

## The Minnesota Tea Case

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case cited by the Court contains a blanket trust created for the payment of all the items of the settlor's and the family budget. This is also very dissimilar to the life insurance trust in the instant case. In the former, the income, like that of the trust, in favor of creditors, is used to pay the legal obligations of the settlor.<sup>18</sup> This he is bound to do. In the case under discussion, however, only a moral obligation of the creator of the trust is settled. When one uses the income of a trust to pay his personal legal obligations he is indirectly receiving the benefits therefrom and should be taxed thereon.<sup>19</sup> Where, however, he irrevocably transfers to others both the corpus and income of a trust to pay for something which will accrue solely to the benefit of a third person, we do not see how he can be taxed upon the income without violating his constitutional rights under the Fifth Amendment.<sup>20</sup>

It is respectfully submitted that the trust, in the instant case, is similar to a charitable trust which has been expressly exempt from the tax.<sup>21</sup> Both trusts leave in the creator only a certain amount of happiness and security of mind and these do not justify a tax under the statute.

ALFRED HECKER.

THE MINNESOTA TEA CASE.—Because of the wording of the statute<sup>1</sup> the decision of the Board of Tax Appeals in the case of the *Minnesota Tea Company v. Commissioner of Internal Revenue*<sup>2</sup> will in our opinion be reversed.

In the *Minnesota Tea* case<sup>3</sup> the petitioner (Minnesota Tea Company) transferred its real estate and some miscellaneous prop-

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<sup>18</sup> *Van Valkenburg v. Watson*, 13 Johns. 480 (N. Y. 1816); *Wanamaker v. Weaver*, 176 N. Y. 75, 68 N. E. 135 (1903); *De Brawere v. De Brawere*, 203 N. Y. 460, 96 N. E. 722 (1911); *Frank v. Carter*, 219 N. Y. 35, 113 N. E. 549 (1916); *Laumeier v. Laumeier*, 237 N. Y. 357, 143 N. E. 219 (1924).

<sup>19</sup> *Supra* note 17.

<sup>20</sup> *Supra* note 6.

<sup>21</sup> *Supra* note 10, §§214, 955, par. 10, subd. a.

<sup>1</sup> Rev. Act 1928 §112 (i) (1): "As used in this Section and in Sections 113 and 115 \* \* \* the term 'reorganization' means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or part of its assets to another corporation if immediately after the transfer the transferee or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization, or (D) a mere change in identity, form, or place of organization, however effected."

<sup>2</sup> 18 B. T. A. — (June, 1933).

<sup>3</sup> *Ibid.*

erty to a corporation formed therefor; the remaining assets were disposed of to the Grand Union Company in exchange for 18,000 shares of the latter company's stocks (239,726 shares outstanding), and a sum of money which was distributed among the three shareholders of the Tea Company, who themselves paid off the liabilities thereof. The majority of the Board held that there was a sale of the corporate assets, and therefore the profit accruing thereon was taxable.<sup>4</sup>

A "statutory reorganization"<sup>5</sup> occurs where a corporation exchanges substantially all of its assets for the stock of another in pursuance of a plan of reorganization. Thus a merger or consolidation is within the meaning of the statute.<sup>6</sup> However a "reorganization" signifies nothing more than the act or process of organizing

<sup>4</sup> Rev. Act 1926 §202 (a): "Except as hereinafter provided in this section, the gain from the sale or other disposition of property shall be the excess from the amount received therefrom over the basis provided in subdivision (a) or (b) of Section 204, and the loss shall be the excess of such basis over the amount realized. \* \* \* (c) The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than the money) received. (d) In case of a sale or exchange, the extent to which the gain or loss determined under this section shall be recognized for the purpose of this title, shall be determined under the provisions of Section 203. \* \* \* Sec. 203 (a) Upon the sale or exchange of property, the entire amount of gain or loss, determined under Section 202, shall be recognized, except as hereinafter provided in this section"; *Sarther Grocery Co., Inc. v. Com'r of Int. Rev.*, 63 F. (2d) 68 (1933).

