The issue was whether distributions made to a shareholder pursuant to a corporate liquidation are taxable as dividend income or as a long term capital gain. For many years Wellington Fund, Inc. ("Fund"), a mutual fund, had separate contracts with Wellington Corporation ("transferor") for investment advisory services, and with W. L. Morgan & Company ("transferee") for the national promotion and distribution of the Fund's securities. These contracts constituted the principal if not exclusive business of the transferor and transferee. In 1952, the Fund terminated its contract with transferor and immediately thereafter entered into a contract with transferee for identical services. Transferor was then liquidated, and the assets that it had utilized in performing the contract with the Fund were conveyed to the transferee.

The provisions of the reorganization section have been written to prevent the use of the section to escape proper taxation by distributing as capital gain what are in effect dividends out of earnings. That an existing corporation in which the taxpayer was the sole shareholder was used instead of a newly formed one cannot alter the true nature of the transaction. Here, the issuance of new stock would have been a meaningless gesture. The court held that the distributions were made in pursuance of a plan of reorganization (a "D" reorganization).