Solomon v. Commissioner, 67 T. C. 379 (1976)

Section 483 of the Internal Revenue Code applies to impute interest on deferred payments received in tax-free corporate reorganizations.

Summary

In Solomon v. Commissioner, the U. S. Tax Court held that section 483 of the Internal Revenue Code applies to deferred payments received in tax-free corporate reorganizations. The Solomons and Katkins exchanged their stock in Quinn and Detroit for Whittaker's stock in a reorganization, with additional shares promised if the value of the initial shares fell below a certain threshold. The court ruled that the additional shares received more than three years later were subject to imputed interest under section 483, as the statute applies to any deferred payment in property exchanges, including those in tax-free reorganizations. This decision emphasizes that the applicability of section 483 hinges on the presence of deferred payments without adequate interest, not on the method of calculating such payments.

Facts

The Solomons and Katkins owned all outstanding stock in Quinn Manufacturing Co. and a majority in Detroit Bolt & Nut Co. In August 1968, they exchanged these shares for Whittaker Corp. 's voting stock in a reorganization. The agreement included provisions for additional shares if the value of the initial Whittaker shares did not reach 120% of their original value by August 1971. No interest was provided on these additional shares. In 1971, Whittaker issued the additional shares to the petitioners, and the Commissioner imputed interest income under section 483.

Procedural History

The Commissioner determined deficiencies in the petitioners' 1971 federal income taxes due to imputed interest on the additional shares. The cases were consolidated and submitted to the U. S. Tax Court under Rule 122. The court held that section 483 applies to deferred payments in tax-free reorganizations and ruled in favor of the Commissioner.

Issue(s)

1. Whether section 483 of the Internal Revenue Code applies to deferred payments received in tax-free corporate reorganizations.
2. Whether the applicability of section 483 is limited to "earn-out" situations where deferred payments are contingent on the earnings of the acquired corporation.

Holding

1. Yes, because section 483 applies to any deferred payment received in an

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exchange of property under a contract without adequate interest, irrespective of whether the exchange is tax-free.
2. No, because the applicability of section 483 depends on the existence of deferred payments without adequate interest, not on the method of calculating such payments.

Court's Reasoning

The court interpreted section 483's plain language, which applies to "any payment" on account of a sale or exchange of property due more than six months after the date of such transaction. The court emphasized that Congress did not include tax-free reorganizations in the list of exceptions to section 483, and the legislative history intended the rules of section 483 to apply for all purposes of the Code. The court rejected the argument that section 483 only applies to "earn-out" situations, finding that the examples in legislative history and regulations were illustrative, not exhaustive. The court distinguished the case from Rev. Rul. 70-120, which dealt with escrowed shares, as the reserve stock accounts here did not create a valid escrow. Judge Goffe concluded that the additional shares received by the petitioners were subject to section 483's imputed interest provisions.

Practical Implications

This decision impacts how deferred payments in tax-free reorganizations are treated for tax purposes. Attorneys and tax professionals must consider the potential for imputed interest under section 483 when structuring such transactions, even if no actual interest is provided. The ruling clarifies that the method of calculating deferred payments, such as value-based triggers versus earnings-based "earn-outs," does not affect the applicability of section 483. This may influence the structuring of future reorganization agreements to account for potential tax liabilities. The case also distinguishes between reserve accounts and escrow arrangements, which could affect how parties structure contingency provisions in corporate reorganizations. Later cases, such as Don E. Williams Co. , have affirmed the broad application of section 483 to various types of property exchanges.

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