Cocker v. Commissioner, 69 T. C. 369 (1977)

Section 483 can be applied to deferred payments in tax-free reorganizations to tax a portion of the stock received as ordinary income.

Summary

In Cocker v. Commissioner, the Tax Court held that section 483 of the Internal Revenue Code applies to deferred payments in tax-free reorganizations, specifically under section 368(a)(1)(B). The case involved shareholders of Cocker Machine & Foundry Co. who exchanged their stock for Walter Kidde & Co. stock, with additional stock distributed later based on future earnings. The court rejected the petitioners' arguments that section 483 should not apply to tax-free reorganizations, emphasizing the statute's broad application to deferred payments regardless of the recognition of gain or loss. The decision highlights the court's interpretation of section 483 as a tool to tax what is substantively interest income.

Facts

On July 1, 1964, shareholders of Cocker Machine & Foundry Co. exchanged their stock for Walter Kidde & Co. stock under a reorganization agreement. This 'first distribution' was followed by a 'second distribution' based on Cocker's earnings from 1965 to 1968, with a guaranteed minimum purchase price subject to adjustments for undisclosed liabilities. The second distribution occurred in two parts: 4,049 shares on July 3, 1969, and 5,500 shares on March 9, 1971. The IRS determined that a portion of the second distribution constituted interest income under section 483, which petitioners contested.

Procedural History

The IRS issued notices of deficiency for the petitioners' 1969 and 1971 tax years, asserting that a portion of the Kidde stock received was taxable as interest income under section 483. The petitioners challenged this determination in the U. S. Tax Court, which consolidated their cases for trial and opinion.

Issue(s)

1. Whether section 483 applies to deferred payments in a tax-free reorganization under section 368(a)(1)(B)?
2. Whether the deferred payments in this case were based on a future earnings formula, thereby subjecting them to section 483?
3. Whether the deferred payments constituted 'boot' that would disqualify the transaction as a reorganization under section 368(a)(1)(B)?

Holding

1. Yes, because section 483 applies to deferred payments in sales or exchanges of

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property, including tax-free reorganizations, to tax what is substantively interest income.
2. Yes, because the second distribution was contingent on future earnings, and section 483 applies to such payments regardless of whether they are definite or indefinite at the time of the exchange.
3. No, because interest imputed under section 483 does not constitute 'boot' under section 368(a)(1)(B).

Court's Reasoning

The court applied section 483 to the deferred payments received by the petitioners, citing the statute's broad language and intent to tax what is substantively interest income. The court rejected the petitioners' argument that section 483 was limited to installment sales, noting that the statute's exceptions were clearly enumerated in section 483(f). The court also clarified that interest imputed under section 483 is severable from the principal and does not constitute 'boot' that would disqualify the transaction as a reorganization. The court emphasized that the deferred payments were based on future earnings, and even if a portion was fixed, section 483 still applied to the entire amount. The court distinguished the petitioners' situation from cases involving liquidations and escrow accounts, finding no basis for the application of exceptions to section 483 in this case.

Practical Implications

This decision clarifies that section 483 can apply to deferred payments in tax-free reorganizations, requiring parties to consider potential tax implications of such arrangements. Legal practitioners must advise clients on the tax consequences of deferred payments in reorganizations, ensuring compliance with section 483. Businesses engaging in reorganizations should structure their agreements to account for the possibility of imputed interest income. Subsequent cases, such as Solomon v. Commissioner and Catterall v. Commissioner, have followed this precedent, reinforcing the application of section 483 to various deferred payment scenarios in reorganizations.

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