## ***Bassett v. Commissioner, 45 B.T.A. 113 (1941)***

When a corporation undergoes a recapitalization and issues new stock and other property (like common stock) in exchange for old stock, the entire transaction is considered part of the reorganization, and the distribution of common stock is not treated as a separate taxable dividend if it’s part of the reorganization plan.

### Summary

Bassett concerned whether the issuance of common stock to preferred stockholders during a corporate recapitalization constituted a taxable dividend. The Board of Tax Appeals held that the common stock issuance was an integral part of the reorganization plan, not a separate dividend. The key was that the common stock was part of the consideration for exchanging old preferred stock for new preferred stock. Therefore, it fell under the non-recognition provisions of the tax code applicable to reorganizations. The Board did, however, find that a cash distribution made during the reorganization had the effect of a dividend and was thus taxable.

### Facts

The corporation had outstanding $3.25 preferred stock with accumulated dividend arrearages. A plan of recapitalization was adopted where holders of the old $3.25 preferred stock would exchange their shares for new $2.50 preferred stock plus half shares of common stock. The plan, approved by stockholders, explicitly stated that the common stock was part of the consideration for the exchange. The corporation argued that the common stock issuance was a separate dividend, entitling it to a dividends-paid credit for tax purposes.

### Procedural History

The Commissioner of Internal Revenue determined that the issuance of common stock was part of the reorganization and not a taxable dividend, disallowing the dividends-paid credit claimed by the corporation. The corporation appealed to the Board of Tax Appeals.

### Issue(s)

1. Whether the issuance of common stock to preferred stockholders as part of a recapitalization exchange constitutes a taxable dividend separate from the reorganization.
2. Whether a cash distribution made during the reorganization constitutes a taxable dividend.

### Holding

1. No, because the issuance of common stock was an integral part of the reorganization plan and consideration for the exchange of old preferred stock.

 

2. Yes, because the cash distribution had the effect of a taxable dividend to the distributees.

## Court's Reasoning

The Board reasoned that the common stock issuance was explicitly part of the reorganization plan, as evidenced by the stockholders' resolution and communications with the preferred stockholders. The Board emphasized that the holders of the old preferred stock surrendered their shares in exchange for both the new preferred stock and the common stock. Citing *Commissioner v. Kolb*, the Board stated that even if the common stock issuance was formally declared as a dividend, it remained part of the reorganization if it was part of the overall plan. The Board focused on the "ultimate consequence," which was the continuity of the stockholders' interest in the corporate enterprise through both the new preferred stock and the common stock. Regarding the cash distribution, the Board found that because the corporation had sufficient earnings and profits, the cash distribution had the effect of a taxable dividend under Section 112(c)(2) of the Revenue Act of 1936.

## Practical Implications

*Bassett* clarifies that the tax treatment of stock or other property issued during a corporate reorganization depends on whether it is an integral part of the reorganization plan. Even if the distribution is structured or labeled as a dividend, it will be treated as part of the reorganization if it is part of the consideration for the exchange of stock or securities. This case emphasizes the importance of documenting the intent and purpose of distributions made during reorganizations to ensure proper tax treatment. It also highlights that cash distributions during reorganizations can be taxable dividends to the extent of the corporation's earnings and profits. Later cases have cited *Bassett* for the principle that the substance of a transaction, rather than its form, governs its tax treatment in the context of corporate reorganizations.

 