<sup>5</sup> *Fostoria Milling Co. v. Com'r of Int. Rev.*, 11 B. T. A. 1401 (1928); *James Dugan, et al. v. Com'r of Int. Rev.*, 18 B. T. A. 608 (1930); *Tulsa Oxygen Co. v. Com'r of Int. Rev.*, 18 B. T. A. 1283, 1286 (1930), "By the terms of this contract the purchasing corporation acquired all the petitioner's property, tangible and intangible, except the bare franchise right to be a corporation under and by virtue of the laws of Oklahoma. We think therefore that such acquisition was of substantially all the properties of another corporation and that the transaction constituted a reorganization"; *National Pipe and Foundry Co. v. Com'r of Int. Rev.*, 19 B. T. A. 242 (1930); *Cosby-Wirth Sales Book Co. v. Com'r of Int. Rev.*, 19 B. T. A. 1074 (1930); *First National Bank of Champlain v. Com'r of Int. Rev.*, 21 B. T. A. 415 (1930); *Cortland Specialty Co. v. Com'r of Int. Rev.*, 22 B. T. A. 808 (1931); *Mente & Co., Inc. v. Com'r of Int. Rev.*, 24 B. T. A. 401, 404 (1931), "All stock of another company for exchange of its stock and bonds is a reorganization"; *Green v. Com'r of Int. Rev.*, 24 B. T. A. 719 (1931); *G. C. M. 1345, VI-1 Cum. Bull. 15, 17*; *U. S. Treas. Reg. 74, Art. 574*.

<sup>6</sup> Rev. Act 1926 §203 (B) (3): "No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of a plan of reorganization, solely for stock or securities in another corporation a party of the reorganization. \* \* \* (e) If an exchange would be within the provisions of paragraph 3 of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then \* \* \* (1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, \* \* \* (the wording here is substantially the same as in the Rev. Act. 1928, *supra* note 1).

anew.<sup>7</sup> "Reorganization" is distinguished from consolidation or merger;<sup>8</sup> yet the Revenue Act<sup>9</sup> in its definition of reorganization states that it may include a merger or consolidation.<sup>10</sup>

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<sup>7</sup> FLETCHER, CYCLOPEDIA CORPORATIONS (1931) 8465: "The term \* \* \* has no definite meaning in the law of corporations, but it is applied indifferently to various proceedings and transactions by which successions of corporations are brought about, and also to proceedings by which existing corporations are continued under a different organization without the creation of a new corporation"; MORAWETZ, PRIVATE CORPORATIONS (1886) §812: "The term 'reorganization' is commonly applied to the formation of a new corporation by the creditors and shareholders of a corporation when it is in financial difficulties, for the purpose of purchasing the company's works and property, after the foreclosure of a mortgage or judicial sale. The result of a transaction of this kind is to form a new corporation to carry on the business of the old company upon a new basis, free from its debts and obligations except to the extent that they have been expressly assumed"; *cf. supra* note 5; *ibid.*

