A decision refusing exemption in the *Powell* case probably can not conclude the matter, for the question will continue to arise on slightly different facts until the incidents necessary to establish a producer-consuming classification within the exemption provision have been determined. The ends of the Act will best be served if, bearing in mind the failure of Congress to forbid ownership of coal mines by consumers, the court looks to the length of time the lease-contract arrangement is designed to have effect. If the reasonably long term commitment and other corroborating circumstances are present as assurances of the identity of interest between the consumer and the supplier,[53] the effect of the arrangement upon commerce and the operation of the Act will be little different from that in the so-called pure captive situation, for the exemption of which there is a Congressional mandate.

## CLASSIFICATION OF FORECLOSURE MERGERS AS TAX-FREE REORGANIZATION EXCHANGES

THE tax-free exchange provisions of the Internal Revenue Code are designed to facilitate corporate reorganizations by ignoring formal changes in capital structure and variations in property values, and imposing no tax until a more tangible gain or loss is realized.[1] The ability of a corporate or individual taxpayer to secure non-recognition, for tax purposes, of the results of the exchange of corporate properties is generally conditioned upon the requirement that there be a "reorganization," as defined in Section 112 (g) (1).[2] If the exchange falls within one of the categories of this definitional

53. "It is to the advantage of both coal producer and coal consumer that their relations be more or less permanent. Every time a producer abandons a market that has been educated to his product, or a large consumer changes his source of supply there is introduced an incentive for increased mine development. This shifting about in the search for more profitable outlets or for cheaper and better coal must always continue in a competitive business such as the bituminous coal industry, but the degree to which it has taken place in the past six years has greatly disturbed the trade." HUNT & WILLITS, WHAT THE COAL DIVISION FOUND (1925) 268.

1. See SEN. REP. No. 275, 67th Cong., 1st Sess. (1924); H. R. REP. No. 350, 67th Cong., 1st Sess. (1924); MAGILL, TAXABLE INCOME (1939) 123-131.

2. "The term reorganization means (A) a statutory merger or consolidation, or (B) the acquisition by one corporation in exchange solely for all or a part of its voting stock: of at least 80 per centum of the voting stock and at least 80 per centum of the total number of shares of all other classes of stock of another corporation; or of substantially all the properties of another corporation, or (C) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred, or (D) a recapitalization, or (E) a mere change

part of Section 112, other provisions of that section provide that no gain or loss to either the individual or the corporate taxpayer shall be recognized.[3] The basis provisions of Section 113 further allow a corporation to whom depreciable property has been transferred under the exchange to charge off depreciation thereon using the same base value as was attributed to the property in the hands of the transferor.[4] There has been such a variety of corporate exchanges that the question of whether any given transaction constitutes a "reorganization" has constantly confronted the courts.[5] In the controversy currently significant, corporate and individual taxpayers, participating in mergers of insolvent companies into new going concerns at the instigation of the old bondholders upon foreclosure, are questioning the basis for depreciation and the recognition of gain or loss.

Common to all cases where this issue is now being litigated is the factual situation where the bondholders of an insolvent corporation foreclose their mortgage interests, bid in the assets at the sale, and become stockholders of the new corporation to which they transfer the assets of the old one. From such a transaction, two tax issues most frequently arise. First is the question of whether an individual bondholder, in computing his taxable income, should recognize personal gains or losses resulting from the exchange. The second problem is whether the successor corporation can maintain the same depreciation basis for the property transferred that its predecessor used.[6] The first question is governed either by Section 112(b)(3), stating that no gain or loss will be recognized when stock is exchanged for stock in a reorganization,[7] or by Section 112(b)(4) declaring that non-recognition will also prevail under a reorganization where property is exchanged for stock.[8] The solution

in identity, form, or place of organization, however effected." INT. REV. CODE § 112(g)(1) (1939).

