***Lessinger v. Commissioner, 85 T. C. 824 (1985)***

An exchange under Section 351 does not require issuance of stock when a transfer is made to a wholly owned corporation.

**Summary**

Sol Lessinger transferred his sole proprietorship's assets and liabilities to his wholly owned corporation, Universal Screw & Bolt Co. , Inc. , without issuing additional stock. The IRS argued that this transfer constituted a Section 351 exchange, triggering gain recognition under Section 357(c) due to liabilities exceeding the transferred assets' basis. The Tax Court held that no stock issuance was necessary for a Section 351 exchange in this scenario, overruling prior inconsistent decisions, and confirmed that gain should be recognized under Section 357(c). Additionally, the court denied relief to Lessinger's wife under Section 6013(e), finding no inequity in holding her jointly liable for the tax deficiency.

**Facts**

Sol Lessinger operated a sole proprietorship, Universal Screw & Bolt Co. , which he transferred to his pre-existing wholly owned corporation, Universal Screw & Bolt Co. , Inc. , on January 1, 1977. The transfer included all operating assets and related business liabilities of the proprietorship, but excluded mutual fund shares and the corresponding loan from Chemical Bank. No new stock was issued to Lessinger. The corporation assumed specific liabilities, including those to the factor Trefoil and trade notes payable. The proprietorship's accounts payable were paid by the corporation within 3 to 6 months post-transfer. The excess of liabilities over the adjusted basis of the transferred assets was recorded as a debit to Lessinger's account.

**Procedural History**

The IRS determined deficiencies in the Lessingers' federal income tax for 1977 and 1978, leading to a dispute over whether the transfer constituted a Section 351 exchange and whether gain should be recognized under Section 357(c). The Tax Court ruled on the applicability of Section 351 and Section 357(c), overruling the precedent set by Abegg v. Commissioner, and also addressed the application of the innocent spouse provisions under Section 6013(e).

**Issue(s)**

1. Whether the transfer of assets and liabilities from Sol Lessinger's sole proprietorship to his wholly owned corporation constitutes an exchange under Section 351 despite no issuance of additional stock?
2. Whether gain should be recognized under Section 357(c) due to liabilities assumed by the corporation exceeding the adjusted basis of the transferred assets?
3. Whether Edith Lessinger is entitled to relief under the innocent spouse provisions

of Section 6013(e)?

## Holding

1. Yes, because the transfer to a wholly owned corporation does not require additional stock issuance for Section 351 to apply; the court overruled Abegg v. Commissioner to the extent it was inconsistent.
2. Yes, because the liabilities assumed by the corporation exceeded the adjusted basis of the transferred assets, triggering gain recognition under Section 357(c).
3. No, because Edith Lessinger failed to establish that she had no reason to know of the understatement and it was not inequitable to hold her liable under the circumstances.

## Court's Reasoning

The court reasoned that the issuance of additional stock to a sole shareholder would be a meaningless gesture, applying the principle established in prior cases such as Morgan and King. They overruled Abegg v. Commissioner, which had held otherwise, as it was not squarely on point and was considered anomalous. The court determined that the transfer satisfied Section 351 requirements despite no stock issuance. Under New York law, the corporation was deemed to have assumed the liabilities of the proprietorship, as it paid them in the normal course of business. The court also found that the excess liabilities over the transferred assets' basis resulted in gain recognition under Section 357(c). Regarding the innocent spouse relief, the court cited McCoy v. Commissioner, noting that both spouses were equally 'innocent' of understanding the tax consequences and thus, it was not inequitable to hold Edith Lessinger liable.

## Practical Implications

This decision clarifies that for Section 351 exchanges involving wholly owned corporations, no new stock issuance is required, simplifying corporate restructuring for sole proprietors. Tax practitioners must ensure accurate valuation of assets and liabilities in such transfers to avoid unintended gain recognition under Section 357(c). The ruling also underscores the limited application of innocent spouse relief, emphasizing that both spouses must understand the tax implications of their actions. Subsequent cases and IRS guidance have followed this precedent, affecting how similar transactions are structured and reported.

 