293 U.S. 465 (1935)

A transaction that complies with the literal requirements of the law but lacks a business purpose beyond tax avoidance is a sham and will be disregarded for tax purposes, applying the substance over form doctrine.

Summary

The case of *Gregory v. Helvering* established the principle that transactions structured solely to avoid tax liability, without a legitimate business purpose, will be disregarded. Mrs. Gregory attempted to exploit a corporate reorganization provision to distribute corporate assets to herself without paying taxes. The Supreme Court found that while the transaction technically met the statutory requirements for a reorganization, it lacked any genuine business purpose beyond tax avoidance. Therefore, the Court disregarded the corporate form and treated the transaction as a taxable dividend.

Facts

Mrs. Gregory owned all the shares of United Mortgage Corporation. United Mortgage held shares in the Monitor Securities Corporation. Mrs. Gregory wished to transfer the Monitor shares to herself without paying income taxes. She created a new corporation, the Averill Corporation, and transferred the Monitor shares to it. She then liquidated Averill, distributing the Monitor shares to herself. The transaction was structured to comply with a provision in the Revenue Act of 1928, allowing tax-free reorganizations. The IRS argued that the transaction was a sham, designed solely to avoid tax. The Board of Tax Appeals and the Court of Appeals upheld the IRS determination.

Procedural History

The Commissioner of Internal Revenue assessed a deficiency against Mrs. Gregory, claiming the distribution of the Monitor shares was a taxable dividend. The Board of Tax Appeals upheld the Commissioner’s assessment. The Second Circuit Court of Appeals affirmed the Board’s decision. The Supreme Court granted certiorari.

Issue(s)

Whether the creation and liquidation of a corporation, structured to comply with the literal terms of a tax statute, but lacking any genuine business purpose other than tax avoidance, is a valid corporate reorganization for tax purposes.

Holding

No, because the transaction, while technically complying with the statute, lacked any legitimate business purpose beyond tax avoidance, making it a sham transaction.

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Court’s Reasoning

The Supreme Court, per Justice Sutherland, held that the transaction was not a reorganization because it was not undertaken for a business purpose. The Court recognized that while the transaction complied with the literal terms of the statute, the underlying purpose was to avoid taxes, not to engage in a genuine business operation. The Court stated that the transaction was “a mere device” to get rid of the shares and distribute them to the shareholder. The Court emphasized that a reorganization must have a legitimate business purpose, separate from tax avoidance. The court focused on the substance of the transaction rather than its form, applying what has become known as the “substance over form” doctrine. The Court stated, “The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted.” However, the Court held that the transaction here was not within the intent of the law, as the statute was not meant to be a mechanism for tax evasion. The court noted that the entire transaction was a “plan” and that it did not have the requisite business purpose.

Practical Implications

This case is a cornerstone of tax law and the “substance over form” doctrine. It underscores the importance of having a legitimate business purpose behind any transaction, particularly those that could potentially affect tax liability. Taxpayers cannot simply structure transactions to fit within the literal terms of tax laws if the underlying purpose is solely tax avoidance. Taxpayers and their advisors must carefully consider the economic substance of a transaction. Courts will examine whether there is a real business reason beyond tax savings for the arrangement. The case has been cited in countless cases regarding corporate reorganizations, business purpose, and the scope of tax avoidance schemes. This decision instructs attorneys to advise clients to structure transactions with a clear business purpose in mind and to avoid purely tax-driven schemes. Future cases, such as those involving complex financial instruments or offshore transactions, will likely refer to *Gregory v. Helvering* to determine if they have a valid economic purpose, or are shams intended for tax avoidance.

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