Madison Square Garden Corporation (Formerly Graham-Paige Corporation), Petitioner v. Commissioner of Internal Revenue, Respondent, 58 T. C. 619 (1972)

A parent corporation may use the adjusted basis of its stock to determine the basis of assets received in liquidation if it acquired at least 80% of the subsidiary's stock by purchase within two years of the liquidation.

Summary

In Madison Square Garden Corp. v. Commissioner, the court addressed whether the basis of assets received by Madison Square Garden Corp. (formerly Graham-Paige Corp.) in the liquidation of its subsidiary, Madison Square Garden Corp. , should be determined under Section 334(b)(2) of the Internal Revenue Code. The parent had acquired 80. 22% of the subsidiary's stock through a series of purchases, followed by a merger treated as a liquidation. The court held that the basis of the assets should be the adjusted basis of the stock owned by the parent at the time of the liquidation, but only for the 80. 22% of the assets corresponding to the stock acquired by purchase, after adjusting for cash received. This decision clarified the application of Section 334(b)(2) in complex corporate restructurings involving stock purchases and subsequent liquidations.

Facts

Madison Square Garden Corp. (the parent) acquired a controlling interest in another corporation (Garden) by purchasing 219,350 shares in February 1959. Garden then redeemed some of its own stock, reducing the total outstanding shares. The parent continued to purchase Garden's stock, ultimately owning 80. 22% by March 1960. In April 1960, Garden merged into the parent, a transaction treated as a liquidation under Section 332. The parent sought to determine the basis of the assets received using the adjusted basis of its Garden stock under Section 334(b)(2).

Procedural History

The Commissioner of Internal Revenue determined deficiencies in the parent's federal income taxes for the years 1957, 1958, 1960, and 1961, asserting that the parent was not entitled to use Section 334(b)(2) to determine the basis of the assets received from Garden. The parent filed a petition with the United States Tax Court, which heard the case and rendered its decision in 1972.

Issue(s)

1. Whether the parent acquired 80% of Garden's stock by "purchase" within the meaning of Section 334(b)(2), allowing it to use the adjusted basis of its stock to determine the basis of the assets received in liquidation.
2. If the parent is entitled to use the adjusted basis of its stock, whether this basis applies to all assets acquired or only to the portion corresponding to the 80. 22% of

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stock acquired by purchase, and what adjustments should be made for cash or its equivalent received.

Holding

1. Yes, because the parent owned 80. 22% of Garden's stock, which it had acquired by purchase, at the time of the liquidation, meeting the requirements of Section 334(b)(2).
2. No, because the adjusted basis applies only to the 80. 22% of assets corresponding to the stock acquired by purchase, adjusted for cash received, as the parent did not establish ownership of the remaining 19. 78% of Garden's stock before the liquidation.

Court's Reasoning

The court reasoned that Section 334(b)(2) allows a parent corporation to use the adjusted basis of its stock to determine the basis of assets received in liquidation if it acquired at least 80% of the subsidiary's stock by purchase within two years of the liquidation. The court rejected the Commissioner's argument that the parent needed to acquire 80% of the stock outstanding at the time it began purchasing, finding instead that the 80% requirement should be measured at the time of the liquidation plan's adoption and the property's distribution. The court also held that the adjusted basis applies only to assets received in respect of stock held at the time of liquidation, limiting the parent's stepped-up basis to 80. 22% of the assets. The court further determined that only cash received should be considered "cash and its equivalent" for purposes of adjusting the stock's basis.

Practical Implications

This decision clarifies that in corporate liquidations, the basis of assets received by a parent corporation can be determined under Section 334(b)(2) based on the adjusted basis of its stock, but only if the parent acquired at least 80% of the subsidiary's stock by purchase within two years of the liquidation. The ruling emphasizes that the 80% requirement is measured at the time of the liquidation plan's adoption, not when the parent begins purchasing stock. Practitioners should carefully track stock acquisitions and ensure they meet the purchase requirement to avail themselves of the stepped-up basis under Section 334(b)(2). The decision also limits the application of the adjusted basis to the portion of assets corresponding to the stock acquired by purchase, necessitating precise calculations of stock ownership and cash received in liquidation. This case has been cited in subsequent decisions and revenue rulings addressing the application of Section 334(b)(2) in corporate restructurings.

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