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Corporations

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strable good faith are essential elements in determining whether a particular covenant will be enforced by the court, Professor Blake's article contains much sound practical advice for attorneys called upon to draft employment contracts and is worthy of close study by such practitioners, as well as by students in this area of the law.

JOSEPH P. WARNER
Case Editor

CORPORATIONS

ACQUISITION OF ASSETS OF A SUBSIDIARY: LIQUIDATION OR REORGANIZATION? by Kenneth F. Seplow, 73 Harv. L. Rev. 484 (January 1960).

An examination is made of the treatment accorded under the 1939 and 1954 Internal Revenue Codes and earlier tax statutes to transactions in which parent corporations acquire assets of subsidiaries. After analyzing the transactions, it is concluded that to characterize them as reorganizations is improper. Amendment of the 1954 code is advocated to require recognition of a parent's stock investment in its subsidiary in all cases.

The steps a parent will take in absorbing a subsidiary are frequently dictated by the federal-income-tax consequences. Emphasis will be placed on avoiding recognition of gain accrued in the investment in the separated business. Paying a tax at this point may offset the advantages of unified management because it may entail a withdrawal of part of the investment to pay the tax. If, however, there has been a diminution of the investment in the separated business, an immediate recognition of loss will probably be desirable although, in appropriate circumstances, postponement until the loss can better be utilized to offset capital gains may be more beneficial.

A corporation meeting the requirements of Section 332 of the 1954 Internal Revenue Code can avoid recognition of gain or loss by having the subsidiary liquidate with a distribution of its assets to its shareholders in cancellation or redemption of their stock. This method is, however, unsatisfactory if the parent is not the distributee of a sufficiently large enough portion of the assets to enable it to receive operating facilities intact.

Can these objectives be attained through a tax-free reorganization between a subsidiary and parent pursuant to Section 368 of the 1954 Code and its companion Sections 354 and 361?

As Mr. Seplow points out, this problem was presented to the Tax Court, and, on appeal to the Second Circuit under comparable sections of the 1939 Code, in the recent case of *Bausch & Lomb Optical Co.* The problem posed for decision was the intricate one of determining which of two apparently overlapping tax concepts—reorganization or liquidation—best described the asset acquisition, and should, therefore, have governed the transaction. It is contended that neither opinion conclusively resolves

the dilemma, for, as is said, "the scope and indeed the meaning of each are somewhat clouded."

In the article the author interprets the two opinions and attempts to ascertain their significance in terms of both the 1939 Code under which the case was decided and the 1954 Code currently in force. In determining the validity of the approach taken by both courts, he presents an interesting and informative review of earlier applications of liquidation and reorganization doctrine in similar factual contexts.

In Part III, the relationship of exchanges to reorganizations and the "continuity of interest" test, are discussed, including the ramifications, in this area, of Section 112(b)(3) of the 1939 Code. Part IV is devoted to a discussion of 1934 statutory changes, especially the revision of the reorganization definition in the 1934 Act, and its effect on cases which followed it.

Thus far the author has approached the problem of a parent's acquisition of the assets of its subsidiary from the point of view of recognition of gain or loss to the parent depending upon an exchange pursuant to a reorganization, with the conclusion that, in the case of a wholly owned subsidiary, there could be no reorganization because of lack of continuity of interest or lack of a suitable exchange. At this point Mr. Seplow gives detailed consideration to the nonrecognition features of Section 112(b)(6) of the Internal Revenue Code of 1939.

In Part VI, The 1939 Code Pattern, it is opined that the 1939 Code provisions governing a parent's acquisition of its subsidiary's assets were very unclear in their application. In this vein, the related problem of the so-called "downstream-merger" is discussed.

In conclusion the author points out the changes in the pattern which the 1954 Code revision has effected, examines the future possibilities, and recommends amendment of the 1954 Code so as to require recognition of parent's stock investment in its subsidiary in all cases.

ROBERT F. MCGRATH
Article and Book
Review Editor

LABOR LAW

THE LABOR MANAGEMENT REPORTING AND DISCLOSURE ACT OF 1959, Benjamin Aaron, 73 Harv. L. Rev. 851, 1086 (March, April 1960).

Professor Aaron gives a detailed analysis of the provisions of the Labor Management Reporting and Disclosure Act of 1959, which deals with internal union government and the activities of union officials and employers. The aims and effects of each Section are discussed and evaluated, with due regard for the background from which each was developed.

In a section-by-section analysis of the Act, which has been acclaimed by some as a guarantee of union democracy, the background, debates, and