

**Procedural History**

Plaintiff has filed his motion for summary judgment on both issues, and Defendant, United States of America, has filed its motion for partial summary judgment, seeking judgment in its favor on the first issue only, contending that material issues of fact exist as to the question of the bonds. *in* The parties have dealt separately with each of the questions presented by their motions, and the Court will do likewise.

**Background Facts**

This is an action by Frank W. and Lucile Sharp for the recovery of additional federal income taxes and interest assessed against the Plaintiffs for the year 1959 in the sum of \$67,902.31. Plaintiffs *880*886 paid the assessment and timely filed a claim for refund. The claim for refund was disallowed and this action was then filed *in* Frank W. Sharp will hereinafter be referred to as "Plaintiff" or "Taxpayer," since his wife is a party only because a joint return was filed *in* a Two separate and distinct issues are involved, one being whether the amount received by Plaintiff from a corporation in which he owned a fifty per cent stock interest was the result of a liquidation producing capital gains, or a reorganization producing ordinary income; and the second being whether Plaintiff realized taxable gain on the disposition of certain water district bonds in which Plaintiff contends he owned no interest.

**Background Facts**

During 1954, Plaintiff-Taxpayer acquired an interest in approximately 3925 acres of land known as the Westmoreland property. Shortly thereafter he conveyed approximately 297 acres of this land to Sharptown Development Company (hereinafter referred to as "Development"), a corporation organized in 1954, in which Plaintiff owned a fifty per cent stock interest. The balance of approximately 3628 acres was conveyed to a second corporation known as Sharpstown Investment Company (hereinafter referred to as "Investment"), which was organized in 1954 and in which Plaintiff also owned a fifty per cent stock interest. The remaining common stock of both Development and Investment was held in identical proportions by various members of the Farnsworth family and the Chambers family. The 297 acres conveyed to Development was developed as Section One of the Sharptown Subdivision. Of the land acquired by Investment, 335.3 acres were sold to Development during the fiscal year ending September 30, 1956, and was thereafter known as Section Two of Sharptown Subdivision. No other real property was sold by Investment to Development during the existence of these corporations. With minor exceptions, all real property sold by Investment throughout its existence was from the property referred to above as the Westmoreland property. Also with minor exceptions, all lots sold by Development throughout its existence were lots located within Sections One and Two of Sharptown Subdivision. *in* the early part of 1958 the Farnsworth and Chambers families encountered outside financial difficulties and wanted to get out of the corporations, which were in severe financial straits. The shareholders contributed their Investment stock to Development on February 27, 1958. It was also apparent that much of the land owned by Investment would have to be sold in order to meet the obligations of the corporations. On March 24, 1958, Investment sold to the Plaintiff for a recited consideration of \$500.00 an option to purchase 2376.82 acres of the Westmoreland property for \$8,100,000.00. The option ran from November 1, 1958, through March 24, 1960 *in* Through the Plaintiff's efforts, buyers were found and on April 11, 1958, Investment sold the same 2376.82 acres of the Westmoreland property covered by Plaintiff's option, to Messrs. Smith and Neuhans for a total purchase price of \$5,000,000.00, subject to the option. During April, 1958, Investment sold substantially all of its remaining properties to parties other than Development, the sales totaling 2956.28 acres *in* 887887 On October 16, 1958, Sharpstown Realty (hereinafter referred to as "Realty") was incorporated with capital of \$1,000.00 represented by one thousand shares of common stock with a par value of \$1.00 per share. At all times relevant hereto the common stock of Realty was owned one hundred per cent by the Plaintiff and members of his immediate family, and, except for the Plaintiff, no shareholder of Investment or Development owned any of the common stock of Realty *in* On November 25, 1958, Plaintiff transferred to Realty the option he had purchased from Investment with respect to all but four tracts which were transferred to Realty on December 14, 1959. Investment was liquidated under State law on July 14, 1959, pursuant to a resolution adopted on June 23, 1959. Its assets and liabilities were transferred to Development, and its common stock was surrendered and canceled. On the same date Development was liquidated under State law pursuant to a resolution adopted on June 19, 1959. Its assets and some of its liabilities were distributed to its shareholders as of that date, except for the sum of \$60,000.00 which was retained by Development to pay its remaining liabilities. Thereafter through 1962 all remaining liabilities were paid and the balance of the fund retained was distributed to the shareholders by the end of the calendar year 1962, at which time the common stock of Development was surrendered and canceled. After July 14, 1959, Investment and Development conducted no further business except to complete the distribution of assets in dissolution *in* Pursuant to the dissolution agreement, Plaintiff received certain non-cash assets of Development with a net value of \$53,918.88 which he sold to Realty for that amount. He also received cash in the amount of \$72,628.34 *in* On July 31, 1959, Plaintiff increased the capital of Realty to \$50,000.00, and forty-nine thousand additional shares of common stock were issued with a par value of \$1.00 per share *in* During the period from November, 1958, through July, 1959, Realty purchased approximately 57 acres of land under the option acquired from Plaintiff, and during the years 1958, 1959 and 1960 Realty exercised the option with respect to all but 65,056 acres of the land covered by the option agreement, paying in total approximately \$7,500,000.00 to Messrs. Smith and Neuhans to acquire the property *in* On his federal income tax return for the calendar year 1959, Plaintiff reported long-term capital gain of \$76,547.23 as a result of the distribution received from Development, and paid the appropriate tax thereon. This sum was computed by subtracting the Plaintiff's basis in the Development stock of \$50,000.00 from the total received to liquidation during 1959 of \$126,547.23 *in* Upon audit, the Internal Revenue Service determined that the transaction was 880888 in substance a reorganization and that Plaintiff realized \$118,834.68 of ordinary dividend income as a result of the dissolution distribution.

