

**Procedural History**

The Board of Tax Appeals upheld the respondent.

**Background Facts**

It will aid understanding of the problem if we narrate the steps taken by the principal stockholder of the taxpayer, to defer or avoid substantial tax burdens, and detail his frankly avowed purposes as we refer to the statutory provisions upon which he relied, and the contemporaneous development of the law interpreting them. The taxpayer is a corporation organized June 6, 1930, under the laws of Delaware, and its principal stockholder is G. Albert Lyon. Prior to May 3, 1930, Lyon was engaged in the manufacture of metal covers for automobile tires, in Detroit. He was also the owner of numerous applications for American and Canadian patents relating to tire covers, and owned machinery and equipment for their manufacture. In February, 1930, he negotiated with the 211\*211 Houdaille-Hershey Company for the sale of his business and patent applications, and on May 3, a contract was consummated whereby Lyon, or a corporation to be formed by him, would sell the Houdaille-Hershey Company the tire cover business and Lyon would grant it an exclusive license to manufacture under his patents. At the time of the agreement the book value of Lyon's assets, exclusive of patent rights, was \$203,572.30, and he carried patent rights on his books at cost of development, \$56,411.90. The contract also granted to the purchaser an option to buy the patents. Since the patent rights were found by the Board to have had at the time a fair market value of over a million dollars, it will readily be seen that Lyon's tax situation at once became to him a matter of great concern. He consulted counsel and was advised that if he transferred his assets to a temporary corporation in exchange for all of its stock, and then caused the temporary corporation to transfer the assets so received to a permanent operating corporation in exchange for less than 80% of its stock, neither the transfer to the temporary corporation nor its transfer to the permanent corporation would be subject to tax, and the permanent corporation would be entitled to use, as the cost of the assets, their value at the time they were acquired. A plan in accordance with this advice was put into effect. On June 12, 1930, Lyon transferred his tire cover business, including patent applications, subject to the agreement of May 3, to a corporation organized by him under the style "Lyon Development Company, Inc.," and received in exchange all of the corporation's stock. Two days later, on June 14, this corporation transferred the assets received from Lyon, likewise subject to the contract of May 3, to the petitioner in exchange for 885 shares of petitioner's Class A voting stock and 1600 shares of its Class B non-voting stock. The stock received by the temporary corporation constituted 79.27% of the taxpayer's total stock. On June 13, 1930, Lyon's wife, Elizabeth Aikens Lyon, transferred certain stocks owned by her to the taxpayer in exchange for 650 shares of its Class A voting stock, which resulted in all of the stock being owned by the Lyons.

**Analysis**

Lyon's plan was to sell his tire cover business and patent applications in such manner that the tax upon any gain derived therefrom would be postponed, and the corporation formed to hold the patents enabled to use a basis for depreciation, stepped up from Lyon's cost to current fair value. The first part of his purpose was in part achieved by the transfer of all of his assets to the temporary corporation in exchange for all of its stock. This was a tax-free transaction within § 112(b) (5) of the Revenue Act of 1928, 26 U.S.C.A. Int.Rev.Acts, page 377,

**Analysis**

It will be observed that under § 113(a) (7), a transfer by a corporation in connection with a reorganization leaves the basis the same as in the hands of the transferor only if immediately after the transfer an interest or control in the property of 80% remains in the same persons, or any of them. It was for this reason that the temporary corporation exchanged its assets for stock which constituted but 79.27% of the petitioner's capitalization. The remaining stock of the taxpayer was acquired directly from the taxpayer by Mrs. Lyon in exchange for some stock that she held in Lyon & Wilson, Inc., and additional stock in that company which Lyon, at the time, gave her as a gift, for the purpose of making the exchange. Since the interests of Mrs. Lyon and the temporary corporation in the property transferred were thought to be substantially disproportionate to the amounts of stock respectively received by them it was believed that the taxpayer would not be required to use the transferor's basis but would be permitted to use as a basis its own cost in pursuance of the provisions of §§ 112(b) (5) and 113(a) (8).

**Analysis**

The changing of one corporation having no business purpose into another corporation without business purpose, is but a change of style and still lacks business purpose. It is but the same thing under another name. But when a corporation however lacking in economic reason for existence is so transformed and vitalized that a new economic enterprise has come into being with purpose, function and reason for permanent existence, then we think it is the product of a reorganization both in its technical and popular sense.

**Rule**

No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange."

**Rule**

By virtue of § 113(a) (6), 26 U.S.C.A. Int.Rev.Acts, page 381, however, the basis for valuing the transferred assets remained the same in the hands of the corporation as when they were owned by Lyon. The stepped up basis was sought to be achieved by the transfer of the assets to a second corporation, and thereby not only to effect a tax-free reorganization but to make applicable to depreciation base § 113(a) 212\*212 (7) of the same statute, which provides: "(7) Transfers to corporation where control of property remains in same persons. If the property was acquired after December 31, 1917, by a corporation in connection with a reorganization, and immediately after the transfer an interest or control in such property of 80 per centum or more remained in the same persons or any of them, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made. This paragraph shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the issuance of stock or securities of the transferee as the consideration in whole or in part for the transfer."

**Rule**

The Supreme Court, in the Gregory case, said 293 U.S. 465, 55 S.Ct. 267, 79 L.Ed. 596, 97 A.L.R. 1355: "When subdivision (B) speaks of a transfer of assets by one corporation to another, it means a transfer made 'in pursuance of a plan of reorganization' (section 112(g) of corporate business; and not a transfer of assets by one corporation to another in pursuance of a plan having no relation to the business of either, as plainly is the case here."

**Rule**

Section 113(a) (12) of the Revenue Act of 1934, 26 U.S.C.A. Int.Rev.Acts, page 700, provides that if property was acquired by a corporation in any taxable year prior to January 1, 1934, the basis thereof shall be the same as the basis prescribed in the Revenue Act of 1932, § 113(a) (7), 26 U.S.C.A. Int.Rev.Acts, page 516, which provides that if the property of a corporation was acquired after December 31, 1917, in connection with a reorganization and immediately after the transfer the interest and control in such property of 50 or more per cent remained in the same persons, or any of them, the basis shall be the same as though in the hands of the transferor. The 80% limitation was reduced to 50% to check tax avoidance not only in the Revenue Act of 1932 but in subsequent Revenue Acts.

**Conclusion**

Having concluded that notwithstanding the taxpayer's reliance upon the decision in Gregory v. Helvering, supra, there was a reorganization, the Board's decision sustaining the Commissioner in limiting the depreciation base to Lyon's cost, must be upheld, unless there is persuasiveness in the taxpayer's concluding argument.

**Conclusion**

The decision of the Board of Tax Appeals is affirmed.