***Goldstein Bros., Inc. v. Commissioner*, 23 T.C. 1055 (1955)**

To qualify as a tax-free reorganization under I.R.C. § 112(b)(10), a transaction in bankruptcy must involve a plan of reorganization approved by the court and an exchange of assets solely for stock or securities, demonstrating a continuity of interest among the former owners of the business.

**Summary**

This case concerns whether a corporation that purchased assets from a bankrupt predecessor at a public auction could use the predecessor's basis in those assets to calculate its excess profits tax credit. The Tax Court held that the transaction did not qualify as a tax-free reorganization under I.R.C. § 112(b)(10) because the acquisition was for cash, not stock or securities, and lacked the required court-approved plan of reorganization and continuity of interest. The court found the stockholders of the new corporation, who were also stockholders of the old corporation, did not have a continuing interest in the assets after the bankruptcy sale since creditors were not paid in full and the assets were purchased for cash.

**Facts**

Goldstein Brothers, a partnership, operated a retail home furnishings business. In 1923, the partnership formed Goldstein Bros., Inc. (the "old corporation"), with stock issued to the partners in proportion to their partnership interests. The old corporation filed for bankruptcy in 1934. In February 1934, the petitioner, Goldstein Bros., Inc. (the "new corporation"), was formed with the same stockholders as the old corporation. The assets of the old corporation were sold at a public auction by the trustee in bankruptcy to the new corporation for cash. The new corporation claimed the same basis in the assets as the old corporation. The IRS disagreed and the Tax Court was asked to decide if the reorganization provisions applied.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in the new corporation's excess profits tax. The new corporation challenged these deficiencies in the Tax Court, arguing that the transaction qualified as a reorganization, thus entitling the new corporation to use the old corporation's asset basis. The Tax Court ruled in favor of the Commissioner.

**Issue(s)**

1. Whether the transaction qualified as a reorganization under I.R.C. § 112(b)(10).

2. Whether the petitioner was entitled to use the basis of the assets in the hands of the old corporation in computing its excess profits credit.

**Holding**

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1. No, the transaction did not qualify as a reorganization under I.R.C. § 112(b)(10) because the asset transfer was not solely for stock or securities, and the bankruptcy court did not approve a plan of reorganization.

2. No, the petitioner was not entitled to use the old corporation's basis because the transaction was a purchase of assets for cash, rather than a reorganization.

**Court's Reasoning**

The court focused on the requirements of I.R.C. § 112(b)(10). This provision requires a transfer of property pursuant to a court-approved plan of reorganization and an exchange for stock or securities. The court determined that the sale of assets at a bankruptcy auction for cash did not meet these criteria. "Here the assets of the old corporation were transferred, not in exchange for stock or securities, of the petitioner, but for cash." The court emphasized that the bankruptcy court only approved the sale to the highest bidder, not a plan of reorganization. The court distinguished the case from those involving reorganizations under other sections of the code, which did not involve bankruptcy proceedings. The court found there was no continuity of interest between the beneficial owners of the assets of the old corporation (the creditors) and the stockholders of the petitioner since the creditors were not paid in full and the stockholders bought the assets for cash. The Court cited the legislative history of I.R.C. § 112(b)(10), which indicated that Congress did not intend for the reorganization provisions to apply to transactions that were essentially liquidations and sales to new or old interests.

**Practical Implications**

This case underscores the strict requirements for tax-free reorganizations in bankruptcy. Practitioners must ensure that: (1) the transfer of assets is made under a court-approved plan of reorganization; and (2) the consideration for the assets is solely stock or securities of the acquiring corporation, and that this reflects a continuity of interest of the stakeholders of the original company. The case highlights the importance of the distinction between a genuine reorganization and a liquidation and sale of assets. It shows how crucial it is that the bankruptcy court approves a reorganization plan and that the historical equity holders have a continuing stake in the business. Failure to meet these conditions will likely result in the transaction being treated as a taxable sale, not a tax-free reorganization, as a practitioner would need to understand in providing advice to clients. The case also serves as a warning that a new corporation's purchase of assets for cash, even if the new corporation's stockholders were previously stockholders of the old, is unlikely to qualify as a reorganization under § 112(b)(10).

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