J. M. Turner & Co., Inc., 19 T.C. 808 (1953)

To qualify as an "acquiring corporation" or "purchasing corporation" under the Internal Revenue Code for excess profits tax credit purposes, a corporation must acquire "substantially all" of the properties of another business; what constitutes "substantially all" is a fact-specific determination based on all the circumstances of the transaction.

Summary

J.M. Turner & Co., Inc. sought to use the base period experience of J.M. Turner's sole proprietorship in calculating its excess profits credit. The court found that the corporation had not acquired "substantially all" of the proprietorship's properties, as required by the relevant sections of the Internal Revenue Code of 1939. The court emphasized that the transfer of assets was incomplete, with a significant portion of physical assets, contracts, and other assets remaining with the proprietorship. Furthermore, the proprietorship continued to operate after the purported acquisition. The Tax Court concluded that the corporation did not meet the statutory requirements to be considered an "acquiring" or "purchasing" corporation for tax purposes, denying the corporation the claimed tax credit.

Facts

J.M. Turner operated a sole proprietorship. Turner formed a corporation, J.M. Turner & Co., Inc., and transferred some, but not all, of his proprietorship's assets to the corporation. The corporation sought to use the base period experience of Turner's proprietorship to calculate its excess profits credit for the year 1951. The assets of the proprietorship included cash, physical assets (e.g., a power saw, cement mixer, and a valuable power shovel), contracts in progress, and miscellaneous assets. The proprietorship retained a significant portion of these assets, including 12 of its 14 contracts in progress, and continued to operate after the transaction. The corporation paid cash for the shares of stock.

Procedural History

The case was heard by the United States Tax Court. The Tax Court considered the case based on the facts, and evidence presented by the parties and made a determination in favor of the respondent.

Issue(s)

1. Whether J.M. Turner & Co., Inc. acquired "substantially all" the properties of J.M. Turner's sole proprietorship within the meaning of sections 461(a) or 474(a) of the Internal Revenue Code of 1939, thereby qualifying as an "acquiring corporation" or "purchasing corporation."
2. Whether the form of the transaction, where stock was issued solely for cash, rather than an exchange of properties, qualified for a tax-free exchange under

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Section 112(b)(5) and related sections of the Internal Revenue Code.
3. Whether the seller (Turner's proprietorship) satisfied the requirement of not continuing any business activities other than those incident to complete liquidation after the transaction, as well as ceasing to exist within a reasonable time, in order to apply for the excess profit credit under Section 474(a).

Holding

1. No, because the corporation did not acquire "substantially all" of the properties.
2. No, because the transaction involved solely a cash purchase, not a tax-free exchange.
3. No, because the proprietorship continued significant business activities and did not cease to exist.

Court's Reasoning

The court applied the statutory definitions of "acquiring corporation" (under § 461(a)) and "purchasing corporation" (under § 474(a)), which both required the acquisition of "substantially all" the properties of the prior business. The court determined that whether "substantially all" had been acquired was a question of fact, not subject to a fixed percentage. The court examined several classes of assets and found that the corporation had not acquired the bulk of the proprietorship's assets. The corporation received only a portion of the physical assets, and the proprietorship retained the majority of its contracts, which represented its most valuable assets. "It is our opinion that petitioner did not acquire 'substantially all the properties' of Turner's proprietorship, irrespective of whether cash is included or excluded from consideration." Furthermore, the court noted the proprietorship continued operations after the alleged transfer. The court emphasized that the cash paid for the stock was not property acquired in a tax-free exchange, and that the selling proprietorship did not cease business activities or exist. "…petitioner did not acquire either cash or property in any transaction which falls within the ambit of these sections."

Practical Implications

This case highlights the importance of carefully structuring business acquisitions to meet specific statutory requirements for tax benefits. Lawyers must pay particular attention to what constitutes "substantially all" of the assets and ensuring all relevant assets are actually transferred in a manner that qualifies for the applicable tax provisions. This case is instructive for determining what qualifies as "substantially all" of a business's assets in a corporate acquisition. The decision stresses the need to analyze the substance of the transaction, not merely its form, and illustrates that the acquiring entity must acquire the bulk of the assets of the acquired business to meet the tax law requirements. The continued operation of the selling entity and the nature of the consideration exchanged will also have a

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significant impact. Subsequent cases in corporate taxation rely on the framework established here, including analysis of whether the selling entity continues to operate following the transaction.

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