3. INT. REV. CODE § 112(b)(3) and (4) (1939). See notes 7 and 8 *infra*.

4. INT. REV. CODE § 113(a)(6) and (7) (1939). For § 113(a)(7) see note 9 *infra*.

5. For a general discussion of the reorganization provisions, see Fahey, *Income Tax Definition of Reorganization* (1939) 39 COL. L. REV. 933.

6. Since most corporations involved in receivership mergers in the last few years acquired depreciable assets in periods of higher prices, it is to their interest to establish a reorganization and gain the advantage of depreciating on the basis of the high value at which the property was originally acquired. For further consideration of this situation and its revenue implications see discussion *infra* at page .....

7. "No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of a plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization." INT. REV. CODE § 112(b)(3) (1939). Corporations involved in foreclosure reorganizations fall well within the definition of a "party to a reorganization." See INT. REV. CODE § 112(g)(2) (1939).

8. "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 to the reorganization." INT. REV. CODE § 112-(b)(4) (1939).

of the second is controlled by Section 113(a)(7)[9] which grants the successor corporation the same depreciation basis as its predecessor "if the property was acquired . . . by a corporation in connection with a reorganization."[10] Although a court would be dealing with the individual bondholders in the first case and the successor corporations in the second, the tax liability of each depends on whether these foreclosure mergers constitute "reorganizations" as defined in Section 112(g)(1).[11]

This question has arisen in five court cases during 1941. The four Circuit Courts of Appeals which have passed upon the point are evenly divided. In *Commissioner v. Marlborough House, Incorporated*,[12] the Commissioner had assessed deficiencies against the corporation as a result of his determination that the basis for depreciation of the property acquired by the corporation was the price bid and paid for it at the foreclosure sale, and that the estimated remaining life of the property was 45 years. The corporation, on the other hand, claimed a greater basis and a shorter life for the property in calculating depreciation. The Board of Tax Appeals granted the corporation the larger basis, *i.e.*, cost to the predecessor company.[13] But this decision was reversed by the Ninth Circuit Court of Appeals which held that there was no reorganization because the bondholders had no "continuing interest" in the original company. The court relied on the decision in the *LeTulle*[14] case that the receipt of bonds provides no proprietary interest in a solvent corporation, for its interpretation of the "continuity of interest" rule. In the recent case of *Helvering v. New President Corporation*[15] the Eighth Circuit Court of Appeals also refused to allow the taxpaying corporation to use the value of the property when acquired by its predecessor

9. "(a) The basis of property shall be the cost of such property; except that . . .

(7) If the property was acquired (A) after December 31, 1917, and in a taxable year beginning before January 1, 1936, 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 person or any of them, or (B) in a taxable year beginning after December 31, 1935, by a corporation in connection with a reorganization, then the basis shall be the same as it would be in the hands of the transferor." INT. REV. CODE § 113 (1939).

Section 204(a)(7) of the Revenue Act of 1926 became § 113(a)(7) of the Revenue Act of 1928 and has remained fundamentally unchanged throughout subsequent Acts.

10. As provided in the Internal Revenue Code, and corresponding sections of all Revenue Acts from 1926 to date, § 23(l) grants a reasonable allowance for depreciations, § 23(n) sets the depreciation basis at that offered in § 114, § 114 specifies that the basis shall be the adjusted basis under § 113(b), and § 113(b) establishes the basis as that determined in § 113(a) with adjustments. Section 113(a) then provides that the basis shall be the cost of the property except in certain cases and § 113(a)(7) sets out the exception for reorganizations.

11. See note 2 *supra*.

12. 118 F. (2d) 511 (C. C. A. 9th, 1941).

13. 40 B. T. A. 882 (1939).

14. 308 U. S. 415 (1940).