**Analysis**

Development was liquidated for valid and pressing business reasons, none of which had a tax avoidance purpose. The business of Development was to buy land held by Investment, develop it into subdivisions, and sell lots. Investment effected a bona fide sale to third parties in an arms-length transaction in April, 1958, of the great majority of the land held, and it was liquidated into Development on July 14, 1959. When Development was liquidated on the same date, the only assets it had to distribute were cash and certain non-cash assets which constituted the remnants of the corporations. Its business operations ended at that time, and the only circumstance that could form a basis for the Government's contention that they continued under a different corporate shell was the fact that Realty had an option to purchase the acreage which had been sold to Smith and Neuhans, a small part of which had already been exercised. It is the acquisition of this option by the Taxpayer that gives rise to the Government's apparent view that he planned all along to continue the development of the Sharptown area without interruption, and did so. The undisputed facts, however, do not bear this out.

**Analysis**

None of the parties involved in these transactions, with the possible exception of the Taxpayer, could foresee the accesses which were to follow, at the time of Development's liquidation. Nevertheless, his hopes of being able to purchase the land at some future date were based on too many uncertainties to amount to a plan of reorganization.

**Rule**

The Fifth Circuit Court of Appeals recently discussed the type "D" reorganization, as well as type "T", § 569(a)(1)(F), which defines a reorganization as "a mere change in identity, form, or place of organization, however effected", in *Davant et al. v. C. I. R.*, 366 F.2d 874, August 22, 1966 *in* 880890 The court there determined that a reorganization had occurred under both § 368(a)(1)(D) and (F), where identical owners transferred the operating assets of one corporation which was liquidated, to an existing corporate shell by way of a purported sale, and received a distribution of cash

**Background Facts**

During September, 1956, the Harris County Water Control and Improvement District No. 51 sold nine hundred, \$1,000.00 denomination, bearer bonds to Wiley Caldwell, Trustee, for a principal purchase price of \$810,000.00 plus accrued interest of \$6,187.50. This sale was arranged by the Plaintiff and by Dushar Chambers whose engineering company was owed a substantial balance for the construction of water and sewage facilities under contract with the Water District. The company, Farnsworth & Chambers Engineering Company, was then paid partially from the proceeds of the bonds and the balance by the acceptance of another forty-five bonds *in* The purchase price of the bonds was financed through the Bank of the Southwest by a loan in the amount of \$916,187.50 made to the Trustee and secured by a pledge of the bonds as collateral and by the signatures of Plaintiff and Chambers as co-sureties *in* On George Kessler, who was then a city councilman for the City of Houston, had been contacted by the Plaintiff about the purchase of these bonds at ninety per cent of their par value, and told that he (Kessler) could make a profit on such a transaction since the bonds would increase in value to par when the Water District was annexed by the City of Houston and its obligations assumed by the City *in* 880891 On September 25, 1956, the note was signed by the Trustee, guaranteed by the Plaintiff and Chambers, the purchase price of the bonds was paid, and \$100,000.00 was deposited into a checking account opened on that date at the Bank of the Southwest in the name of George W. Kessler, who disbursed this fund for his own use and benefit.

**Analysis**

Without unduly prolonging this opinion, suffice it to say that this Court finds the testimony as to the bond transaction far from clear. There are sufficient discrepancies between the deponents to require a trial of the issues involved.

**Rule**

A type "D" reorganization requires that there be a plan of reorganization, that the corporation to which assets were transferred must acquire substantially all of the assets of the transferor corporation, and the stockholders must exchange stock in the old company for stock in the new. In addition, the transferor, or one or more of its shareholders, must be in control of the transferor corporation. Section 368(c) defines "control" as the ownership of at least eighty per cent of the voting stock and at least eighty per cent of all other classes of stock.

**Analysis**

This Court cannot agree that a plan of reorganization existed under the facts presented here, or that substantially all of the assets of Development were acquired by Realty.

**Conclusion**

The above cases, as well as the others cited by the parties, point up the fact that the transactions involved here simply do not fit a theory of reorganization as contemplated by the Internal Revenue Code *in* The distribution from Development, received by the Taxpayer, was properly reported as long-term capital gain pursuant to a valid liquidation, and should receive the tax treatment provided by § 331. *in* Therefore, Plaintiff's motion for summary judgment on the first issue will be granted, and Defendant's motion for partial summary judgment on the first issue will be denied.

**Conclusion**

Viewing all inferences to be drawn from the underlying facts in this record in the light most favorable to the Government, Plaintiff has not shown that no genuine issue of fact exists.