20 T.C. 849 (1953)

To qualify for a tax-free reorganization under Section 112(g)(1)(D) of the Internal Revenue Code, the transferor or its shareholders must own at least 80% control of the acquiring corporation immediately after the transfer.

Summary

The case involved three corporations (Austin Transit, Bus Leasing, and Zachry Realty) contesting deficiencies in their income taxes. The IRS argued that the acquisition of assets from Austin Transit Company by the petitioners was a tax-free reorganization under Section 112(g)(1)(D) of the Internal Revenue Code, requiring a carryover basis. The Tax Court held that the transaction was taxable because the Murchison brothers, who were the shareholders of the original company, owned less than 80% of the stock in the newly formed corporations immediately after the transfer. The court emphasized that the 80% control requirement in Section 112(h) was not met, thus making the reorganization taxable, and entitling the petitioners to a cost basis.

Facts

C.W. Murchison and his sons (the Murchisons) wanted to acquire the assets of Austin Transit Company. After the owners refused to sell assets, the Murchisons purchased 97.296% of the stock of Austin Transit Company. The Murchisons then liquidated Austin Transit Company, transferring its assets to three newly formed corporations: Austin Transit, Inc., Bus Leasing Corporation, and Zachry Realty Co. The Murchisons owned 69% of the stock of each of these new corporations immediately after the transfer. The remaining stock was held by other parties, including an attorney and an individual who received stock as a finder’s fee. The IRS contended that the transaction was a tax-free reorganization under the Internal Revenue Code, while the petitioners argued for a taxable transaction.

Procedural History

The Commissioner of Internal Revenue determined income tax deficiencies against Austin Transit, Inc., Bus Leasing Corporation, and Zachry Realty Co. The cases were consolidated in the United States Tax Court. The primary dispute concerned the basis for depreciation and amortization deductions, contingent on whether the asset acquisition was taxable or tax-free.

Issue(s)

Whether the acquisition of assets by the petitioner corporations from Austin Transit Company constituted a tax-free reorganization under Section 112(g)(1)(D) of the Internal Revenue Code.

Holding

No, because the Murchisons, as shareholders of the transferor corporation (Austin Transit Company), did not meet the 80% control requirement outlined in Section 112(h) of the Internal Revenue Code, the transaction was taxable and not a tax-free reorganization.

Court's Reasoning

The court focused on the interpretation of the Internal Revenue Code provisions regarding tax-free reorganizations, specifically Section 112(g)(1)(D) and Section 112(h). The court cited that for a reorganization to be tax-free, the transferor or its shareholders must have 80% control in the acquiring corporation immediately after the transfer. Here, the Murchisons owned only 69% of each of the new corporations. The court distinguished this case from other cases where the transferors had 100% control. The court rejected the government's position, and sided with the petitioners.

Practical Implications

This case is crucial for understanding the specific requirements for tax-free reorganizations. The 80% control threshold is a critical element, and a failure to meet this percentage will render the transaction taxable, regardless of whether the transfer meets other requirements of a reorganization. Tax practitioners must carefully analyze stock ownership immediately after the transfer to determine if the transaction qualifies for non-recognition treatment. This decision highlights that while a business purpose may exist for structuring the transaction as a reorganization, if the control requirements are not met, the transaction will be taxed. The case confirms the importance of strict adherence to the statutory requirements for achieving tax-free treatment in corporate reorganizations.

