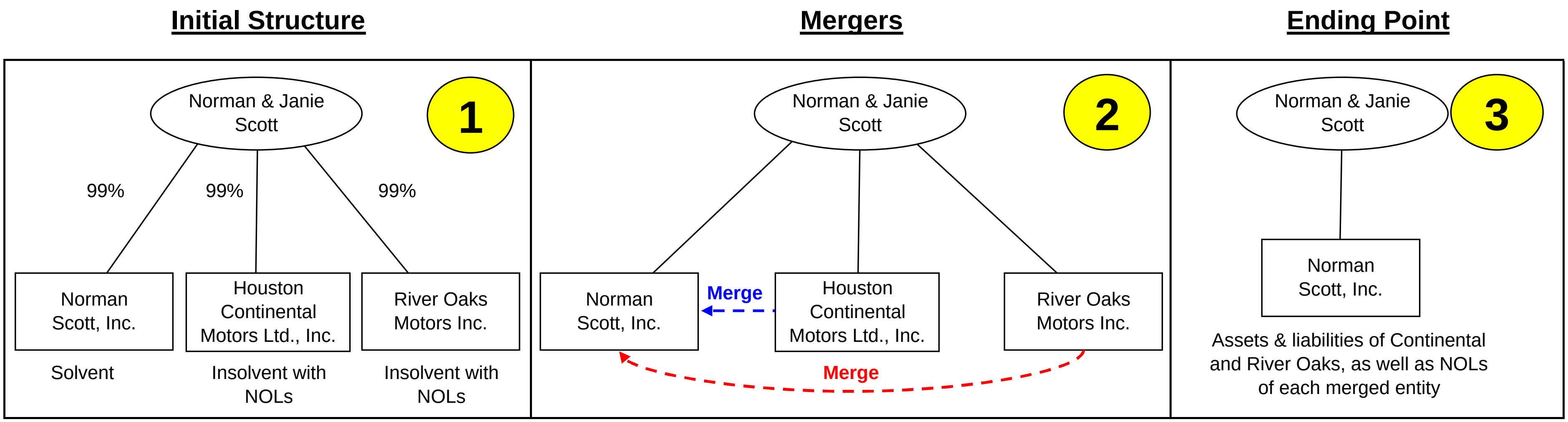
Norman Scott, Inc. v. Commissioner
48 T.C. 598 (1967)

Valid Mergers of Insolvent Corporations



The issue for decision was whether a transaction between Norman Scott, Inc., River Oaks Motors, Inc., and Houston Continental Motors Ltd., Inc., which took place between May 31, 1961, and August 3, 1961, qualifies as a statutory merger within the meaning of section 368(a)(1)(A), so that Norman Scott, Inc. is entitled to a deduction on its Federal income tax return for the taxable year ended June 30, 1962 for net operating loss carryovers. Norman J. Scott and his wife, Janie Scott, owned approximately 99 percent of the common stock of Norman Scott, Inc., Continental, and River Oaks. As of the date of the merger Continental had a net operating loss of $18,900.98 which had not been carried back and absorbed for prior taxable years.

The IRS contended that the transferor corporations were insolvent as of the date of transfer, that any stock which their stockholders exchanged was therefore worthless, and thus the stockholders of Continental and River Oaks could not have received a proprietary interest in Norman Scott, Inc.. Alternatively, the IRS argued that since Norman Scott, Inc. was the substantial creditor of each transferor corporation, the merger was, in reality, the satisfaction of an indebtedness.

The court disagreed with the IRS. The stockholders of River Oaks and Continental received Norman Scott, Inc.'s stock under the terms of the merger. A creditor of an insolvent corporation qualifies as having a proprietary interest in such corporation. See Helvering v. Alabama Asphaltic Limestone Co., 315 U. S. 179 (1942); Seiberling Rubber Co. v. Commissioner, 169 F. 2d 595 (C. A. 6, 1948); Meyer v. United States, supra; and Alexander E. Duncan, 9 T. C. 468 (1947). Thus Norman and Janie Scott had a proprietary interest in River Oaks and Continental prior to the merger, either as stockholders or as creditors. The court held it was not necessary to determine the exact nature of their interest for "surely it was one or the other." The holders of the proprietary interest in both River Oaks and Continental maintained the requisite proprietary interest in petitioner as the surviving corporation of the merger.