Cornell Law Review

Volume 56
Issue 4 *April 1971*

Article 6

# Combining a Section 333 Liquidation With a C Reorganization

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# COMBINING A SECTION 333 LIQUIDATION WITH A "C" REORGANIZATION

Section 331 of the Internal Revenue Code of 1954[1] allows a shareholder's gain upon the complete liquidation of a corporation to be taxed at capital gains rates. Section 333[2] grants relief from section 331

1 INT. REV. CODE OF 1954, § 331(a)(1) [hereinafter cited as CODE], provides: "Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock."

2 *Id.* § 333 provides in pertinent part:

(a) *General rule.*—In the case of property distributed in complete liquidation of a domestic corporation (other than a collapsible corporation to which section 341(a) applies), if—

(1) the liquidation is made in pursuance of a plan of liquidation adopted on or after June 22, 1954, and

(2) the distribution is in complete cancellation or redemption of all the stock, and the transfer of all the property under the liquidation occurs within some one calendar month,

then in the case of each qualified electing shareholder (as defined in subsection (c)) gain on the shares owned by him at the time of the adoption of the plan of liquidation shall be recognized only to the extent provided in subsections (e) and (f).

. . . .

(c) *Qualified electing shareholders.*—For purposes of this section, the term "qualified electing shareholder" means a shareholder (other than an excluded corporation) of any class of stock (whether or not entitled to vote on the adoption of the plan of liquidation) who is a shareholder at the time of the adoption of such plan, and whose written election to have the benefits of subsection (a) has been made and filed in accordance with subsection (d), but—

(1) in the case of a shareholder other than a corporation, only if written elections have been so filed by shareholders (other than corporations) who at the time of the adoption of the plan of liquidation are owners of stock possessing at least 80 percent of the total combined voting power (exclusive of voting power possessed by stock owned by corporations) of all classes of stock entitled to vote on the adoption of such plan of liquidation . . . .

. . . .

(d) *Making and filing of elections.*—The written elections referred to in subsection (c) must be made and filed in such manner as to be not in contravention of regulations prescribed by the Secretary or his delegate. The filing must be within 30 days after the date of the adoption of the plan of liquidation.

(e) *Noncorporate shareholders.*—In the case of a qualified electing shareholder other than a corporation—

(1) there shall be recognized, and treated as a dividend, so much of the gain as is not in excess of his ratable share of the earnings and profits of the corporation accumulated after February 28, 1913, such earnings and profits to be determined as of the close of the month in which the transfer in liquidation occurred under subsection (a)(2), but without diminution by reason of distributions made during such month; but by including in the computation thereof all amounts accrued up to the date on which the transfer of all the property under the liquidation is completed; and

(2) there shall be recognized, and treated as short-term or long-term capital gain, as the case may be, so much of the remainder of the gain as is not in excess of the amount by which the value of that portion of the assets received by him which consists of money, or of stock or securities acquired by the corporation after December 31, 1953, exceeds his ratable share of such earnings and profits.

This provision was first enacted in the Revenue Act of 1938 and applied to all for non-corporate shareholders[3] of corporations with little or no earnings and profits but substantial appreciated assets by, in effect, postponing the recognition of gain; appreciated properties distributed to a shareholder in a section 333 liquidation assume the basis of the stock given up by the shareholder,[4] and any gain is taxed only at the time that the shareholder sells the appreciated assets. Gain will be recognized at the time of distribution, however, if money, stock, or securities are distributed, or where there are earnings or profits.[5]

The 1954 Code carefully defines in section 368 transactions that "effect only a readjustment of continuing interest in property under modified corporate forms."[6] Such reorganizations receive special tax treatment regarding the recognition of gain to the transferor corporation and its shareholders. A "C" reorganization consists of the transfer by one corporation of "substantially all" of its assets to another corporation "in exchange solely for all or a part of [the transferee's] voting stock."[7] On such an exchange, the transferor corporation has no recognized gain[8] and can distribute the stock it holds in the transferee corporation to its shareholders in exchange for its own stock. The recipient shareholder recognizes no gain on this exchange except to the extent that cash, property, or other "boot" has been distributed.[9] The shareholder's basis in the new stock remains his basis in the old stock; again the tax is postponed until a sale of the new stock by the shareholder.[10]

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liquidation plans adopted after January 1, 1938, and executed during December of 1938. J. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME TAX LAWS, 1938-1861, at 49-52 (1938). The 1943 Act restored a provision for liquidations in 1944 and the 1950 and 1951 Acts contained a provision for the years 1951 and 1952, respectively. 1 J. SEIDMAN, SEIDMAN'S LEGISLATIVE HISTORY OF FEDERAL INCOME AND EXCESS PROFITS TAX LAWS, 1953-1939, at 1541-50 (1954). Section 333 of the 1954 Act is the first such provision of indefinite duration.

