1 T.C. 424 (1943)

A dividend irrevocably set aside for preferred stockholders upon conversion of shares during a recapitalization is not a preferential distribution, even if not all stockholders have surrendered shares by year-end, provided the recapitalization is binding under state law.

Summary

United Artists Theatre Circuit sought a dividends paid credit after a corporate recapitalization where a dividend was declared for preferred shareholders who converted their shares. The Commissioner argued the distribution was preferential because not all shareholders had converted and received the dividend by year-end. The Tax Court held that because the recapitalization was binding on all shareholders under Maryland law, the dividend was not preferential. The court focused on the fact that the right to the dividend was uniformly available to all preferred shareholders upon conversion, regardless of when they acted.

Facts

United Artists had outstanding preferred stock with cumulative unpaid dividends. To address this, the company proposed a recapitalization plan where preferred shares would be exchanged for new shares and a $15 dividend, with accumulated unpaid dividends (except the $15) being waived. The company's charter allowed amendment of preferred stock preferences with a two-thirds vote, which was obtained. A dividend of $450,000 was declared and deposited with Chase National Bank to pay converting shareholders. Not all shareholders converted their shares by the end of the tax year.

Procedural History

The Commissioner of Internal Revenue determined that United Artists was not entitled to a dividends paid credit, arguing the distribution was preferential. United Artists petitioned the Tax Court, contesting the Commissioner's determination. The Tax Court ruled in favor of United Artists, allowing the dividends paid credit.

Issue(s)

Whether a dividend declared as part of a corporate recapitalization, irrevocably set aside for preferred stockholders upon conversion of their shares, constitutes a preferential distribution under Section 27(g) of the Revenue Act of 1936, if not all stockholders had surrendered their shares and received the dividend by the end of the tax year.

Holding

No, because the recapitalization was binding on all shareholders under Maryland law, and the dividend was available to all preferred shareholders upon conversion, the distribution was not preferential.

Court's Reasoning

The court relied heavily on Maryland state law, which governed the rights of the preferred shareholders. The court cited *McQuillen v. National Cash Register Co.*, a federal case interpreting a similar provision of Maryland law, which held that a recapitalization plan approved by a two-thirds vote was binding on all stockholders. The Tax Court deferred to the federal court's interpretation of Maryland law, citing *Helvering v. Stuart*. The court reasoned that because the amendment to the charter was binding on all preferred shares, all shares were automatically converted, regardless of whether the physical certificates were surrendered. Therefore, the $15 dividend was not preferential because it was available to all shareholders based on their stock ownership, not on a voluntary election to surrender additional rights. The court distinguished *Black Motor Co. v. Commissioner*, noting that in that case, the corporation intentionally made unequal distributions, while in the present case, the dividend was made available to all stockholders impartially.

Practical Implications

This case clarifies that a dividend paid in connection with a corporate recapitalization can qualify for the dividends paid credit, even if not all shareholders receive the dividend during the tax year. The key is whether the recapitalization is legally binding on all shareholders and whether the dividend is made available to all shareholders equally based on their stock ownership. This case highlights the importance of state corporate law in determining the tax consequences of corporate actions. It also demonstrates that the requirement to surrender old stock certificates as a prerequisite to receiving a dividend does not automatically make the distribution preferential, as long as the requirement applies uniformly to all stockholders and does not impinge on their substantive rights. Later cases would likely analyze if the offer was truly available to all shareholders, without undue restrictions, before concluding the dividend was non-preferential.

