Kass v. Commissioner, 60 T. C. 218 (1973)

A statutory merger that is part of an integrated plan to acquire a subsidiary's assets does not qualify as a tax-free reorganization if it fails the continuity-of-interest test.

Summary

In Kass v. Commissioner, the Tax Court ruled that a minority shareholder, May B. Kass, must recognize gain on the exchange of her shares in Atlantic City Racing Association (ACRA) for shares in Track Associates, Inc. (TRACK) following a merger. TRACK had first acquired 83. 95% of ACRA's stock, then merged ACRA into itself. The court held that since the stock purchase and subsequent merger were part of an integrated plan, continuity-of-interest must be measured by looking at all pre-tender offer shareholders, not just the parent and non-tendering shareholders. With over 80% of shareholders selling their stock for cash, the merger failed the continuity-of-interest test required for tax-free reorganization treatment under IRC Section 368.

Facts

Track Associates, Inc. (TRACK) was formed by a group of shareholders who also owned 10. 23% of Atlantic City Racing Association (ACRA). TRACK purchased 83. 95% of ACRA's stock through a tender offer, then merged ACRA into itself. May B. Kass, owning 2,000 shares of ACRA, did not tender her shares and received TRACK stock on a 1-for-1 basis in the merger. Kass argued her exchange should be treated as a tax-free reorganization under IRC Section 368(a)(1)(A).

Procedural History

The Commissioner of Internal Revenue determined a deficiency in Kass's 1966 federal income tax and Kass petitioned the U. S. Tax Court. The case was submitted under Tax Court Rule 30 with fully stipulated facts. The Tax Court ruled in favor of the Commissioner, holding that Kass must recognize gain on the exchange.

Issue(s)

1. Whether the statutory merger of ACRA into TRACK qualifies as a reorganization under IRC Section 368(a)(1)(A), allowing Kass to exchange her ACRA stock for TRACK stock without recognizing gain.

Holding

1. No, because the merger fails the continuity-of-interest test. The court held that since the stock purchase and merger were part of an integrated plan, continuity must be measured by looking at all pre-tender offer shareholders. With over 80% of shareholders selling for cash, the merger did not maintain a substantial proprietary stake in the enterprise.

Court’s Reasoning

The court applied the continuity-of-interest doctrine, which requires that in a reorganization, the transferor corporation or its shareholders retain a substantial proprietary stake in the transferee corporation. The court found that the purchase of ACRA stock by TRACK and the subsequent merger were interdependent steps in an integrated plan to acquire ACRA’s assets. Therefore, continuity must be measured by looking at all ACRA shareholders before the tender offer, not just TRACK and the non-tendering shareholders like Kass. Since over 80% of ACRA’s shareholders sold their stock for cash, the merger failed to maintain the required continuity of interest. The court rejected Kass’s arguments that the continuity test should not apply or that the incorporation of TRACK should be integrated into the transaction for IRC Section 351 purposes.

Practical Implications

This decision clarifies that when a parent corporation purchases a subsidiary’s stock as part of an integrated plan to acquire the subsidiary’s assets through a merger, the continuity-of-interest test applies to all pre-transaction shareholders. Practitioners must carefully analyze whether a transaction’s steps are interdependent when advising clients on potential tax-free reorganizations. The case also highlights the importance of the continuity-of-interest doctrine in determining whether a transaction qualifies as a tax-free reorganization. Subsequent cases have applied this principle, and it remains a key consideration in corporate reorganization planning.