3 Although corporate shareholders are given relief by CODE § 333(f), this note will be concerned with § 333 liquidations by non-corporate shareholders only.

4 *Id.* § 334(c). Proper adjustment to basis must be made for any money received by the shareholder or gain recognized to him. *Id.*

5 *Id.* §§ 333(e)(1)-(2).

6 Treas. Reg. § 1.368-1(b) (1955).

7 CODE § 368(a)(1)(C) defines a "C" reorganization as:

> [T]he acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded . . . .

8 *Id.* § 361(a) states: "No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization."

9 *Id.* §§ 354(a), 356(a)-(b).

10 *Id.* § 358(a).

A combination of these two sections—a section 368(a)(1)(C) reorganization and a section 333 liquidation—in separate but successive transactions would enable the shareholders in the transferor-liquidating corporation to receive some stock and some appreciated assets without the recognition of gain or loss on either of the distributions.

Consider the following hypothetical situation: John Elderly is the sole shareholder in Home Antiques, Inc. Despite a fine inventory, Home Antiques has not proved profitable and Elderly wishes to discard the corporate form of business and perhaps, due to his age, forego operation of the business.

National Antiques, Inc., approaches Elderly, seeking a consolidation of their businesses through a "C" reorganization. Elderly hesitates, however, because he wishes to retain several antiques to decorate his home. He realizes that if he obtains these appreciated assets in a section 354 distribution pursuant to the plan of reorganization they will be taxable as "boot" under section 356. Since Elderly will receive no cash as a result of the section 354 distribution, he desires to postpone the tax on the gain from the appreciated assets.

After consultation, Home Antiques proceeds with a plan of "C" reorganization and transfers its real estate, client lists, accounts receivable, and ninety-two percent of its inventory to National. Home Antiques retains the remaining eight percent of the antiques.

Subsequent to the reorganization and a section 354 distribution of the National stock to Elderly for most of his Home Antiques stock, Home Antiques files a plan of section 333 liquidation and liquidates within one month.[11] The remaining antiques are distributed to Elderly without the recognition of gain, and they assume the basis of his remaining Home Antiques stock given up in exchange.

## I

## The Legitimacy of the Combination Under the Code

The Internal Revenue Code of 1954 neither expressly allows nor expressly forbids the combination contemplated. Thus, whether it is permitted must be determined by reference to actions taken by courts considering similar combinations and to the langnage and legislative history of the sections.

### A. *Combining a Spin-Off and a Reorganization*

A closely analogous combination of Subchapter C sections has recently come before the courts and the Commissioner of Internal Reve-

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11 *Id.* § 333(a)(2).

nue and has received general approval. Corporations composed of two distinct businesses have used a section 355[12] spin-off to separate one of these businesses so that the other could be transferred in a subsequent reorganization. Section 355 allows non-recognition of gain or loss upon a "spin-off," which is "the separation . . . of two or more existing businesses formerly operated, directly or indirectly, by a single corporation."[13] Although the reorganization constitutes the second transaction in this combination, analogous questions of construction of relief sections, compatibility of Subchapter C sections, legislative history, and step transactions are all presented.

