Tribune Publishing Co. v. Commissioner, 79 T. C. 1029 (1982)

A right of first refusal in favor of a parent corporation can make stock owned by subsidiary employees 'excluded stock' for determining control in parent-subsidiary controlled groups under IRC § 1563.

Summary

Tribune Publishing Co. and News Review Publishing Co. were involved in a dispute over their classification as a controlled group under IRC § 1563. Tribune owned 70% of News's stock and had a right of first refusal on the remaining shares owned by News's employees. The court held that this right constituted a substantial restriction, making the employees' stock 'excluded' for control calculations, thus classifying the companies as a parent-subsidiary controlled group. This decision impacts how similar corporate structures are analyzed for tax purposes, emphasizing the significance of rights of first refusal in determining control.

Facts

In 1967, Tribune purchased 100 of the 250 shares of News Review Publishing Co. and entered into an agreement granting it a right of first refusal on any sale of News's remaining stock. By 1972, Tribune increased its ownership to 175 shares, with the remaining 75 shares owned by two News employees, William and A. J. Marineau. The agreement's right of first refusal applied to the Marineaus' shares, which were crucial in determining whether Tribune and News constituted a controlled group under IRC § 1563.

Procedural History

The Commissioner of Internal Revenue determined that Tribune and News were a controlled group and issued deficiency notices for the years 1976-1978. The companies contested this classification in the U. S. Tax Court, arguing that the Marineaus' stock should not be treated as 'excluded stock' due to the right of first refusal.

Issue(s)

1. Whether the right of first refusal in favor of Tribune constituted a condition that substantially restricted the Marineaus' right to dispose of their News stock under IRC § 1563(c)(2)(A)(iii).

Holding

1. Yes, because the right of first refusal was a condition running in favor of Tribune that substantially restricted the Marineaus' right to dispose of their stock, making it 'excluded stock' under IRC § 1563(c)(2)(A)(iii).

Court’s Reasoning

The court applied IRC § 1563(c)(2)(A)(iii) and the corresponding regulation, which explicitly states that a right of first refusal in favor of the parent corporation constitutes a substantial restriction on an employee’s right to dispose of stock. The legislative history supported this interpretation, indicating that such a right qualifies as a substantial restriction. The court rejected the taxpayers’ argument that the reciprocal nature of the right of first refusal should exempt it from being considered a substantial restriction, as this exception applies only to brother-sister controlled groups, not parent-subsidiary groups. The court also dismissed the argument that the restriction was unenforceable under state law, finding that the shareholders’ agreement was valid and enforceable between the parties. The court emphasized that the tax code’s application does not depend on tax-avoidance motives but on the legal structure and agreements in place.

Practical Implications

This decision clarifies that a right of first refusal in favor of a parent corporation can be a significant factor in determining control under IRC § 1563 for parent-subsidiary groups. Legal practitioners should carefully review shareholder agreements for similar provisions when assessing corporate control for tax purposes. Businesses should be aware that such agreements can impact their tax liabilities by affecting their classification as a controlled group. Subsequent cases, such as Barton Naphtha Co. v. Commissioner, have reinforced this principle, emphasizing that tax-avoidance motives are irrelevant in applying these rules. This ruling underscores the importance of considering all aspects of corporate governance and shareholder agreements in tax planning and compliance.

