***Alderman v. Commissioner, 55 T. C. 662 (1971)***

When liabilities assumed by a corporation in a section 351 exchange exceed the adjusted basis of the transferred property, the excess is taxable gain to the transferor.

**Summary**

In Alderman v. Commissioner, the Tax Court ruled that when Velma and Marion Alderman transferred their lumber-trucking business to Alderman Trucking Co. , Inc. , the excess of liabilities assumed by the corporation over the adjusted basis of the transferred assets was taxable gain. The Aldermans transferred assets worth $62,782. 20 but the corporation assumed liabilities totaling $72,011. 79, creating a $9,229. 59 excess. The court held that this excess was taxable as ordinary income under section 357(c) because the promissory note they issued to the corporation had a zero basis, and section 1239 applied since the transferred assets were depreciable.

**Facts**

Velma and Marion Alderman operated a lumber-trucking business as a sole proprietorship. On February 13, 1963, they transferred the business to Alderman Trucking Co. , Inc. , a newly formed corporation, in exchange for 99 shares of stock and the corporation's assumption of all business liabilities. The transferred assets consisted of trucks and trailers with an adjusted basis of $62,782. 20. The liabilities assumed by the corporation totaled $72,011. 79, comprising $24,420. 14 in accounts payable and $47,591. 65 in encumbrances on the trucks and trailers. To balance the corporation's books, the Aldermans executed a personal promissory note for $10,229. 59, creating a capital stock account of $1,000.

**Procedural History**

The Commissioner of Internal Revenue determined a deficiency of $4,568. 42 in the Aldermans' 1963 Federal income tax, asserting that the excess of liabilities over the adjusted basis of the transferred assets ($9,229. 59) was taxable gain under section 357(c). The Aldermans petitioned the Tax Court for a redetermination of the deficiency. The case was submitted under Rule 30 of the Tax Court Rules of Practice, and all facts were stipulated.

**Issue(s)**

1. Whether section 357(c) applies when property is transferred pursuant to section 351(a) and the transferor issues a promissory note equal to the amount by which the liabilities assumed by the transferee exceed the adjusted basis of the assets transferred.
2. Whether the excess of the liabilities over basis of the assets is taxable as ordinary income to the transferor under section 1239.

 

## Holding

1. Yes, because the promissory note had a zero basis, and thus did not increase the adjusted basis of the transferred assets, the excess of liabilities over basis ($9,229. 59) is taxable gain under section 357(c).
2. Yes, because the transferred assets were depreciable property, the gain recognized under section 357(c) is taxable as ordinary income under section 1239.

## Court's Reasoning

The court's decision was based on the literal interpretation of sections 351(e)(1) and 357(c), as supported by prior case law and revenue rulings. The court determined that the promissory note had a zero basis because the Aldermans incurred no cost in issuing it, and thus it did not increase the adjusted basis of the transferred assets. Therefore, the excess of liabilities over basis ($9,229. 59) was taxable gain under section 357(c). Additionally, since the transferred assets were depreciable property and the Aldermans controlled the corporation, the gain was taxable as ordinary income under section 1239. The court rejected the Aldermans' argument that the note they issued to the corporation should offset the excess liabilities, stating that allowing such a practice would effectively nullify section 357(c).

## Practical Implications

This decision impacts how attorneys and taxpayers should analyze corporate formations where liabilities exceed the basis of transferred assets. It reinforces that issuing a promissory note to offset such an excess does not avoid the tax consequences under section 357(c). Practitioners must carefully calculate the basis of transferred assets and assumed liabilities in section 351 exchanges, ensuring clients understand the potential for taxable gain when liabilities exceed basis. The ruling also highlights the importance of considering the character of the transferred assets (depreciable or non-depreciable) due to the application of section 1239. Subsequent cases and IRS guidance have cited Alderman to support the principle that a zero-basis promissory note does not increase the basis of transferred property in section 351 exchanges.

 