In *Curtis v. United States*[14] and *Commissioner v. Morris Trust*,[15] taxpayers attempted spin-offs prior to "A" reorganizations. The Sixth and Fourth Circuits reached opposite conclusions as to the validity of the combination, but the reasoning of both courts suggests support for consolidating sections 333 and 368. The *Curtis* court held the combination invalid only because the spin-off failed to comply precisely with the section 355 requirements; that is, the court declared that when the parent corporation in a spin-off became the acquired corporation in the subsequent reorganization, it could not be "engaged immediately after the distribution in the active conduct of a trade or business,"[16] as required by section 355. To justify its technical approach, the court noted that "[e]xemptions from general taxation statutes are to be strictly construed."[17] The court neither denied the compatibility of the sections nor invoked the step transaction analysis that had been noted in the district court's decision.[18]

The Fourth Circuit, under similar facts in *Morris Trust*, declared that a literal construction of section 355 "is quite consistent with the prior history" of the section—Congress intended to limit the continued business test of section 355 to the period "*immediately* after the distribution."[19] Here, according to the court, there was no violation of this underlying principle because "[t]here was no empty formalism, no utilization of empty corporate structures, no attempt to recast a taxable transaction in nontaxable form and no withdrawal of liquid assets."[20]

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12 *Id.* § 355.

13 Treas. Reg. § 1.355-1(a) (1955).

14 336 F.2d 714 (6th Cir. 1964).

15 367 F.2d 794 (4th Cir. 1966).

16 336 F.2d at 719, *quoting* CODE § 355(b)(1)(A).

17 *Id.* at 721.

18 Curtis v. United States, 215 F. Supp. 885, 886 (W.D. Ohio 1963), *aff'd*, 336 F.2d 714 (6th Cir. 1964).

19 367 F.2d at 798 (emphasis added).

20 *Id.* at 799.

This court, unlike the Sixth Circuit, determined that section 355 was technically complied with despite the subsequent merger of the parent corporation.[21] Again, the step transaction analysis did not enter into the decision.

Two recent revenue rulings are concerned with similar combinations. Revenue Ruling 70-434 allows a spin-off and "B" reorganization combination where the parent company in the spin-off remains intact as a subsidiary of the acquiring corporation in the reorganization.[22] Revenue Ruling 70-225 denies a more complicated combination of these sections in which the stock of the spun-off corporation is distributed to the parent's shareholder under section 368(a)(1)(D), and the shareholder then transfers the stock to another corporation in a "B" reorganization. The denial relies on application of the step transaction analysis to establish the absence of control required by section 368(a)(1)(D) and the failure of a stock-for-stock transaction required for a "B" reorganization.[23] Thus, the revenue rulings support the court decisions but raise the possibility of step transaction analysis if integration of the transactions would result in failure to comply with the technical statutory requirements of one or more of the sections involved.

Neither the Internal Revenue Service nor the courts questioned

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21 *Id.* at 799-800. The Internal Revenue Service agreed to follow the *Morris Trust* holding in Rev. Rul. 68-603, 1968-2 CUM. BULL. 148.

22 Rev. Rul. 70-434, 1970 INT. REV. BULL. No. 34, at 11.

23 Rev. Rul. 70-225, 1970 INT. REV. BULL. No. 19, at 15:

> *R*, a corporation with one shareholder, *A*, for many years has operated a taxicab business and a car rental business. *T*, an unrelated widely held corporation, desired to acquire *R*'s car rental business. Pursuant to a plan, *R* transferred the assets of its car rental business to a newly formed corporation, *S*, in exchange for all the stock of *S* and distributed the stock of *S* to its sole shareholder (*A*) in a transaction intended to qualify under sections 368(a)(1)(D) and 355 of the Code. As part of the prearranged plan, *A* immediately exchanged all his *S* stock for some of the outstanding voting stock of *T* in an exchange intended to meet the requirements of section 368(a)(1)(B) of the Code.
>
> . . . .
>
> . . . [I]n the instant case, the transfer by *R* of part of its assets to *S* in exchange for all the stock of *S* followed by the distribution of the *S* stock to *A* and by the transfer of the *S* stock to *T* by *A* in exchange for *T* stock is a series of integrated steps which likewise may not be considered independently of each other. Accordingly, neither *R* nor its sole shareholder *A* is in control of *S* after the transfer and the transaction does not constitute a reorganization under section 368(a)(1)(D) of the Code nor a transfer under section 351 of the Code. Section 368(a)(1)(B) of the Code is not applicable to the transaction, since in effect *R* transferred part of its assets to *T* in exchange for part of the *T* stock, rather than *T* having acquired all the stock of a previously existing corporation solely in exchange for its own voting stock.
>
> Accordingly, the receipt by *A* of the stock of *T* is not a distribution to which section 355 of the Code applies. The fair market value of the stock of *T* is taxable to *A* as a distribution by *R* under section 301 of the Code. In addition, gain or loss is recognized to *R* on the transaction.