15. 122 F. (2d) 92 (C. C. A. 8th, 1941).

as the depreciation basis and argued that all proprietary interest in the original company was extinguished by the foreclosure.[16]

On substantially similar facts, the Second Circuit Court of Appeals in *Helvering v. New Haven & Shore Line Railroad Company*[17] reached the opposite conclusion. The bondholders of an insolvent company, pending foreclosure by the trustee, had approved a plan of reorganization whereby it was proposed that they should bid in the property at the foreclosure sale, pay for it by endorsing a credit on the bonds and convey it to a newly organized operating company. The bondholders were to receive all the common shares of the new company in return. After the plan went into effect, the new company, in making out its income tax returns, took a deduction for depreciation on the basis of the value of the property when the predecessor company acquired it. The Commissioner again urged that the proper basis for depreciation was the fair market value of the property on foreclosure, but the Second Circuit of Appeals held that the transaction constituted a reorganization under Section 112(g)(1)(B) of the Revenue Act of 1934. The court reasoned that the insolvency of the predecessor company furnished the "continuity of interest" demanded in relation to the bondholders' proprietorship. Having established the occurrence of a reorganization, the court applied Section 113(a)(7)[18] and concluded that the basis should be the cost to the transferor company. The Circuit Court of Appeals for the Fifth Circuit likewise held that a similar situation constituted a reorganization in *Commissioner v. Southwest Consolidated Corporation*,[19] where the successor corporation wrote off part of the assets at their old value. The court reiterated its conclusion in *Commissioner v. Alabama Asphaltic Company*,[20] where the proper depreciation basis was the issue. In the latter case the court declared the *LeTulle* case was not in point, and held that there was

16. If the court fails to find a reorganization, the basis becomes the smaller one of the value of the property in the hands of the committee. The Federal Income Tax Regulations specify: ". . . if the creditor buys in the mortgaged or pledged property . . . The fair market value shall be presumed to be the amount for which it is bid in by the taxpayer in the absence of clear and convincing proof to the contrary. If the creditor subsequently sells the property so acquired, the basis for determining gain or loss is the fair market value of the property at the date of acquisition." Reg. 103, § 19.23(k)-3; Reg. 101, 94 and 86, Art. 23(k)-3; Reg. 77 and 74, Art. 193; Reg. 69, Art. 153 (first adoption of the rule). Satisfied that there was clear and convincing proof, the court in the *New President Corporation* case found the fair market value to be other than the cost to the committee.

17. 121 F. (2d) 985 (C. C. A. 2d, 1941).

18. See note 9 *supra*.

19. 119 F. (2d) 561 (C. C. A. 5th, 1941).

20. 119 F. (2d) 819 (C. C. A. 5th, 1941). Here general creditors rather than bondholders were involved, but the court sought no distinction on that basis. It attempted to distinguish the *Marlborough House* case on the wholly untenable ground that there was no pre-existing plan of reorganization.

a reorganization under Section 112 of the Revenue Act of 1928,[21] the rationale being that the old corporation was not terminated upon foreclosure; it still had title to its properties, according to the court, but the creditors rather than the stockholders became the beneficial owners and a continuing interest was maintained by them after the exchange of properties for the stock of the new company.

Since all these conflicting decisions have been reached on the basis of the continuity of interest rule, resolution of the tax problem demands, first of all, an analysis of the substance of that rule.[22] Prior to 1934, Part A of the statutory definition of a reorganization, under which the foreclosure-merger situation falls, called for a transfer by a corporation of a majority of its stock or of substantially all of its assets,[23] but made no provision as to the consideration which was to be received from the transferee. Literal compliance with Section 112 could thus be secured by an exchange for cash, which would not harmonize with the legislative purpose of exempting only transactions where nothing tangible was shaken loose from the risks of the business enterprise. To keep the definition within its intended scope, the courts added the continuity requirement.

