## *Glacier State Electric Supply Co. v. Commissioner, 80 T. C. 1047 (1983)*

The step transaction doctrine does not apply to restructure corporate redemptions where the substance aligns with the form of the transactions executed.

### Summary

Glacier State Electric Supply Co. faced tax consequences after redeeming its subsidiary's shares to fulfill obligations under buy/sell agreements following the death of a shareholder. The court rejected the application of the step transaction doctrine, which would have restructured the transaction to avoid tax. The redemption was found not to be essentially equivalent to a dividend, hence treated as a capital gain. The decision emphasized that the form of the transactions matched their substance and that future planned redemptions did not form a 'series' under tax law.

### Facts

In 1946, Glacier State Electric Supply Co. (Glacier State) was formed with shares split between Donald Rearden and J. Kenneth Parsons. In 1953, Glacier State and Arthur Pyle established Glacier State Electric Supply Co. of Billings (GSB), with Glacier State holding two-thirds of GSB's stock. Upon Parsons' death in 1976, buy/sell agreements required Glacier State to redeem its shares from Parsons' estate and GSB to redeem half of Glacier State's GSB shares. The proceeds from GSB were assigned to Parsons' estate. The IRS challenged the tax treatment, arguing for the application of the step transaction doctrine.

### Procedural History

The IRS issued a notice of deficiency, asserting that the transactions should be recharacterized under the step transaction doctrine, resulting in different tax consequences. Glacier State petitioned the U. S. Tax Court for a redetermination of the deficiency. The Tax Court held in favor of the IRS on the step transaction issue but found the redemption was not essentially equivalent to a dividend, resulting in capital gain treatment.

### Issue(s)

1. Whether the step transaction doctrine should be applied to treat the contemporaneous redemption of GSB stock by Glacier State and Glacier State's own stock by Parsons' estate as a distribution to the estate followed by a redemption of those shares directly from the estate?
2. If the step transaction doctrine is inapplicable, whether the distribution to Glacier State from GSB is to be treated as essentially equivalent to a dividend under section 302 of the Internal Revenue Code?

### Holding

 

1. No, because the substance of the transactions aligned with their form; Glacier State was not a mere conduit for the estate.
2. No, because the redemption was not essentially equivalent to a dividend and did not form part of a ‘series of redemptions’ under section 302(b)(2)(D) of the IRC.

## Court’s Reasoning

The court applied the step transaction doctrine, which collapses multiple steps into one if they are integrated, but found it inapplicable here. Glacier State’s ownership of the GSB shares was recognized by all parties involved, and the redemption transactions followed the form dictated by the buy/sell agreements. The court rejected Glacier State’s argument that it was merely a conduit, emphasizing that the officers treated Glacier State as the true owner of the GSB shares. The court also found that the redemption did not qualify as a dividend because it significantly altered control rights in GSB, citing *United States v. Davis*. The planned future redemption of Pyle’s shares was not considered part of a ‘series of redemptions’ due to uncertainty about its occurrence.

## Practical Implications

This case illustrates that the step transaction doctrine will not be applied to restructure transactions into a different form for tax benefits if the form matches the substance. Practitioners must carefully structure corporate transactions to achieve desired tax results, as the court will not retroactively alter transactions to fit an alternative, untaken path. For closely held corporations, buy/sell agreements should be clearly drafted and signed by all parties to ensure enforceability. The decision also clarifies that a redemption is not treated as a dividend if it significantly alters control rights, affecting how similar cases should be analyzed. Subsequent cases have continued to apply these principles in determining tax treatment of corporate redemptions.