the compatibility of these Subchapter C sections. In fact, the Fourth Circuit declared that it could not find "any support for the Commissioner's suggestion of incompatibility between substantially contemporaneous divisive and amalgamating reorganizations" in either the Code or its legislative history.[24]

B. *"Corporate Distributions and Adjustments"*

All of the pertinent sections used in the proposed combination fall within Subchapter C of the Code, which concerns corporate distributions and adjustments. Although limits have been placed on sections 333, 354, and 356, none prohibits the combination proposed herein; a corporation seeking a section 333 liquidation cannot take advantage of a section 337 sale of assets during the liquidation,[25] and distributions under sections 354 or 356 are not to be included within the section 337 rules for the recognition of gain or loss to minority shareholders in certain liquidations.[26]

Congress's sole concern over the combination of section 333 with the reorganization sections is manifested in section 333(g) which prescribes rules for "would have been" personal holding companies.[27] Within these rules, which provide long-term capital gains treatment to certain monies that would otherwise receive dividend treatment, Congress specifically excluded "earnings and profits to which the corporation succeeds . . . pursuant to any corporate reorganization . . . ."[28] But nowhere does section 333 deny its advantages to a corporation that continues to hold property subsequent to a reorganization.

Indeed, it is clear that the transferor corporation in a reorganization need not liquidate after a reorganization.[29] Moreover, it has been noted that unwanted assets in a corporate reorganization could be kept

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24 367 F.2d at 800. *See generally* Cohen, *Tax-Free Acquisition of Part of a Corporation's Assets by Combining a Spin-Off with a Unifying Reorganization,* N.Y.U. 26TH INST. ON FED. TAX. 849 (1968); Massee, *Section 355: Disposal of Unwanted Assets in Connection with a Reorganization,* 22 TAX L. REV. 439 (1967).

25 CODE § 337(c)(1)(B).

26 Treas. Reg. § 1.337-5(a) (1961).

27 "Would have been" personal holding companies were created in 1964 when Congress tightened up the provisions for personal holding companies. Any corporation that would have been a personal holding company under the newly created provisions in one of two of its preceding taxable years was granted special deductions and was allowed special liquidation treatment if it liquidated before 1967. B. BITTKER & J. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 256 (2d student ed. 1966).

28 CODE § 333(g)(1).

29 Helvering v. Minnesota Tea Co., 296 U.S. 378, 386 (1935); John A. Nelson Co. v. Helvering, 296 U.S. 374, 377 (1935). A recent revenue ruling attempts to limit the application of these Supreme Court decisions, however. Rev. Rul. 68-358, 1968-2 CUM. BULL. 156.

by the transferor after the reorganization and after a section 354 distribution of stock.[30]

The House Report on the 1954 Revenue Act contained a provision that would have required liquidation of the transferor corporation in a "C" reorganization under sections 354 and 356.[31] This provision was deleted from the bill in final form, but the subject came before Congress again in 1959 when a Subchapter C Advisory Group recommended a similar provision to "prevent a transferor corporation from distributing the stock of the transferee without tax to its shareholders while at the same time retaining the boot for an ultimate complete liquidation of the transferor (or a sale of its stock by its shareholders) at capital gains rates."[32] The Advisory Group objected primarily to distributions of earnings and profits as capital gains under a section 331 liquidation subsequent to a reorganization. Again Congress refused to act, willingly leaving open the path for a liquidation subsequent to, but not in pursuance of, a reorganization.

## II

## The "Substantially All" Test and Step Transaction Analysis

Were the Commissioner of Internal Revenue to challenge the proposed combination of sections 333 and 368, his initial argument would probably be that Home Antiques failed to satisfy the "substantially all" requirement for "C" reorganizations. Alternatively, he might contend that the section 333 liquidation is invalid through application of the "step transaction" analysis created by the courts. As can be seen, the two approaches produce opposite results: success of the first negates the reorganization but allows the liquidation, and success of the second allows the reorganization but negates the liquidation.[33]

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30 Beck, *How To Dispose of Unwanted Assets of the Seller in Corporate Distributions*, N.Y.U. 21st Inst. on Fed. Tax. 1095, 1105 (1963); Leake, *Problems in Corporate Acquisitions*, 13 Tax L. Rev. 67, 80-82 (1957).

