasoned that the predecessor corporation had 'control' of Mail Order Publishing Co. immediately after the transfer, as it owned all outstanding shares. Applying Section 112(j) of the Revenue Act of 1932, 'control' meant ownership of at least 80% of the voting stock. The Board distinguished this case from those where control is relinquished as an integral part of the reorganization plan, citing *Banner Machine Co. v. Routzahn, 107 F. 2d 147*. Here, the subsequent sale of stock to the public was a separate transaction. The Board noted, "The predecessor's ownership or 'control' was real and lasting; it was not a momentary formality, and its subsequent relinquishment was not part of the plan of reorganization or exchange." Regarding the stock compensation, the Board relied on *Package Machinery Co., 28 B. T. A. 980*, stating that because the agreement specified the number of shares based on a percentage of profits, the deduction should reflect the fair market value of those shares.

Practical Implications

This case clarifies the 'control' requirement in corporate reorganizations for tax purposes. It emphasizes that control must be assessed immediately after the transfer and that subsequent, independent transactions do not necessarily negate initial control. Attorneys structuring reorganizations must ensure the transferor maintains the requisite ownership percentage immediately after the exchange. This case also highlights the importance of properly characterizing stock distributions to employees. If the distribution is tied to a specific number of shares rather than a fixed monetary amount, the deduction is based on the fair market value. Later cases applying this ruling would focus on whether subsequent stock sales were a pre-planned and integral part of the initial reorganization. Businesses should carefully document the steps of a reorganization to clearly establish whether subsequent transactions were part of the initial plan.

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