Kamborian v. Commissioner, 56 T. C. 847 (1971)

For a transaction to qualify for nonrecognition of gain under Section 351, the transferors must possess immediate control of the corporation after the exchange, and token exchanges designed solely to meet the control requirement will not be recognized.

Summary

Kamborian v. Commissioner addressed the application of Section 351's nonrecognition rule for property transfers to a corporation in exchange for stock. The case involved four shareholders exchanging their Campex stock for International Shoe Machine Corp. stock, alongside a fifth shareholder purchasing additional International stock for cash. The court held that only the four shareholders transferring Campex stock were considered transferors under Section 351, and their collective ownership post-transfer did not meet the required 80% control. Consequently, the gain from the exchange was fully recognized. The court also upheld the validity of a regulation excluding token exchanges from Section 351, emphasizing that the primary purpose of such exchanges must not be to artificially meet the control requirement.

Facts

Four shareholders of International Shoe Machine Corp. (International) transferred their stock in Campex Research & Trading Corp. (Campex) to International in exchange for International's common stock. Simultaneously, a fifth shareholder, the Elizabeth Kamborian Trust, purchased additional shares of International for cash. The transferors intended to meet the 80% control requirement of Section 351(a) and Section 368(c) to avoid recognizing gain on the exchange. However, without counting the shares purchased by the trust, the transferors held only 77. 3% of International's stock post-exchange.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the taxpayers' income tax returns for the years involved, asserting that the exchange did not qualify for nonrecognition under Section 351 due to the failure to meet the control requirement. The case proceeded to the United States Tax Court, where the petitioners challenged the Commissioner's determination.

Issue(s)

1. Whether the exchange of Campex stock for International stock by four shareholders, coupled with the purchase of additional International stock by a fifth shareholder, qualifies for nonrecognition of gain under Section 351(a)?
2. Whether the regulation excluding token exchanges from Section 351 is valid and applicable to the transaction in question?

Holding

1. No, because the transferors of the Campex stock did not meet the 80% control requirement of Section 351(a) and Section 368(c) immediately after the exchange, as the fifth shareholder's purchase of additional stock for cash was not considered a transfer of property under Section 351.
2. Yes, because the regulation is a reasonable interpretation of the statute and applies to the transaction, as the primary purpose of the fifth shareholder's purchase was to artificially meet the control requirement.

Court's Reasoning

The court upheld the validity of the regulation excluding token exchanges from Section 351, reasoning that it was designed to ensure substantial compliance with the control requirement. The court found that the regulation was consistent with the statute's purpose and not plainly inconsistent with it. Regarding the applicability of the regulation, the court determined that the primary purpose of the Elizabeth Kamborian Trust's purchase of International stock was to qualify the other shareholders' exchanges under Section 351, thereby making the regulation applicable. The court also considered the fair market value of International's stock, factoring in transfer restrictions and the possibility of their waiver, and found it to be $13 per share for class A stock and $12. 50 per share for class B stock as of the transaction date.

Practical Implications

This decision underscores the importance of meeting the 80% control requirement under Section 351(a) to achieve nonrecognition of gain. It also clarifies that token exchanges, where the primary purpose is to artificially meet the control requirement, will not be recognized. Practitioners must ensure that all transferors are genuinely transferring property for stock and that the control requirement is met without relying on token exchanges. The case has implications for corporate restructuring and tax planning, particularly in ensuring compliance with the control requirement in Section 351 transactions. Subsequent cases have cited Kamborian in interpreting the control requirement and the validity of related regulations.

