

## Helvering v. Elkhorn Coal Co.

65 F.2d 732 (4<sup>th</sup> Cir., 1937)

Parker, Circuit Judge,

This is a petition to review a decision of the Board of Tax Appeals holding profit realized by the Elkhorn Coal & Coke Company upon a transfer of certain mining properties to the Mill Creek Coal & Coke Company to be nontaxable. The ground of the decision was that the transfer was made pursuant to a plan of reorganization within the meaning of section [§368(a)(1)(C)]...

Prior to December 18, 1925, the Elkhorn Coal & Coke Company, to which we shall hereafter refer as the old company, owned certain coal mining properties in West Virginia and certain stocks in other mining companies engaged in business in that state. It was closely associated with the Mill Creek Coal & Coke Company, which owned neighboring property; and a majority of the directorate of both corporations consisted of the same persons. Early in December, 1925, a plan was formed whereby the old company was to transfer its mine, mining plant, and mining equipment at Maybeury, W. Va., to the Mill Creek Company in exchange for 1,000 shares of the capital stock of that company. This exchange was accomplished on December 31, 1925, at which time, it is stipulated, the stock received by the old company had a fair market value of \$550,000 which is in excess of the deficiency asserted by the Commissioner. There is no contention that the transfer by the old company was to a corporation controlled by it or by its stockholders and therefore within the nonrecognition provision of [§368(a)(1)(D)] of the act; but the argument of the taxpayer is that the transfer was of all the properties of one corporation for the stock of another, and therefore within the nonrecognition provision of section [§368(a)(1)(C)].

The contention that the transfer in question was of all the properties of the old company depends upon the legal conclusion to be drawn from certain evidentiary facts relating to the prior organization of another corporation and the transfer to it of all the property of the old company which was not to be

transferred to the Mill Creek Company. These facts, which were found by the Board and are undisputed, are as follows: At the time that the transfer to the Mill Creek Company was decided upon, the officers of the old company caused another corporation to be organized under the name of the Elkhorn Coal Company, which we shall refer to hereafter as the new company, and on December 18, 1925, transferred to it, in exchange for 6,100 shares of its stock, all of the property of the old company which was not to be transferred to the Mill Creek Company except certain accounts, which were transferred to the new company on December 28, 1931, in consideration of its assuming the liabilities of the old company. The 6,100 shares of stock in the new company were promptly distributed by the old company as a dividend to its stockholders. This left the old company owning only the property which was to be transferred to the Mill Creek Company under the plan and which was transferred to that company on December 31st, as mentioned in the preceding paragraph. Following that transfer and the receipt by the old company of the 1,000 shares of the stock of the Mill Creek Company pursuant thereto, the new company proceeded to place itself in the same position relative to the stockholders of the old company that the old company had occupied, and then to wind up its affairs. It accomplished that result in the following manner: On January 22, 1926, it exchanged 1,440 shares of its capital stock for the 7,540 shares of the outstanding capital stock of the old company, making the exchange with the stockholders of that company. This gave those who had been stockholders in the old company the same interest in the new company that they had had in the old, and gave to the new company the ownership of all of the stock in the old. The 1,000 shares of stock received from the Mill Creek Company were then transferred to the new company and the old company was dissolved. No business whatever was done by the old company after the transfer of assets to the Mill Creek Company on December 31st; and no reason appears for the organization of the new company except to provide a transferee to take over and hold the assets which were not to be

transferred to the Mill Creek Company so that the transfer to that company when made would be a transfer of all the assets of the old company.

The Board was of opinion that all of these transactions were carried through pursuant to prearranged plan, saying: "We do not doubt that before a single step was taken a plan had been formulated for regrouping the corporate assets"; and "The stipulated facts justify the inference that one of the motives which the stockholders of Elkhorn had in organizing the new corporation and causing the three corporations to adopt the several steps or plans of reorganization which were adopted and carried out, was to make the transfer of the mining properties from Elkhorn to Mill Creek without resulting tax liability to Elkhorn or to themselves." The Board thought, however, with five members dissenting, that because the transfers from the old company to the new were genuine and were separate and distinct from the transfer to the Mill Creek Company, the latter must be treated as a transfer of substantially all of the properties of the corporation within the meaning of the reorganization statute....

