Background Facts

Petitioners are the surviving trustees under the will of John B. Lewis who died December 29, 1930. On January 9, 1931 John D. Lewis, Inc., a Rhode Island corporation, was organized to take over the sole proprietorship business operated by John B. Lewis prior to his death. Petitioners, as trustees, acquired all the issued and outstanding stock of the corporation consisting of 4,000 shares of common stock having a basis of $435,000. At the beginning of 1941, the tax year in question, the corporation was engaged in three different lines of business, the manufacture of synthetic resins, the manufacture of chemicals for the textile industry and the distribution of chemicals. On June 30, 1941 the corporate name was changed to John D. Lewis Company. In July of the same year two branches of the business, the synthetic resin business and the chemical distribution business, were sold for a consideration in the aggregate of approximately $325,000 in cash and marketable securities. The corporation continued to operate the remaining line of business.\n\nOn December 27, 1941, the board of directors of John D. Lewis Company (hereinafter called the old company) voted to transfer to John D. Lewis Company (hereinafter called the new company), a corporation to be organized, all the assets of the old company other than (1) securities and (2) cash in excess of $90,000, i. e. essentially the assets pertaining to the remaining line of business were to be transferred to the new company. The stockholders, petitioners herein, on the same day, ratified the action of the directors and also voted to change the name of the old company to Traverse Street Corporation. The change of name was accomplished on December 29, 1941.\n\nThe new company was incorporated on December 29, 1941 with an authorized capital of 500 shares of no par common stock. Both the old company and the new company were Rhode Island corporations. At 11:00 a. m. on the same day the assets of the remaining line of business of the old company referred to in the previous resolutions amounting to approximately $156,000 were transferred to the new company and the old company received in exchange all the stock of the new company. At 11:30 a. m. on the same day, after the exchange had been effected, the directors of the old company voted to liquidate that company by distributing all the remaining assets including the stock of the new company to the shareholders of the old company in cancellation and redemption of the outstanding 4,000 shares of common stock of the old company. Immediately thereafter the stockholders of the old company ratified this action of the directors. Thereupon, the following assets, at the fair market value indicated, were distributed to the petitioners, the sole stockholders of the old company, in complete cancellation and redemption 841*841 of all the issued and outstanding stock of that company:\n\nCash $166,375.74\nStock of John D. Lewis Company\n(the new company) 156,598.61\nOther stocks and bonds 177,496.15\nNotes 636.80\n\n\tTotal $501,107.30\n\nThe Tax Court found that the gain realized by the petitioners on this transaction was $66,107.30 and petitioners do not now dispute this amount. The earnings or profits of the old company accumulated since 1931 exceeded on December 29, 1941 the amount of gain realized.\n\nPetitioners on their income tax return reported the gain as a gain realized upon complete liquidation of a corporation under Internal Revenue Code § 115(c)[1] and taxable as a long term capital gain under Internal Revenue Code § 117. 26 U.S.C.A. Int.Rev.Code, § 117. The Commissioner assessed a deficiency since he determined that the liquidating transfer by the old company constituted an exchange pursuant to a plan of reorganization of the old company within the meaning of Internal Revenue Code § 112(b) (3)[2] and that the gain was therefore taxable in full as the distribution of a taxable dividend under Internal Revenue Code § 112(c) (1) and (2).[3]

Procedural History

The Tax Court sustained the Commissioner. It found that the transfer by the $42*842 old company of part of its assets to the new company in exchange for all the stock of the new company was a reorganization literally within the definition of Internal Revenue Code § 112(g) (1) (D).[4] The Tax Court then applied §§ 112(b) (3) and 112(c) (1) and (2), holding that the distribution had the "effect of the distribution of a taxable dividend" under the authority of Commissioner v. Estate of Bedford, 1945, 325 U.S. 283, 65 S.Ct. 1157, 89 L.Ed. 1611.\n\nPetitioners' chief argument is directed at the Tax Court's finding that a "reorganization" occurred. It is asserted that the requirement of "business purpose" as laid down by Gregory v. Helvering, 1935, 293 U.S. 465, 55 S.Ct. 266, 79 L.Ed. 596, 97 A. L.R. 1355 is lacking. The Tax Court found as a fact that: "The purposes of the transfer of the operating assets from the old company to the new company were to continue the chemical manufacturing business under the new company and to liquidate and distribute the remaining assets of the old company to its stockholders." In the course of its opinion the Court stated again that one of the reasons for the transfer of assets was to continue the chemical manufacturing business and that the new company was not formed for the purpose of liquidating or disposing of the assets it had acquired. The Tax Court went on to say: "To assert that the primary purpose in this case was the complete liquidation of the old company and that the organization of the new company was but an incident thereof is to obscure the essential nature of the transaction. From the evidence, it seems to us that the real end desired was not complete liquidation but rather partial liquidation. There was no purpose to wind up the business completely. The chemical manufacturing business, one of the three lines of business formerly conducted by the old company, was to be continued. * * * We conclude that there was a plan of reorganization within the meaning of the statute, and that the distribution to petitioners in liquidation of the old company was but one step in the integrated transaction * * *."

