Bhada v. Commissioner, 89 T. C. 959 (1987)

Stock of the acquiring corporation received in a parent-subsidiary transaction is not considered 'property' for purposes of IRC §304(a)(2).

Summary

In Bhada v. Commissioner, shareholders of McDermott, Inc. exchanged their stock for stock and cash from its subsidiary, McDermott International, Inc. , as part of a corporate reorganization to reduce tax liabilities. The Tax Court held that the stock received from the subsidiary was not 'property' under IRC §304(a)(2), meaning it should not be treated as a distribution in redemption of the parent company's stock. This ruling focused on the statutory definition of 'property' and the legislative intent behind §304, which aimed to prevent asset withdrawals from corporate solution, not mere changes in corporate structure.

Facts

McDermott, Inc. , and its wholly-owned subsidiary, McDermott International, Inc. , underwent a corporate reorganization in 1982. The subsidiary offered to exchange its own stock and cash for McDermott's stock to take advantage of lower tax rates abroad. Shareholders, including Bhada and Caamano, participated in this exchange, receiving International's stock and a small cash payment. Post-exchange, International became the parent company with approximately 68% control of McDermott, and the former McDermott shareholders owned about 90% of International's voting power.

Procedural History

The IRS challenged the tax treatment of the transaction, asserting that the International stock should be treated as 'property' under IRC §304(a)(2), thus triggering redemption rules. The case came before the U. S. Tax Court on cross-motions for partial summary judgment to resolve this issue.

Issue(s)

1. Whether the stock of McDermott International, Inc. received by McDermott, Inc. 's shareholders in exchange for McDermott stock constitutes 'property' within the meaning of IRC §304(a)(2).

Holding

1. No, because the stock of the acquiring corporation is not 'property' under IRC §317(a), which defines 'property' as excluding stock of the corporation making the distribution.

Court's Reasoning

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The Tax Court's decision hinged on the interpretation of IRC §317(a), which defines 'property' for tax purposes. The court concluded that the stock of the subsidiary was not 'property' since it was the stock of the corporation distributing it. The court rejected the IRS's argument that the transaction should be treated as if McDermott had directly redeemed its own stock, emphasizing that the purpose of §304 was to prevent asset withdrawals from corporate solution, not to tax mere changes in corporate structure. The court also reviewed the legislative history of §304, which aimed at preventing indirect redemptions through cash or other assets, not through stock swaps. The court noted that the reorganization did not result in a division of the corporations but a change in ownership structure, thus not triggering the anti-bailout provisions of §304 or §355.

Practical Implications

This decision clarifies that in a parent-subsidiary reorganization where the subsidiary issues its own stock in exchange for the parent's stock, the subsidiary's stock is not treated as 'property' under IRC §304. This ruling impacts how similar reorganizations are analyzed for tax purposes, allowing such exchanges to potentially avoid being treated as redemptions under §304. It also influences legal practice by requiring attorneys to carefully structure corporate reorganizations to achieve desired tax outcomes. For businesses, this ruling may encourage similar reorganizations to achieve tax efficiency without triggering redemption rules. Subsequent cases have distinguished this ruling, particularly in situations where other forms of property are exchanged, but it remains a significant precedent for corporate reorganizations involving stock swaps between parent and subsidiary corporations.

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