32 T.C. 646 (1959)

When a taxpayer receives both stock and cash in a corporate reorganization, the gain recognized is limited to the cash received if the exchange would have qualified as a tax-free reorganization under Section 112(b)(3) of the Internal Revenue Code if only stock had been exchanged.

Summary

Grover Turnbow, the owner of all stock in International Dairy Supply Co. (Supply), exchanged his shares for stock in Foremost Dairies, Inc., and $3,000,000 in cash. The Commissioner of Internal Revenue contended that Turnbow should recognize the entire gain, while Turnbow argued for recognition limited to the cash received, citing Section 112(c)(1) of the 1939 Internal Revenue Code. The U.S. Tax Court held for Turnbow, ruling that Section 112(c)(1) applied because the exchange would have qualified under Section 112(b)(3) as a tax-free reorganization if only stock had been exchanged. The court applied a well-established method of analyzing the transaction as if the cash were omitted to determine if it met the requirements of a tax-free reorganization, thus limiting the recognized gain to the 'boot' received.

Facts

- Grover D. Turnbow owned all the stock of International Dairy Supply Co. (Supply) and International Dairy Engineering Co.
- Supply owned 60% of Diamond Dairy, Inc., with Turnbow and others owning the remaining 40%.
- Foremost Dairies, Inc. (Foremost) sought to acquire Supply, Engineering, and Diamond Dairy.
- An agreement was made where Turnbow exchanged all of his Supply stock for Foremost stock and $3,000,000 in cash (the "boot").
- Turnbow also exchanged Engineering stock for Foremost stock.
- As a result, Supply became a subsidiary of Foremost.
- Turnbow's expenses related to the exchange totaled $15,007.23.

Procedural History

The Commissioner determined deficiencies in Turnbow's income tax for 1952 and 1953, arguing the entire gain from the stock exchange was taxable. Turnbow filed a petition with the U.S. Tax Court, claiming the gain should be limited to the cash received under Section 112(c)(1). The Tax Court ruled in favor of Turnbow, concluding that Section 112(c)(1) applied.

Issue(s)

1. Whether Section 112(c)(1) of the 1939 Internal Revenue Code applies to a transaction where a shareholder receives cash and stock in an acquiring corporation in exchange for stock in another corporation, making the taxable

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gain limited to the cash received.

Holding

1. Yes, because the exchange of stock for stock, excluding the cash consideration, would have qualified for non-recognition treatment under Section 112(b)(3) of the 1939 Code.

Court's Reasoning

The court's reasoning centered on the application of Section 112(c)(1) in the context of corporate reorganizations. The court emphasized that Section 112(c)(1) applies to exchanges that would be tax-free under other parts of Section 112(b) but for the receipt of "other property or money" (boot). The court followed the established method for analyzing the transaction. First, the court determined if the exchange of stock for stock met the requirements of a tax-free reorganization under Section 112(b)(3) as if the cash consideration was omitted from the transaction. If the exchange, excluding the cash, qualified as a reorganization, Section 112(c)(1) then limited the gain to the amount of cash received. The court considered the legislative history and prior court interpretations. The court referenced that the regulations in the 1939 code and 1954 code adopted the method the court followed. The court deferred to its prior interpretations and the Commissioner's own regulations to conclude that Section 112(c)(1) did apply in this case.

Practical Implications

This case provides essential guidance for structuring corporate reorganizations. It confirms that in a reorganization involving "boot," the gain is recognized only to the extent of the cash or other non-qualifying property received, provided the transaction would have been tax-free under the reorganization provisions if solely stock was exchanged. Attorneys should analyze transactions by first determining whether the core exchange (stock for stock) meets the requirements of a tax-free reorganization. This case is critical for tax planning in mergers and acquisitions, stock redemptions, and other corporate restructurings. Practitioners must understand this principle to advise clients accurately and structure transactions in a tax-efficient manner. Furthermore, subsequent courts rely on this case, which is consistently cited in the context of determining when gain must be recognized in corporate reorganizations, emphasizing the need to treat an exchange of stock for stock plus cash (or other boot) as eligible for partial tax-free treatment.

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