While we are bound by the Board's findings of evidentiary facts, we are not bound by the foregoing conclusion set forth in the opinion and embodying a mixed question of law and fact....

A careful consideration of the evidentiary facts discloses no purpose which could have been served by the creation of the new company and the transfer of the assets to it, except to strip the old company of all of its properties which were not to be transferred to the Mill Creek Company, in anticipation of that transfer. The creation of the new company and its acquisition of the assets of the old was not a corporate reorganization, therefore, within the meaning of the statute or within any fair meaning of the term "reorganization." It did not involve any real transfer of assets by the business enterprise or any rearranging of corporate structure, but at most a mere shifting of charters, having no apparent purpose except the avoidance of taxes on the transfer to the Mill Creek Company which was in contemplation. To use in part the language of the

Supreme Court in *Gregory v. Helvering*, 293 U.S. 465, 469, 55 S.Ct. 266, 267, 79 L.Ed. 596, 97 A.L.R. 1355, it was "simply an operation having no business or corporate purpose - a mere device which put on the form of a corporate reorganization as a disguise for concealing its real character, and the sole object and accomplishment of which was the consummation of a preconceived plan, not to reorganize a business or any part of a business," but to give to the intended transfer to the Mill Creek Company the appearance of a transfer of all the corporate assets so as to bring it within the nonrecognition provision of section [§368(a)1(C)].

Under such circumstances we think that the decision in *Gregory v. Helvering*, supra, is controlling. In that case, for the purpose of avoiding taxes on a liquidating dividend of shares of stock held by a corporation, a subsidiary was organized within the terms of the reorganization statute and the shares were transferred to it. The stock of the subsidiary was then delivered to the sole stockholder of the original corporation and shortly thereafter the subsidiary was dissolved and the shares which had been transferred to it were delivered to the stockholder. The court held that although the organization of the subsidiary came within the letter of the reorganization statute, such corporate manipulation would be ignored when it fulfilled no proper corporate function and was not in reality a reorganization within the meaning of the statute. The court said: "In these circumstances, the facts speak for themselves and are susceptible of but one interpretation. The whole undertaking, though conducted according to the terms of subdivision (B), was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. The rule which excludes from consideration the motive of tax avoidance is not pertinent to the situation, because the transaction upon its face lies outside the plain intent of the statute. To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose."

We do not see how that case can be distinguished from this. If the property which was to be

transferred to Mill Creek had been transferred to a new company created for the purpose and had been by that company transferred to Mill Creek, no one would contend that there was a distinction; and certainly there is no difference in principle between creating a subsidiary to take and convey the property to the intended transferee and creating a subsidiary to take over the other assets and having the old company make the transfer. In either case, the apparent reorganization is a mere artifice; and it can make no difference which of the affiliated corporations makes the transfer of assets which it is desired to bring within the nonrecognition provisions of the statute.

It is suggested in the opinion of the Board that the case before us is analogous to that which would have been presented if the old company, prior to the transfer to Mill Creek, had distributed to its stockholders all of the assets except those destined for such transfer; but the distinction is obvious. In the case supposed, the business enterprise would have definitely divested itself of the property distributed. Here it did not divest itself of the property at all, but merely made certain changes in the legal papers under which it enjoyed corporate existence. No rule is better settled than that in tax matters we must look to substance and not to form; and no one who looks to substance can see in the mere change of charters, which is all that we have here, any reason for permitting a transfer of a part of the corporate assets to escape the taxation to which it is subject under the statute.

Congress has seen fit to grant nonrecognition of profit in sale or exchange of assets only under certain conditions, one of which is that one corporation shall transfer "substantially all" of its properties for stock in another. If nonrecognition of profit can be secured by the plan adopted in this case, the exemption is broadened to cover all transfers of assets for stock, whether "substantially all" or not, if only the transferor will go to the slight trouble and expense of getting a new charter for his corporation and making the transfer of assets to the new corporation thus created in such way as to leave in the old only the assets to be transferred at the time the transfer is to be made. We do not think the

statutory exemption may be thus broadened by such an artifice...

For the reasons stated, the decision of the Board will be reversed, and the cause will be remanded to it for further proceedings in accordance with this opinion.

Reversed.

(Dissenting opinion by Judge Watkins omitted)

On Rehearing

PARKER, Circuit Judge.