<sup>8</sup> Atlantic Gulf R. R. Co. v. Georgia, 98 U. S. 359 (1878); Lee v. Atlantic Coast Lines, 150 Fed. 775, 787 (1906): "In a consolidation, both go out of existence as separate corporations, and a new corporation is created, which takes their place and property. In a merger, one loses its identity by absorption in the other, which remains in existence, and succeeds to its property, and issues its own stock to the stockholders of the merged company"; Atlantic Coast Line R. R. Co. v. Cone, 53 Fla. 75, 43 So. 514 (1907): "Generally the effect of a consolidation, as distinguished from a union by merger by one company into another, is to work a dissolution of the companies consolidating and to create a new corporation out of the elements of the former"; Louisville & Nashville R. R. Co. v. Hughes, 134 Ga. 75, 67 S. E. 542 (1909); C. E. & I. R. R. Co. v. Doyle, 256 Ill. 514, 100 N. E. 278 (1912); Vicksburg, etc. Telephone Co. v. Citizen's Telephone Co., 79 Miss. 341, 30 So. 725 (1901): "There can never be a consolidation of corporations, except where all the constituent companies cease to exist as separate corporations, and the new corporation, to wit, the consolidated corporation, comes into being. A merger, rightly understood, is not the equivalent of consolidation at all, but exists where one of the constituent companies remains in being, absorbing or merging in itself all the other constituent corporations"; Lauman v. Lebanon Valley R. Co., 30 Pa. 42 (1858); *cf.* (1930) 30 COL. L. REV. 732; THOMPSON, CORPORATIONS (1927) §396, it has been seen that consolidations frequently take the form of one company purchasing the capital stock of another. In such cases, and in others that may be imagined, the terms of the union may be such that one corporation, without any change of name, merely absorbs or annexes the other is dissolved; FLETCHER, *op. cit. id.*, at 8467: "Reorganization is clearly distinguishable from consolidation or merger. Sometimes, however, the term 'reorganization' is loosely used as synonymous with consolidation or merger, but in reality there is a clear line of demarcation in that in the former case there are always two or more existing corporations which combine together, while in the latter case there is in effect but one corporation which merely changes its form and ordinarily dies upon the creation of the new corporation which is its successor. In order words, in case of a reorganization there ordinarily are at no time two or more going corporations in existence, while in the case of consolidation or merger there must always be two or more existing corporations before there can be any consolidation or merger"; 2 ELLIOT, RAILROADS (1907) §335.

<sup>9</sup> *Supra* note 1.

<sup>10</sup> *Ibid.*; see National Pipe and Foundry Co. v. Com'r of Int. Rev., 19 B. T. A. 242, 250 (1930): "Definitions of a reorganization of what a reorganization might be in the absence of the definition in the statute do not have the effect of changing what the statute specifically provides shall be included in a reorganization."

The Board of Tax Appeals in the *Minnesota Tea* case<sup>11</sup> concluded that in regard to part (A)<sup>12</sup> of the definition of reorganization the acquisition by one corporation of substantially all the properties of another corporation is not of itself a statutory reorganization; (1) that the acquisition of substantially all the properties must be part of a strict merger or consolidation, (2) or something which partakes of the nature of a merger or consolidation and has a real semblance to a merger, (3) or consolidation and involves a continuance of essentially the same interests through a modified corporate structure.<sup>13</sup> The majority opinion tends to depart from the statutory definition of reorganizations and to give a stricter interpretation to the words "merger" and "consolidation."<sup>14</sup> There is an apparent disregard for the interpretation put upon the statute hitherto.<sup>15</sup> The legislature, since 1921<sup>16</sup> has re-enacted in substantially the same form the phrase "substantially all"; but in 1924, part (B)<sup>17</sup> was inserted into the statute; and it is preceded by the conjunction "or." Part (A)<sup>18</sup> of the same act is divided into three parts, each introduced by the disjunctive "or." To delve into the intent of the legislature<sup>19</sup> we must take cognizance of this key word.<sup>20</sup> Under part (B) control is necessary, under part (A) control is not necessary.<sup>21</sup> Therefore if a corporation acquires substantially all of the assets of another corporation, there is a "statutory reorganization."<sup>22</sup>

In *Fostoria Milling and Grain Co.*, the Court says,

"The test (of whether it was a reorganization) is not identity of stock ownership in the two companies, but whether some interest of the stockholders in the old is presumed in the new."<sup>23</sup>

<sup>11</sup> *Supra* note 2.

<sup>12</sup> *Supra* note 1.

<sup>13</sup> (1933) 11 TAX MAGAZINE 291.

