***32 T.C. 80 (1959)***

A corporate recapitalization, specifically the exchange of stock for debentures, can qualify as a tax-free reorganization under Internal Revenue Code provisions, even if it does not meet the "continuity of interest" requirement applied in merger or consolidation cases.

**Summary**

The U.S. Tax Court addressed whether an exchange of stock for debentures in a corporate recapitalization qualified as a non-taxable reorganization under the Internal Revenue Code of 1939. The Commissioner argued that the transaction did not meet the "continuity of interest" requirement. The court found that the recapitalization of the Hickok Manufacturing Co. was a valid reorganization and that the exchange of common stock for debentures was tax-free. The court distinguished recapitalizations from mergers and consolidations, holding that the "continuity of interest" doctrine does not apply to recapitalizations. It also determined that the recapitalization served a valid business purpose, eliminating a hostile minority group of stockholders.

**Facts**

Hickok Manufacturing Co., Inc., faced disagreements and hostility from minority stockholders, particularly the Wertheim group. To eliminate this group and other dissident shareholders, the company explored reorganization plans, ultimately deciding on a recapitalization involving the issuance of debentures in exchange for common stock. The board of directors implemented a plan to offer stockholders the option to exchange their common stock for 20-year debenture bonds. Alan O. and Raymond T. Hickok, along with other shareholders, participated in the exchange. The Commissioner determined deficiencies, arguing the exchange resulted in taxable gains.

**Procedural History**

The Commissioner of Internal Revenue determined income tax deficiencies against the petitioners based on the argument that the stock-for-debenture exchange resulted in a taxable gain. The petitioners contested these deficiencies. The cases were consolidated and presented before the United States Tax Court. The Tax Court ruled in favor of the petitioners.

**Issue(s)**

1. Whether the exchange of common stock for debentures constituted a reorganization under sections 112(b)(3) and 112(g)(1)(E) of the Internal Revenue Code of 1939.

2. Whether the "continuity of interest" doctrine applied to the recapitalization to

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render it taxable.

3. Whether the recapitalization served a valid business purpose.

**Holding**

1. Yes, because the exchange met the requirements of a plan of reorganization as defined in the Internal Revenue Code.

2. No, because the "continuity of interest" principle is not applicable to a recapitalization of a single corporation.

3. Yes, because the plan served a valid business purpose of eliminating a hostile minority group of stockholders.

**Court's Reasoning**

The court addressed the nonrecognition of gain or loss under sections 112(b)(3) and 112(g)(1)(E). The court cited Helvering v. Southwest Corp., 315 U.S. 194 to define recapitalization as a "reshuffling of a capital structure within the framework of an existing corporation." The court found that the debentures were

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