As formulated, the rule requires that the owners of the equity interest[24] in the transferor corporation retain a continuing proprietary interest in the transferee corporation after the reorganization exchange. For example, if *A* Corporation sells securities or property to *B* Corporation and *B* Corporation gives *A* Corporation $x$ in exchange, $x$ must represent such a type of security as will give the equity owners of *A* Corporation a proprietary interest in *B* Corporation.[25] By 1937 the courts had held that, in addition to an exchange for common shares, if $x$ was such an interest as 44% cash plus the remainder in voting stock,[26] or if it was preferred stock,[27] or 50%

21. Revenue Acts of 1924 and 1926, § 203 (h) (1); Revenue Acts of 1928 and 1932, § 112(i) (1). In each of the Acts the sections read: "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 all other classes of stock of another corporation, or substantially all the properties of another corporation). . . ." This embodies the oft-mentioned "parenthetical clause" of the pre-1934 Acts.

22. The rule grew out of Cortland Specialty Co. v. Comm'r, 60 F. (2d) 937 (C. C. A. 2d, 1932), *cert. denied*, 288 U. S. 599 (1933), and Pinellas Ice and Cold Storage Co. v. Comm'r, 287 U. S. 462 (1933).

For a discussion of the "continuity of interest" doctrine, see (1940) 49 YALE L. J. 1079.

23. See note 21 *supra*.

24. The stockholders own the equity interest in a solvent corporation. It is submitted that the equity interest passes to the bondholders upon insolvency.

25. The equity owners of *A* Corporation may obtain this proprietary interest either indirectly by the acquisition and retention of $x$ by *A* Corporation, or directly by immediate distribution of $x$ to the equity owners.

26. Helvering v. Minnesota Tea Co., 296 U. S. 378 (1935).

27. Nelson v. Helvering, 296 U. S. 374 (1935).

stock and the balance in bonds[28] a proprietary interest in *B* Corporation was received and the rule was satisfied.

Before 1937, however, no court had considered whether there would be a continuity of interest maintained if *x* was entirely bonds, or whether the continuity of interest rule applied when not *x* but the original interest in *A* Corporation was under consideration. The first case concerning the status to be accorded the situation where foreclosing bondholders bid in the property at the foreclosure sale and transferred it to a newly organized company in return for the stock of the latter then came before the Circuit Court for the Seventh Circuit.[29] A bondholder attempted to deduct from his income tax returns a loss suffered in the exchange, and, though the court might have permitted non-recognition of the loss under Section 112(b)(5)[30] even if there were no "reorganization," it chose to rest its decision on the ground that a reorganization within the contemplation of Section 112(i)(1)[31] had occurred, creating non-recognition under Section 112(b)(3).[32] Shortly afterwards, the Sixth Circuit Court of Appeals was called upon to decide the same issue where a successor corporation was seeking the larger depreciation basis under its claim that a tax-free reorganization had occurred.[33] In holding for the taxpayer the court decided that the larger "basis," the cost to the transferor, was proper under Section 113(a)(7).[34] Although it was contended that the requisite "continuity of interest" was lacking because the bondholders were devoid of a continuing interest in the original company, neither court made it clear whether its determination that a reorganization had taken place rested on the belief that (1) such continuity was present or that (2) it had rejected the attempt to apply the continuity rule against the original interest of the bondholders in the predecessor company.

These cases determined that a reorganization had occurred under the foreclosure mergers, and litigation on the point subsided for a time.[35] But

---

28. Helvering v. Watts, 296 U. S. 387 (1935).

29. Comm'r v. Kitselman, 89 F. (2d) 458 (C. C. A. 7th, 1937). For a criticism of this decision on the ground it gives insolvent corporations a "basis windfall" far above the market value of the assets, see Surrey, *Income Tax Treatment of Cancellation of Indebtedness* (1940) 49 YALE L. J. 1153, 1187.

30. The relevant part of the Section reads: "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. . . ." It will be noted that there is no prerequisite of a "reorganization." INT. REV. CODE § 112(b)(5) (1939). The court was interpreting the Revenue Act of 1928, identical in the wording of this section.

