Mail Order Publishing Co. v. Commissioner, 30 T.C. 19 (1958)

A transferor corporation's momentary control of a transferee corporation immediately after an asset transfer, followed by a later relinquishment of control not part of the initial reorganization plan, satisfies the 'control' requirement for a tax-free reorganization under Section 112 of the Revenue Act of 1932.

Summary

Mail Order Publishing Co. (petitioner) sought to establish the basis of assets acquired from its predecessor for equity invested capital purposes. The predecessor, in voluntary receivership, transferred assets to the petitioner in exchange for stock. The Tax Court held that the transfer qualified as a tax-free reorganization under Section 112(b)(4) of the Revenue Act of 1932 because the predecessor had sufficient 'control' of the petitioner immediately after the transfer, even though that control was later relinquished. The court also addressed the deductibility of stock issued to employees as compensation.

Facts

The predecessor corporation, in voluntary receivership, transferred certain properties to the newly formed Mail Order Publishing Co. (petitioner). In return, the predecessor received 300,000 shares of the petitioner's common stock, which were the only shares outstanding at that time. Pursuant to a court order, the predecessor's receivers granted key employees of the predecessor (who organized the petitioner) a one-year option to purchase the 300,000 shares. Later, the receivers granted what amounted to a different option to different parties. This later option was exercised, and the 300,000 shares were sold to the public. The petitioner also distributed stock to employees as compensation per a court-ordered plan.

Procedural History

The Commissioner of Internal Revenue determined a deficiency in the petitioner's excess profits tax. The petitioner appealed to the Tax Court, contesting the Commissioner's calculation of its equity invested capital and the deductibility of employee compensation. The Tax Court addressed these issues.

Issue(s)

1. Whether the transfer of assets from the predecessor corporation to the petitioner constituted a tax-free reorganization under Section 112(b)(4) of the Revenue Act of 1932, allowing the petitioner to take its predecessor's basis in the assets.

2. Whether the petitioner could deduct the fair market value, rather than the par value, of its own capital stock distributed to its employees as compensation.

Holding

1. Yes, because the predecessor corporation had sufficient control of the petitioner immediately after the transfer, and the subsequent relinquishment of control was not part of the initial reorganization plan.

2. Yes, because the provision for stock distribution was effectively a payment of shares of an aggregate par value equal to a percentage of profits, necessitating valuation at fair market value.

Court's Reasoning

Regarding the reorganization issue, the court emphasized that the predecessor held real and lasting control of the petitioner immediately after the transfer of assets for stock. The subsequent sale of stock to the public was not an inseparable part of the reorganization plan. The court distinguished cases where the transferor relinquished control as a step in the plan of reorganization. The court stated, "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." The court also noted that the intention of the stockholders is not determinative if the transferor in fact disposes of the stock shortly after receipt, provided the disposition was not required as part of the plan. Regarding the compensation issue, the court followed *Package Machinery Co., 28 B.T.A. 980*, holding that when stock is issued as compensation based on a percentage of profits, the deduction is based on the fair market value of the stock at the time of distribution, not its par value.

Practical Implications

This case clarifies the 'control' requirement in tax-free reorganizations under Section 112. It establishes that momentary control by the transferor is sufficient if the later relinquishment of control is not a pre-planned step in the reorganization. Attorneys should advise clients that post-reorganization transactions, if independent and not part of the initial plan, will not necessarily disqualify a transaction from tax-free treatment. This ruling gives more flexibility in structuring reorganizations. It also confirms that compensation paid in stock is deductible at its fair market value, not par value, impacting the tax treatment of employee stock options and similar compensation arrangements. Later cases have cited this case to distinguish situations where the relinquishment of control was, in fact, part of an integrated plan. This case highlights the importance of clearly documenting the reorganization plan to demonstrate that post-transfer dispositions of stock were not pre-arranged.