<sup>14</sup> *Supra* note 7.

<sup>15</sup> (1932) 45 HARV. L. REV. 648.

<sup>16</sup> REV. ACT 1921 §202 (C), the word "reorganization" as used in this paragraph, includes a merger or consolidation (including the acquisition of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or of substantially all the properties of another corporation), recapitalization, or mere change in identity, form, or place of organization of a corporation (however affected).

<sup>17</sup> *Supra* note 1.

<sup>18</sup> *Ibid.*

<sup>19</sup> REP. NO. 179, 68th Cong. 1st Sess., p. 16; REP. FIN. COMM., NO. 398, 68th Cong. 1st Sess., p. 17.

<sup>20</sup> REP. NO. 179, HOUSE COMM. WAYS AND MEANS, 68th Cong. 1st Sess., p. 17, said, "It should be noted that the conjunction 'or' is used to denote both conjunctive and disjunctive."

<sup>21</sup> (1932) 45 HARV. L. REV. 648, 663, 664.

<sup>22</sup> *Tulsa Oxygen Co. v. Com'r of Int. Rev.*; *National Pipe and Foundry Co. v. Com'r of Int. Rev.*, both *supra* note 5.

<sup>23</sup> *Fostoria Milling & Grain Co. v. Com'r of Int. Rev.*, *supra* note 5.

The question in the *Minnesota Tea* case must be determined by that which was actually done and not upon the effect of the exchange;<sup>24</sup> nor may it be predicated merely upon what might have been the purport or design of the parties to the transaction;<sup>25</sup> nor is it material that the very result might have been obtained by another method or plan of reorganization.<sup>26</sup> In the *Langenbach* case,<sup>27</sup> the Court said.

"In determining what was actually done in any case, the Board will regard substance rather than form. However, material and essential facts will not be dismissed or put aside as mere matters of form simply because they are related to and are steps in a comprehensive plan of reorganization, or together constitute a method for the attainment of a single desired result."

In the *Green* case,<sup>28</sup> Marquette, concurring, said that the transaction should be considered as a whole; not considering the form alone, nor dissecting the transaction that occurred by overemphasizing any separate step in the process by which the reorganization was accomplished.

The courts hitherto have been persistent in maintaining that where substantially all the assets of a corporation have been acquired by another corporation, there is a reorganization.<sup>29</sup> In the *Cosby-Wirth Sales Book Co.* case, the Court said,<sup>30</sup> that where the assets of one corporation have been transferred to another corporation, the latter corporation transferring its own stocks to the stockholders of the former corporation as consideration, a reorganization occurs, and therefore the transaction is not taxable under Section 203 of the Revenue Act of 1926.

If the decision in the *Minnesota Tea* case<sup>31</sup> should be upheld it would be opposed to the interpretation handed down by the Board of Tax Appeals during a decade of consistency in their decisions on "what a reorganization is."

MAURICE A. M. EDKISS.

<sup>24</sup> *Saul v. Com'r of Int. Rev.*, 4 B. T. A. 639, 647 (1926).

<sup>25</sup> *United States v. Phellis*, 257 U. S. 156, 172 (1921).

<sup>26</sup> *Harkness v. Com'r of Int. Rev.*, 1 B. T. A. 127, 130 (1924).

<sup>27</sup> *Langenbach v. Com'r of Int. Rev.*, 2 B. T. A. 777, 784 (1925).

<sup>28</sup> *Green v. Com'r of Int. Rev.*, *supra* note 5 at 726: "In my opinion the several transactions discussed in the Board's Report were all steps in carrying out one general plan and their effect should be considered as a whole and not separately. So considered, they constitute a reorganization within the meaning of the Act, and by reason of Sec. 203 (b) (2), the exchange does not give rise to gain or loss."

<sup>29</sup> *Supra* note 2.

<sup>30</sup> *Ibid.*

<sup>31</sup> *Supra* note 2.