The rehearing granted in this case and careful consideration of the briefs filed and arguments made thereon have served only to strengthen the majority of the court in the opinion heretofore expressed; and we see no basis whatever for the contention that our former opinion was based on a ground not considered by the Board of Tax Appeals. The question before the Board was whether the transfer to Mill Creek was of all the assets of the old company; and that question must necessarily have been answered there as it must be here by a consideration of the real nature of the incorporation of the new company and the transfer made to it when reviewed in relation to the plan for the transfer of assets to Mill Creek.

It was not intended by what was said in the original opinion, to the effect that the transfer of assets from the old company to the new did not constitute a bona fide reorganization, to suggest that the transfer was a taxable transaction, but to point out that the creation of the new company and the transfer of the assets to it was a mere shifting of charters having no purpose other than to give to the later transfer to Mill Creek the appearance of a transfer of all the corporate assets so as to bring that transfer within the non-recognition provisions of section [§368(a)(1)]... The transfer to the new company was non-taxable whether it was a real reorganization or a mere shifting of charters, which would of course come within the terms of the reorganization statute. It is only in relation to the

subsequent transfer to Mill Creek that it becomes important to determine whether the organization of the new company and its taking over of the assets was a genuine reorganization. If there was no real reorganization and transfer, but a mere shifting of charters, the subsequent transfer to Mill Creek was not within the terms of the nonrecognition provision of the statute.

We are confirmed in our original opinion by the recent decision of the Supreme Court in *Minnesota Tea Co. v. Helvering*, 58 S.Ct. 393, 395, 82 L.Ed. . In that case there was a reorganization in which stockholders paid the debts of a corporation from the cash distributed to them in the course of the reorganization. The question was whether the corporation was taxable on the amount of the debts thus paid on the theory that the cash used for that purpose was in reality received by the corporation, or whether it was nontaxable on the theory that the distribution to the stockholders was within the nonrecognition provisions of the statute. In holding the corporation taxable thereon the court said:

"The conclusion is inescapable, as the court below very clearly pointed out, that by this roundabout process petitioner received the same benefit 'as though it had retained that amount from distribution and applied it to the payment of such indebtedness.' Payment of indebtedness, and not distribution of dividends, was, from the beginning, the aim of the understanding with the stockholders and was the end accomplished by carrying that understanding into effect. *A given result at the end of a straight path is not made a different result because reached by following a devious path.* The preliminary distribution to the stockholders was a meaningless and unnecessary incident in the transmission of the funds to the creditors, all along intended to come to their hands, so transparently artificial that further discussion would be a needless waste of time."

In the case at bar, the "aim" of the incorporation of the new company and the transfer made to it, was that the transfer to Mill Creek should appear to be a transfer of all of the assets of the company; and this was the end accomplished, and the only end

accomplished so far as the record shows, by the incorporation and transfer. The incorporation of the new company and the transfer to it was a "meaningless and unnecessary incident." It is true that the new company was incorporated under the laws of a different state from the old; but it does not appear that any corporate purpose was served by this change of jurisdictions and certainly the integrity of the existing business was not affected by the change. ... It is said that the transfer to Mill Creek had a real corporate purpose. This is true, but it was taxable unless constituting a transfer of all of the assets of the corporation. The incorporation of and transfer to the new company, which had no proper corporate purpose, were resorted to in order to give the transfer to Mill Creek the appearance of being a transfer of all the assets of the transferor and hence not taxable. All that was done by the complicated corporate maneuvering employed was the transfer of a part of the assets of the old company to Mill Creek in exchange for 1,000 shares of its stock, leaving the business of the old company in the hands of the old stockholders, with a new charter, but otherwise unaffected. This result is "not a different result because reached by following a devious path."

And we think it clear that the incorporation of the new company and the transfer made to it were but parts of a single plan under which the transfer was made to Mill Creek and that they should be treated as parts of one transaction. When this is done, there is no room for the contention that all of the assets of the corporation were transferred to Mill Creek. Even though there was no unifying contract, the unity of the plan brings the case within the rule applied in *Starr v. Commissioner*, 4 Cir., 82 F.2d 964.

For the reasons stated here and in our former opinion, the decision of the Board of Tax Appeals will be reversed.

Reversed.

(Dissenting opinion by Judge Watkins omitted)