31 H.R. Rep. No. 1337, 83d Cong., 2d Sess., at 40, A134 (1954).

32 Revised Report on Corporate Distributions and Adjustments To Accompany Subchapter C Advisory Group Proposed Amendments 79 (1958).

33 Of the two arguments, "substantially all" is the easier to answer but probably the more important to Home Antiques. If the step transaction analysis is applied to the transactions, the distribution of the antiques to Elderly will be treated as § 356 "boot" and taxed as capital gains (not as § 356(a)(2) dividends because there are no earnings and profits). If the "substantially all" requirement is unsatisfied, however, the reorganization would be invalid and the transaction treated as a sale, resulting in tax on the gain.

A. *"Substantially All"*

In recent years the statistical and qualitative approaches to the "substantially all" requirement have merged in decisions of the Commissioner and the courts. Two early cases established the statistical rule that transfer of eighty-six percent of a corporation's assets would meet the requirement[34] but that sixty-eight percent would not.[35] This approach has since been modified in revenue rulings by consideration of "the nature of the properties retained by the transferor, the purpose of the retention, and the amount thereof."[36] The courts have looked particularly to the disposition of the operating assets of the transferor[37] and to the use of retained assets where larger retentions are involved.[38] Essentially involved is the interpretation of a statutory provision which offers no guidelines, but the legislative history of which belies a statistical approach.[39]

The hypothetical Home Antiques transfer satisfies both the statistical and qualitative measures of the "substantially all" requirement. A transfer of more than ninety percent of a corporation's assets almost ensures approval.[40] Moreover, the antiques retained do not impair Home Antiques's operating assets, and Home Antiques will not use

34 Commissioner v. First Nat'l Bank, 104 F.2d 865 (3d Cir. 1939).

35 Arctic Ice Mach. Co. v. Commissioner, 23 B.T.A. 1223 (1931), *modified & aff'd*, 67 F.2d 983 (6th Cir. 1933).

36 Rev. Rul. 57-518, 1957-2 CUM. BULL. 253, 254.

37 Moffatt v. Commissioner, 363 F.2d 262, 267-68 (9th Cir. 1966), *cert. denied*, 386 U.S. 1016 (1967): "In the setting of a service organization such as a consulting engineering operation, the retention of physical non-operating assets such as land should not cloud the fact that the essential tangible and intangible assets of one corporation have been transferred to another . . . ."; James Armour, Inc., 43 T.C. 295, 309 (1964): "Thus, it will be seen that as a result of the transactions . . . [the acquiring company] either acquired title to, or the use of, all the assets essential to the conduct of the business . . . ."; *see* National Bank of Commerce v. United States, 158 F. Supp. 887 (E.D. Va. 1958).

38 Payson v. Commissioner, 166 F.2d 1008 (2d Cir. 1948); Harden Taylor, 43 B.T.A. 563 (1941), *aff'd*, 128 F.2d 885 (2d Cir. 1942); Rev. Rul. 57-518, 1957-2 CUM. BULL. 253. If Home Antiques needed to retain some liquid assets and continue in existence for an indefinite period to terminate liabilities, its position would be strengthened not only as to the "substantially all" requirement, but also as to the step transaction analysis. *See* text accompanying note 48 *infra*.

39 The House Report on the 1954 Revenue Act contained the provisions within § 359 (§ 368 in the Code as enacted) that "substantially all" be eliminated and that 80% of the transferor's assets be substituted. It also suggested that retained assets only be permitted to be used for payment of liabilities. H.R. REP. No. 1337, *supra* note 31, at A 133. Both of these provisions were rejected by Congress.