31. See note 21 *supra*.

32. See note 7 *supra*.

33. Comm'r v. Newberry Lumber and Coal Co., 94 F. (2d) 447 (C. C. A. 6th, 1938).

34. See note 9 *supra*.

35. See Frederick L. Leckie, 37 B. T. A. 252 (1938), where the taxpayer presumably had no reason to appeal from a decision of the Board that a reorganization had occurred.

the controversy was rekindled as a result of the decision in *LeTulle v. Scofield*.[36] LeTulle was the sole stockholder of a solvent irrigation company whose assets were transferred to a solvent water company in exchange for $50,000 cash and $750,000 in its bonds. LeTulle received the cash and bonds in the form of a dividend from the irrigation company, which was dissolved immediately thereafter. Seeking to escape additional income tax assessments, he contended that this was a tax-free reorganization within the purview of Section 112 of the Revenue Act of 1932, but the court held that the receipt of bonds in exchange did not provide the necessary continuity of interest.[37] The decision was put on the ground that creditors, though the maturity of their debts might be distant and might be secured by a lien, still had no interest in the debtor's property. As a result of this determination it soon became apparent that the status of a merger instigated by the bondholders of an insolvent company was again thrown into doubt, as the appeal of the question to five of the federal Circuit Courts of Appeals during the first six months of this year and the resulting decisions indicate.

The injection of the *LeTulle* case as a precedent into the confusion surrounding the treatment of the foreclosure merger situation has attained partial success. Some courts have accepted that decision as a determinant of the fact that a continuity of interest is lacking when the rule is applied to bondholders' stakes in insolvent companies.[38] But other courts have more properly held that the case has no bearing on the issue.[39] The *LeTulle* case may be distinguished on its facts, for the court was there treating the bonds of a *solvent* corporation. Unfortunately the Supreme Court did not clarify its position, for, although it mentioned one of the earlier foreclosure cases,[40] it expressed neither approval nor disapproval of the decision.

In the fundamental argument against a reorganization which has been advanced in the recent cases, it is urged that the bondholders lack a continuity of interest.[41] The *LeTulle* case stands for the proposition that there must

36. 308 U. S. 415 (1940), 53 HARV. L. REV. 683. A companion decision is Helvering v. Tyng, 308 U. S. 527 (1940).

37. See Silverson, *The Meaning of LeTulle v. Scofield* (1940) 18 TAXES 492.

38. Comm'r v. Marlborough House, Inc., 118 F. (2d) 511 (C. C. A. 9th, 1941); Helvering v. New President Corp., 122 F. (2d) 92 (C. C. A. 8th, 1941).

39. Helvering v. New Haven & Shore Line R. R., 121 F. (2d) 985 (C. C. A. 2d, 1941); Comm'r v. Southwest Consolidated Corp., 119 F. (2d) 561 (C. C. A. 5th, 1941); Comm'r v. Alabama Asphaltic Co., 119 F. (2d) 819 (C. C. A. 5th, 1941).

40. LeTulle v. Scofield, 308 U. S. 415, 420n (1940).

41. Under a weaker line of argument, sometimes utilized, an attempt is made to dismember the plan by separating it into several stages viewing the sale to the bondholders upon foreclosure as an independent transaction, and treating the sale of the properties to the newly organized corporation, in exchange for its stock, as though it stood alone. Such efforts have been constantly repudiated by the courts under the "single transaction" rule. *Cf.* Snowden v. McCabe, 111 F. (2d) 743 (C. C. A. 6th, 1940); Helvering v. Elkhorn Coal Co., 95 F. (2d) 732 (C. C. A. 4th, 1938); Bassick v. Comm'r, 85 F. (2d) 8 (C. C. A. 2nd, 1936); Prairie Oil and Gas Co. v. Matter,

be a retention of a "proprietary interest" and a "substantial stake in the enterprise" in order to constitute a reorganization. With this in mind some courts have reasoned that debts are payable in money and give creditors neither the power to control the debtor's property nor any concern with its vicissitudes; creditors do not share in the debtor's gains nor suffer from its losses. While this must be admitted in respect to a solvent, going concern, the incidence of insolvency alters the secured creditor's status. The stockholders' interest is then worthless or, at best, uncertain.[42]

