Austin Transit, Inc. v. Commissioner, 20 T.C. 849 (1953)

For a corporate asset transfer to qualify as a tax-free reorganization under I.R.C. § 112(g)(1)(D), the transferor or its shareholders must retain at least 80% control of the acquiring corporation immediately after the transfer as defined by I.R.C. § 112(h).

Summary

The case concerns whether the acquisition of assets by three newly formed corporations from Austin Transit Company constituted a tax-free reorganization. The Murchisons, who had previously purchased all the stock of Austin Transit Company, formed the three petitioner corporations and transferred the assets to them. The issue was whether the transfer qualified as a tax-free reorganization under I.R.C. § 112(g)(1)(D), which requires that the transferor corporation or its shareholders maintain at least 80% control of the acquiring corporation immediately after the transfer. Because the Murchisons and their associates owned less than 80% of the stock of the new corporations, the court held that the transaction was not a tax-free reorganization, and the petitioners were entitled to use their own cost basis for the acquired assets.

Facts

The Murchisons purchased all of the stock of Austin Transit Company. The Murchisons then formed three petitioner corporations, with each having an initial capital of $10,000. Austin Transit Company was liquidated, and its assets were distributed among the three petitioner corporations in exchange for $1,181,730.38. At the conclusion of the reorganization, the Murchisons owned 69% of the stock of each of the petitioner corporations; their attorney and another individual owned the remainder.

Procedural History

The Commissioner of Internal Revenue determined that the asset transfer was a tax-free reorganization, thus requiring the petitioners to use the predecessor corporation’s basis in the assets. The petitioners contested this determination, arguing that they should be allowed to use their own cost basis for the assets. The case was brought before the Tax Court.

Issue(s)

1. Whether the transfer of assets from Austin Transit Company to the three petitioner corporations constituted a tax-free reorganization under I.R.C. § 112(g)(1)(D).

2. Whether the Murchisons and their associates possessed the requisite 80% control of the petitioner corporations immediately after the transfer as defined by I.R.C. §

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112(h).

Holding

1. No, because the transfer did not meet the requirements of a tax-free reorganization under I.R.C. § 112(g)(1)(D).

2. No, because the Murchisons and their associates did not retain the required 80% control of the petitioner corporations.

Court’s Reasoning

The court’s reasoning centered on the interpretation of I.R.C. § 112(g)(1)(D) and (h). The court held that even assuming the Commissioner’s argument that there was a reorganization under § 112(g)(1)(D) was correct, the lack of the 80% control required by § 112(h) meant that the reorganization could not be tax-free. The court found that the Murchisons owned only 69% of the stock in each of the new corporations. The court distinguished this case from others cited by the Commissioner, emphasizing that in those cases, the transferors owned 100% of the stock of the acquiring corporations.

Practical Implications

This case underscores the importance of strictly adhering to the control requirements of I.R.C. § 112(h) in corporate reorganizations. It serves as a reminder that the ownership structure of the acquiring corporation after an asset transfer is critical for determining the tax consequences. Attorneys advising on such transactions must ensure that the transferor or its shareholders maintain the requisite level of control to achieve tax-free treatment. Otherwise, the acquiring corporation will be required to use its own cost basis in the assets, which could result in significant tax liabilities. The case also demonstrates the importance of careful planning and structuring of the transaction, to ensure the desired tax outcome. Subsequent cases citing Austin Transit, Inc. reinforce the need for precise compliance with all statutory requirements for tax-free reorganizations.

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