Rule

There can be no doubt that the transaction between the old and new companies is literally within the definition of "reorganization" of Internal Revenue Code § 112(g) (1) (D). But the Supreme Court in the Gregory case, where the transferee corporation was merely used as a conduit for the distribution of a dividend to the shareholder, has said that in addition to compliance with the literal terms of the statutory definition there must be a "business purpose" i. e., it is necessary that there be "a transfer made 'in pursuance of a plan of reorganization' § 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 * * *". 293 U.S. at page 469, 55 S.Ct. at page 267, 79 L.Ed. 596, 97 A.L. R. 1355.\n\nTreasury Regulation 103, § 19.112(g)-1 states: "* * * The purpose of the reorganization provisions of the Internal Revenue Code is to except from the general rule specifically described exchanges incident to such readjustments of corporate structures, made in one of the particular ways specified in the Code, as are required by business exigencies * * * such transactions and such acts must be an ordinary and necessary incident of the enterprise and must provide for a continuation of the enterprise * * *". And § 112(g)-2 says: "* * *. Moreover, the transaction or series of transactions, embraced in a plan of reorganization must not only come within the specific language of section 112(g) (1), but the readjustments involved in the exchanges effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization * * *". $43*843 (Italics supplied). See also Helvering v. Winston Bros. Co., 8 Cir., 1935, 76 F.2d 381.\n\nThe "business purpose" requirement for § 112(g) reorganizations has often been used to defeat taxpayer contentions for postponement of taxes under the tax free exchange provisions of § 112(b). See Electrical Securities Corporation v. Commissioner, 2 Cir., 1937, 92 F.2d 593; Helvering v. Elkhorn Coal Co., 4 Cir., 1938, 95 F.2d 732, certiorari denied, 1938, 305 U.S. 605, 59 S.Ct. 65, 83 L.Ed. 384.

Rule

Where an essential finding is lacking and such finding is necessary to a proper decision of the case, the correct procedure is to remand the case to the Tax Court to make such a finding and to render a decision accordingly. See Helvering v. Rankin, supra; Vogt's Investment Co., Ltd. v. Commissioner, 9 Cir., 1937, 92 F.2d 861. This procedure should also be followed where only the ultimate finding is lacking even though the reviewing court should consider itself competent to make such findings. Doenbecher Mfg. Co. v. Commissioner, 9 Cir., 1935, 80 F.2d 573; Belridge Oil Co. v. Helvering, 9 Cir., 1934, 69 F.2d 432.[5]

Conclusion

Thus we are obliged to remand the case even though there be findings of fact which we would consider a foundation for a proper finding of "business purpose".

Analysis

Ordinarily as in the Gregory case the use of the transferee company to avoid taxes and its immediate dissolution are sufficient to indicate that the transaction was not "required by business exigencies", was not a "necessary incident of the [conduct of the] enterprise" and was not undertaken for "reasons germane to the continuance of the business". But immediate dissolution of the transferee corporation does not necessarily indicate a Gregory situation if there were business reasons for its creation. Lea v. Commissioner, 2 Cir., 1938, 96 F.2d 55. Usually, however, the continuance of the business in the hands of the transferee (or by a reorganized company in the case of a recapitalization) is deemed sufficient indication of the required "business purpose" and the Treasury Regulations quoted above list this as a requirement for the statutory reorganization. On the other hand, the court in the Electrical case applied the Gregory doctrine where the existence of the transferee was ephemeral despite continuation of the business by the transferee. But the immediate liquidation and dissolution of the transferor is frequently part of the plan of reorganization and does not prevent the reorganization from being within the statute if the transaction conforms to the statutory definition and "business purpose" is found. See Commissioner v. Whitaker, 1 Cir., 1938, 101 F.2d 640; Helvering v. Schoellkopf, 2 Cir., 1938, 100 F.2d 415; Gross v. Commissioner, 5 Cir., 1937, 88 F.2d 567.

