***29 T.C. 492 (1957)***

For a corporate reorganization to qualify for non-recognition of gain or loss under the Internal Revenue Code, the former owners of the business must maintain a 'continuity of interest' in the reorganized entity, even if the interest is held through a parent corporation and its subsidiaries.

**Summary**

The U.S. Tax Court addressed whether a corporate reorganization qualified for tax-free treatment under the Internal Revenue Code of 1939, focusing on the "continuity of interest" doctrine. Following a receivership, the bondholders of Sun Realty Company formed Consolidated Office Buildings Company (Consolidated) and two wholly-owned subsidiaries, Chester Williams Building Company (Williams) and Seventh and Flower Roosevelt Building Company (Roosevelt). Consolidated acquired the assets of Sun Realty and then transferred leasehold interests to Williams and Roosevelt in exchange for their stock. The Commissioner argued that the transfers to Williams and Roosevelt did not qualify for tax-free treatment because the former bondholders did not directly own the subsidiaries' stock. The Court held that the reorganization satisfied the continuity of interest requirement because the bondholders, through Consolidated, maintained a continuous interest in the underlying properties and the reorganized business.

**Facts**

Sun Realty Company, facing financial difficulties, entered receivership in 1932. Its assets included the Consolidated Office Building and leasehold interests in the Chester Williams Building and the Seventh and Flower Roosevelt Building. A bondholders' committee was formed to protect the bondholders' interests. The committee formulated a reorganization plan, approved by the court, which involved the creation of three new corporations: Consolidated, Williams, and Roosevelt. Consolidated acquired the Sun Realty assets, and subsequently transferred the Williams and Roosevelt leaseholds to their respective corporations in exchange for their stock and promissory notes. Consolidated's stock was issued to the former bondholders of Sun Realty. The Commissioner of Internal Revenue disallowed the use of the predecessor's basis for depreciation by Williams and Roosevelt.

**Procedural History**

The Commissioner of Internal Revenue determined deficiencies in income tax against Consolidated, Williams, and Roosevelt. The cases were consolidated for trial in the U.S. Tax Court. The Tax Court had to decide whether Williams and Roosevelt could use the basis of their predecessor, Sun Realty Company, in calculating depreciation.

**Issue(s)**

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1. Whether the transfers of leasehold interests from Consolidated to Williams and Roosevelt qualified as tax-free reorganizations under Section 112(b)(10) of the Internal Revenue Code of 1939.

2. Whether the "continuity of interest" requirement was satisfied, given that the former Sun Realty bondholders held stock in Consolidated, the parent company, and not directly in Williams and Roosevelt, the subsidiaries.

**Holding**

1. Yes, because the reorganization complied with the requirements of Section 112(b)(10) of the Internal Revenue Code of 1939.

2. Yes, because the "continuity of interest" doctrine was satisfied even though the former bondholders did not directly hold stock in the subsidiaries.

**Court's Reasoning**

The court determined that the reorganization qualified under Section 112(b)(10) of the Internal Revenue Code. This section provides for non-recognition of gain or loss in certain corporate reorganizations pursuant to a court order in a receivership or similar proceeding, provided that property is transferred solely in exchange for stock or securities. The court acknowledged the necessity of "continuity of interest" in such reorganizations. The court cited previous cases, such as *Cortland Specialty Co. v. Commissioner*, *Pinellas Ice & Cold Storage Co. v. Commissioner*, *Helvering v. Minnesota Tea Co.*, and *Le Tulle v. Scofield*, to support this principle. The Commissioner argued that continuity of interest was broken because the bondholders of Sun Realty did not directly receive stock in Williams and Roosevelt. However, the Court rejected this argument, stating that "the bondholders retained their complete investment in the three buildings." The court found that the interposition of Consolidated did not break the continuity of interest, as the bondholders, through Consolidated, still held the ultimate ownership and control of the three buildings. The court reasoned that the reorganization was a continuation of the old enterprise in a modified form, and the bondholders retained the same economic interest. The court stated: "It is the effect of the reorganization that is important. The test is whether the existing ownership interests persist as such in what is a continuing enterprise, in some different corporate form."

**Practical Implications**

This case provides guidance on the application of the continuity of interest doctrine in corporate reorganizations, specifically in parent-subsidiary structures under Section 112(b)(10) of the 1939 Code. The decision makes it clear that direct ownership of stock in the transferee corporation is not always required to satisfy the continuity of interest test. Instead, the court looks at the substance of the transaction and whether the former owners continue to have a substantial economic

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interest in the assets or the ongoing business. This is particularly relevant in bankruptcy and receivership situations where a reorganization is designed to save the business. This case helps to clarify that tax-free reorganization status may be available even when multiple corporate entities are involved, provided that the ultimate economic ownership remains with the original stakeholders. Future cases in tax law regarding reorganizations must still consider the specific facts to determine whether continuity of interest exists, but this case provides an example of how courts will interpret such rules in the context of a parent-subsidiary relationship. The case also illustrates that the tax code's aim is to give relief to reorganization plans where the original stakeholders retain the business, even if the form of ownership is changed.

**Meta Description**

The *Consolidated Office Buildings Co.* case clarifies the

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