40 Britt v. Commissioner, 114 F.2d 10 (4th Cir. 1940). *See* Rev. Proc. 66-34, 1966-2 CUM. BULL. 1232, in which the Commissioner returned to the statistical approach by prescribing 90% of net assets and 70% of gross assets as sufficient to warrant a ruling by the Commissioner that the "substantially all" requirement was satisfied in a specific case.

the retained assets to continue in business. Thus, the "substantially all" test can be met within a combination of sections 333 and 368.[41]

B. *"Step Transactions"*

The court-developed step transaction analysis presents a challenge to the proposed combination. If this analysis is applied, the liquidation will be incorporated into the reorganization and the appreciated assets will be treated as section 356 "boot." The purpose of the step transaction doctrine is to prevent corporations from circumventing the rigid rules for reorganization under section 368 by establishing sham corporations or transferring property prior to or subsequent to the reorganization. The analysis has been variously applied and interpreted, and several tests have emerged: the timing test, the intention of the parties or "end results" test, and the interdependence test.[42]

Although no one test has been agreed upon by the courts, the interdependence test, first established in *American Bantam Car Co.*,[43] has received the widest application. The Tax Court stated the interdependence test in *Southwell Combing Co.*:[44]

> It is well settled that where a transaction is comprised of a series of interdependent steps, that is to say, where the legal relationships created by any one step would have been fruitless without the completion of the entire series, the various steps are to be

41 *See generally* Pomeroy, *"C" Reorganizations—Exchange of Stock for Assets*, 19 CASE W. RES. L. REV. 998, 1001-06 (1968). The "substantially all" requirement does place a practical limitation on the use of this combination. *See* p. 675 *infra*.

42 Treas. Reg. § 1.368-1(c) (1955):

> A scheme, which involves an abrupt departure from normal reorganization procedure in connection with a transaction on which the imposition of tax is imminent, such as a mere device that puts on the form of a corporate reorganization as a disguise for concealing its real character, and the object and accomplishment of which is in the consummation of a preconceived plan having no business or corporate purpose, is not a plan of reorganization.

*See generally* Gutkin, *Step Transactions*, N.Y.U. 9TH INST. ON FED. TAX. 1219, 1219-20 (1951); Mintz & Plumb, *Step Transactions in Corporate Reorganizations*, N.Y.U. 12TH INST. ON FED. TAX. 247, 249-53 (1954).

In a recent Supreme Court case, the "binding commitment" test was established, but the effect of this ruling is unclear. Commissioner v. Gordon, 391 U.S. 83, 96 (1968). The interesting aspect of this case is that the taxpayer urged application of step transaction analysis while the Commissioner opposed it on the ground that the second step could not be integrated into the first unless there was a binding commitment to take the second step. Such a reversal of roles casts some doubt on the value of the decision as precedent. *See* Jacobs, *Supreme Court Further Restricts the Step Transaction Doctrine*, 29 J. TAXATION 2 (1968).

43 11 T.C. 397 (1948), *aff'd*, 177 F.2d 513 (3d Cir. 1949), *cert. denied*, 339 U.S. 920 (1950).

44 30 T.C. 487 (1958).

integrated into one for the purpose of arriving at the tax consequences of the transaction.[45]

Surely, the two transactions completed by Home Antiques were not interrelated in this sense. If the reorganization were invalid, the liquidation would still serve a useful purpose; likewise, if the liquidation were invalid the reorganization would still be important to the corporations involved.

The timing test creates the presumption that transactions closely related in time are interdependent,[46] and the end results test focuses "upon whether the result which the parties intended to accomplish by the series of steps conforms to the terms of the statute."[47] In the Home Antiques transactions, no sham corporations were established and neither intention to circumvent nor actual circumvention was manifested. Temporal proximity of the two transactions would occur only in the event that Home Antiques has no outstanding liabilities to satisfy after the reorganization.[48]

Besides the tests employed, the theory behind the use of the step transaction analysis should be examined. The courts that have used this analysis when integrating prior and subsequent transactions with an attempted reorganization would deny reorganization treatment for failure to meet the technical statutory and judicial requirements—the "substantially all" test, the "continuity of interest" requirement, and the "solely for voting stock" requirement.[49] And a series of transactions has been analyzed together for the purpose of establishing a reorganization when, by a series of steps, a taxpayer has tried to avoid reorganization treatment.[50] The courts have yet to decide, however, whether a subsequent transaction should be incorporated into a valid reorganization when the reorganization would be valid both with or without that subsequent transaction.[51] If the subsequent transaction were a qualified

45 *Id.* at 497.

