

### **3 T.C. 1199 (1944)**

Dividend scrip issued as part of a corporate recapitalization, representing accumulated unpaid dividends, is considered a security exchanged for stock within the reorganization, not a taxable dividend eligible for a dividends-paid credit.

#### **Summary**

Globe-News Publishing Co. recapitalized, exchanging old preferred stock with dividend arrears for new preferred stock, common stock, dividend scrip, and cash. The company sought a dividends-paid credit for the scrip's face value. The Tax Court held that the scrip was not a taxable dividend but part of a tax-free exchange under the reorganization provisions. Therefore, the company was entitled to a dividends-paid credit only for the cash portion of the exchange, as the scrip represented securities exchanged within the reorganization, not a separate dividend payment.

#### **Facts**

- Globe-News Publishing Co. had outstanding preferred stock with accumulated unpaid dividends.
- In 1937, the company implemented a recapitalization plan.
- Under the plan, old preferred stockholders received new preferred stock, common stock, dividend scrip (representing \$12.50 per share in unpaid dividends), and \$1 cash per share.
- The dividend scrip was payable within 25 years at the company's option, bearing 4% cumulative interest and was transferable only on the company's books, subordinate to bond payments.
- The company claimed a dividends-paid credit including the face value of the scrip.

#### **Procedural History**

- The Commissioner of Internal Revenue disallowed the portion of the dividends-paid credit attributed to the dividend scrip.
- Globe-News Publishing Co. petitioned the Tax Court for review.

#### **Issue(s)**

1. Whether dividend scrip, issued as part of a corporate recapitalization to cover accumulated unpaid dividends on old preferred stock, constitutes a taxable dividend eligible for a dividends-paid credit under Section 27(d) of the Revenue Act of 1936.

#### **Holding**

1. No, because the dividend scrip was part of a tax-free exchange of securities within a corporate reorganization under Section 112(b)(3), not a separate

dividend payment.

### **Court's Reasoning**

The Tax Court reasoned that the issuance of the dividend scrip was an integral part of the reorganization, not a separate dividend payment. The court emphasized the following points:

- The right to dividend arrears was considered part of the preferred shares.
- The scrip constituted