While admitting that insolvency does make a difference, some courts have still held that, with the extinction of the stockholders' interest upon foreclosure, all interests in the corporation have been wiped out. But this position seems fallacious since the control of the corporation passes to the secured creditors under the prior contract of indebtedness upon insolvency and foreclosure. The creditors become the beneficial owners of the property and need only to utilize prescribed legal formalities to become the legal owners thereof. Courts have constantly said the receipt of the stock of the new corporation in exchange for the properties of the old one admittedly satisfies the requirement of a substantial and material stake in the enterprise. Ownership has thus been exchanged for ownership, and the continuity rule seems to be satisfied.

Moreover, it seems that the rule was never meant to apply to the original interest the reorganizers held in *A* Corporation. When *A* Corporation transferred property or securities to *B* Corporation in return for the consideration, *x*, from *B* Corporation, the courts looked at *x* to determine whether a continuing proprietary interest in *B* Corporation existed. *x* and the interest it provided in *B* Corporation were the sole objects of scrutiny under the continuity of interest requirement. Thus the purpose of the continuity rule was to fill the gap in the parenthetic clause of Section 112(i)(1) of the Revenue Acts of 1928 and 1932[43] and corresponding sections of prior

66 F. (2d) 309 (C. C. A. 10th, 1933); Tulsa Tribune Co. v. Comm'r, 58 F. (2d) 937 (C. C. A. 10th, 1932). The courts continually emphasize the principle that the substance, rather than the form, of a series of transactions, is controlling.

Application of the single transaction rule is complicated by the many factual situations under which it may arise. For a general treatment of the doctrine, see PAUL, STUDIES IN FEDERAL TAXATION, (2d Ser. 1938) 200-254.

42. Although the position of the stockholders in a foreclosure proceeding differs slightly from that under § 77B of the Bankruptcy Act [48 STAT. 912, 11 U. S. C. § 207 (1934)] the analogy is close enough to warrant reference to such decisions as Case v. Los Angeles Lumber Products Co., Ltd., 308 U. S. 106, 115 (1939), *reh'g denied,* 308 U. S. 637 (1939), holding that the "fair and equitable" provision of § 77B requires the elimination of the stockholders of a corporation in favor of the bondholders where the debtor corporation is insolvent, not only in the equity sense, but also in the bankruptcy sense, unless the stockholders supply a consideration sufficient to justify their participation. *Cf.* also *In re* 620 Church Street Corp., 299 U. S. 24, 27 (1936).

43. See note 21 *supra.*

statutes. Lacking statutory regulation of the consideration which might be received from the transferee, the courts sought to delimit such a "reorganization" exchange in order to achieve the objective sought by the tax-free exceptions granted in the statute.[44] That the continuity rule concerned only the consideration received by the transferor is shown by the fact that, when the rule was written into Section 112(g)(1)(B) of the Revenue Act of 1934 and subsequent acts, it was expressed merely in the words: ". . . in exchange solely for all or a part of its voting stock."[45] Nor have the courts applied the rule otherwise except in the foreclosure cases now in litigation. The *LeTulle* case did not depart from the definition of the rule in terms of the exchange given by the transferee; hence, that case is no authority for extending the continuity of interest requirement to the situation in receivership mergers where bondholders' interest in the original company, the transferor, is under surveillance. The continuity requirement is such an excellent argumentative device that the Bureau of Internal Revenue and counsel for taxpayers naturally have attempted to extend its application. It is submitted that extension of the continuity rule to the original interest in the transferor is unwarranted and should be rejected.