46 Mintz & Plumb, *supra* note 42, at 249; *see* Love v. Commissioner, 113 F.2d 236 (3d Cir. 1940); *cf.* D.W. Douglas, 37 B.T.A. 1122 (1938).

47 Mintz & Plumb, *supra* note 42, at 250 (footnote omitted).

48 *See* note 38 *supra.*

49 *E.g.*, Helvering v. Elkhorn Coal Co., 95 F.2d 732 (4th Cir. 1937), *cert. denied*, 305 U.S. 605 (1938). The judicially created "continuity of interest" requirement ensures that the owners of the acquired corporation retain a degree of ownership in the acquiring corporation as a result of the reorganization.

50 *E.g.*, Piedmont Financial Co., 26 B.T.A. 1221 (1932).

51 The only similar cases are those referred to at notes 14-15 *supra*, concerning spinoffs prior to a valid reorganization. In those two cases neither of the appellate courts relied on a step transaction analysis for its decision.

A simpler step transaction argument for the Commissioner would be to ignore the liquidation entirely and treat all distributions subsequent to the reorganization as "in pursuance" of the reorganization. *Cf.* D.W. Douglas, 37 B.T.A. 1122 (1938).

one, the purpose for integrating it with a valid reorganization would be non-existent.

## III

## THE EQUITIES OF THE COMBINATION

The Commissioner could also argue that Home Antiques is manipulating two relief sections of the Code to avoid imposition of tax upon John Elderly. Relief sections should be strictly construed, he would point out, because they provide exceptions from normal tax consequences. The taxpayer, nevertheless, can retort with forceful arguments of his own.

First, Elderly and Home Antiques are merely using the Code to their best possible advantage—a well-recognized and oft-applauded endeavor. The courts have declared that one may avoid certain taxation by skillful manipulation of the Code without being cited for evasion.[52] Second, the combination herein proposed does not represent a major "loophole" in the Code because limitations are imposed by the requirements of the relevant sections. The "substantially all" requirement restricts the amount of retained properties to a minimum and the type of properties to non-essential operating assets. The elections required for section 333 liquidations suggest the need for a close-knit group of shareholders, and the one-month liquidation period further limits the type of corporations to which the combination can apply. Most importantly, the corporation must have little or no accumulated earnings and profits. The government thus will not be swamped by corporations seeking large tax savings.

Third, Elderly belongs to the particular class of taxpayers that sections 333 and 368 were meant to relieve. Congress first established section 333 to aid the taxpayer who found the corporate form of business unprofitable or inconvenient and desired to leave that form while retaining his assets.[53] Section 333, as permanently enacted into the 1954 Code, offers Elderly this relief by not recognizing gain on appreciated properties at the time of liquidation.[54] Section 368 provides the taxpayer with several methods to change his form of business—he may consolidate, sell out, recapitalize, or merge. When Home Antiques transferred "substantially all" of its assets to National and distributed

52 Gregory v. Helvering, 293 U.S. 465, 469 (1935): "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."

53 83 CONG. REC. 5171-72 (1938). *See* note 2 *supra*.

54 CODE § 333(e)(1).

the National stock it received in exchange, Elderly continued an interest in the antiques business, albeit in modified form. In this circumstance Congress intended that he might postpone the tax.[55]

Finally, Elderly receives no tax advantage through the proposed combination which would not have accrued to him if Home Antiques had transferred all of its assets to National in a "C" reorganization or if Home Antiques had simply liquidated under section 333. In the reorganization, Elderly would receive a proportionately greater amount of stock from National, but still without the recognition of gain. In the liquidation, Elderly would receive all of the antiques, the client lists, the accounts receivable, and the real estate without the recognition of gain. In both situations the gain is the same, and the tax treatment is equivalent. In the proposed combination, Elderly receives some stock and a small amount of property yet the gain remains the same as in each of the above transactions.

## Conclusion

The history and construction of Subchapter C sections as well as the acceptance of a section 355 and section 368 combination point the way to a combination of sections 333 and 368. The spin-off-reorganization cases should warn those attempting the proposed combination that there must be strict compliance with all sections involved. Corporations should also be aware that the step transaction doctrine, although muted in the spin-off cases, may be pressed with vigor as the major remaining argument that the Commissioner can urge.

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55 *See* Treas. Reg. § 1.368-1(b) (1955).