Rule

It can therefore be readily observed that the "business purpose" requirement is not necessarily satisfied by a finding that the purpose of the exchange was the continuation of the business in the hands of the transferee since every decision depends on the particular facts in each case.

Analysis

Here then the Tax Court's finding of fact that the purposes of the transfer were to continue the business under the new company and to liquidate and dissolve the old company cannot be treated as necessarily indicating absence or presence of "business purpose". Moreover, we have difficulty in finding the "business exigencies" or "reasons germane to the continuance of the business" which necessitated this transaction. The only result of this "reorganization" obvious to us seems to have been to place the old company in a position to effect a complete liquidation. When the series of transactions here accomplished are examined as a unit rather than in their separate parts, see Bassick v. Commissioner, 2 Cir., 1936, 85 F.2d 8, certiorari denied 1936, 299 U.S. 592, 57 S.Ct. 120, 81 L.Ed. 436; Hazeltine Corporation v. Commissioner, 3 Cir., 1937, 89 F.2d 513, and regard is had for substance rather than form, see Case v. Commissioner, 9 Cir., 1939, 103 F.2d 283, the ultimate result seems to have been merely the partial liquidation of the old company. The Tax Court in its opinion and the Commissioner in his brief concede that the effect of these transactions was a partial liquidation. Since the gain under a partial liquidation would be treated under the then existing provisions of the Internal Revenue Code as a short term capital gain, the taxpayer of course seeks to avoid this result. If the avoidance of the tax consequences of a partial liquidation was the sole consideration for the "reorganization" we are unable to discern how the Gregory requirement has been satisfied and especially is this true if shareholder business purposes are considered as not satisfying the "business purpose" requirement. See Bazley v. Commissioner, 3 Cir., 1946, 155 F.2d 237. None of the usual examples of "business purpose" seem to be here present, e. g. modification of the corporate structure, Helvering v. Winston Bros. Co., supra; the addition of new business enterprises or the severance of part of the old, Gross v. Commissioner, supra. Further examples may be found in the list of 10 "business purposes" shown to exist for the "reorganization" $44*844 in Commissioner v. Kolb, 9 Cir., 1938, 100 F.2d 920, 926.

Analysis

The taxpayer here urges us to reverse the Tax Court because he alleges that "business purpose" is lacking. It is our view that if the Tax Court found either that "business purpose" existed or was lacking, the rule of the Dobson case would prevent our reexamination of the question. See Bazley v. Commissioner, supra. If on the other hand the Tax Court were to say that a "reorganization" under § 112(g) (1) had occurred despite the lack of "business purpose", it would seem that a clear cut question of law would be presented. See Gregory v. Commissioner, supra. Likewise review might be had of the Tax Court's construction of "business purpose" if not in conformity with court decisions or the Regulations, see Helvering v. Rankin, 1935, 295 U.S. 123, 131, 55 S. Ct. 732, 79 L.Ed. 1343, although delimitation of the scope of the Dobson rule is difficult to state in the abstract. See Note (1947) 60 Harvard Law Review 448 passim. But the findings of fact, the inferences to be drawn therefrom and their application to the rules of law are functions for the Tax Court and are subject only to limited review on the question of substantial evidence. See Commissioner v. Scottish American Investment Co., Ltd., 1944, 323 U.S. 119, 123, 124, 65 S.Ct. 169, 89 L. Ed. 113. Here the Tax Court made no finding concerning "business purpose" except the limited finding mentioned above which we pointed out as not being determinative. Nor does the statement in the court's opinion that "there was a plan of reorganization within the meaning of the statute" demonstrate that a finding of "business purpose" was made inferentially since the Tax Court may have ignored that requirement or applied the wrong standard or an improper construction of "business purpose" to the facts and inferences drawn therefrom.