The proper limits of the continuity rule should encompass only the *interest retained in the transferee* at the completion of the transaction, and the nature of the *original investment in the transferor* should be disregarded in determining the character of the plan purporting to be a reorganization. To treat the original interest as irrelevant would produce no unjust consequences. If the bondholders of a solvent corporation were to receive, without the consent of the stockholders of the old corporation, the stock of a new corporation to whom the assets of the original corporation were transferred, the transaction would be objectionable on the wholly independent ground that it was a fraud on the stockholders; if the bondholders of an insolvent corporation acquire the stock of the transferee they are only receiving a legal exchange. Thus it would seem that there has been a reorganization in these

44. *Cf.* Cortland Specialty Co. v. Comm'r, 60 F. (2d) 937 (C. C. A. 2d, 1932), *cert. denied,* 288 U. S. 599 (1933); Pinellas Ice and Cold Storage Co. v. Comm'r, 287 U. S. 462 (1933).

45. It is apparent that a foreclosure reorganization cannot fall within the definition under § 112(g)(1)(B) of the 1934 and subsequent Revenue Acts unless the exchange has been solely for voting stock. See note 2 *supra.* However, reorganizations failing to satisfy this requirement may still come within § 112(g)(1)(C) if the bondholders may be treated as "stockholders" and if the requisite of control of the transferee can be met. For a general discussion of the "control" provisions of the Revenue Act, see (1941) 50 YALE L. J. 1237.

Even in the absence of a "reorganization" the bondholder-taxpayer may attain nonrecognition of gain or loss under § 112(b)(5) if he can show that the amount of stock and securities received is in proportion to his interest in the property prior to the exchange. For § 112(b)(5) see note 30 *supra.*

receivership cases both within the literal definition in Section 112[46] and the underlying purpose of the tax-free exception, since no "realized" gain has been shorn from the business *res*.[47] It is submitted that the Supreme Court, when called upon to resolve the problem, should limit the *LeTulle* case and classify foreclosure mergers as "reorganizations."[48]

To take the stand that a reorganization has occurred may well have an adverse effect on governmental revenues. Establishment of the basis of depreciation at cost to the original company will invariably provide a larger base value, will allow greater deductions for depreciation and will reduce ultimate corporate tax liability. Non-recognition of gain or loss to the individual or corporate taxpayer, however, will not necessarily result in a diminution of tax revenues, for a non-recognition of gain carries with it a non-recognition of loss and the corporation or bondholder will be unable to deduct losses sustained from the transaction in arriving at a net income figure. Conceding a possible fall in tax returns, the expressed legislative policy can be met only by classifying foreclosure mergers as tax-free reorganizations.

---

46. If the reorganization proceeds under § 77B of the Bankruptcy Act [48 STAT. 912, 11 U. S. C. § 207 (1934)] it has been held not to be a "statutory merger or consolidation" within the definition under § 112(g)(1)(A), but may qualify under § 112-(g)(1)(C) if the requirements of that section are met. James Q. Newton Trust, 42 B. T. A. 473 (1940).

47. It is possible that, under some situations, the foreclosure reorganizations may involve the question of whether the transferee corporation acquires "substantially all the assets" of the transferor, under § 112(g)(1)(B) of the definition, since the ordinary corporate mortgage covers real estate but not cash or stock in trade; hence, coverage is less than all of the properties of the mortgagor.

48. The Court has granted certiorari in the *Marlborough House*, *Southwest Consolidated*, and *Alabama Asphaltic Limestone* cases. (1941) 10 U. S. L. WEEK 3122.

Petition for certiorari has also been filed in Palm Springs Holding Corp. v. Comm'r, 119 F. (2d) 846 (C. C. A. 9th, 1941) (bondholder retained assets bought in at foreclosure sale). The facts are not on all fours with the foreclosure mergers but the issue is so analogous that a decision by the Supreme Court might encompass both situations.