Charles G. Berwind Trust for David M. Berwind et al. v. Commissioner of Internal Revenue, T. C. Memo. 2023-146 (U. S. Tax Court 2023)

In a significant ruling, the U. S. Tax Court determined that a $191,257,353 payment received by the Charles G. Berwind Trust in a 2002 settlement was subject to imputed interest under Section 483, dating back to a 1999 merger. The decision hinges on the timing of a corporate merger and its tax implications, resolving a complex dispute over whether the payment was for shares exchanged in 1999 or a settlement in 2002. This case sets a precedent for how settlement payments are treated in relation to corporate mergers under federal tax law.

Parties

The petitioners were the Charles G. Berwind Trust for David M. Berwind, David M. Berwind, D. Michael Berwind, Jr. , Gail B. Warden, Linda B. Shappy, and Valerie L. Pawson, as trustees, collectively referred to as the "David Berwind Trust" or "the Trust," and the individual beneficiaries, including David M. Berwind and Jeanne M. Berwind, D. Michael Berwind, Jr. and Carol R. Berwind, Duncan Warden and Gail Berwind Warden, and Russell Shappy, Jr. and Linda Berwind Shappy. The respondent was the Commissioner of Internal Revenue.

Facts

In 1963, Charles G. Berwind, Sr. , established trusts for his four children, including the David Berwind Trust, which held stock in Berwind Corporation. Over the years, the Berwind Corporation underwent various corporate restructurings, including the creation of Berwind Pharmaceutical Services, Inc. (BPSI) and the redemption of shares from some of the trusts. By 1999, BPSI, under the control of Charles G. Berwind, Jr. (Graham Berwind), initiated a short-form merger with BPSI Acquisition Corporation, which resulted in the David Berwind Trust's shares being cancelled and converted into a right to receive payment. The Trust challenged this merger and sought fair value for its shares, leading to a consolidated legal action known as the Warden litigation and an appraisal proceeding. A settlement was reached in 2002, with BPSI agreeing to pay the Trust $191,000,000, which was placed in an escrow account and later released with accrued interest totaling $191,257,353. The IRS asserted that the payment was subject to imputed interest under Section 483, dating back to the 1999 merger date.

Procedural History

The David Berwind Trust filed a petition with the U. S. Tax Court contesting a notice of deficiency issued by the IRS, which claimed that $31,096,783 of the settlement payment was imputed interest and should be taxed accordingly. The case was consolidated with related petitions filed by the Trust's beneficiaries. The IRS argued that the payment was a deferred payment for the 1999 merger, whereas the Trust contended that the payment was for a 2002 sale of stock. The case involved

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extensive litigation and settlement negotiations, culminating in the Tax Court's decision to apply Section 483 to the payment.

Issue(s)

Whether the sale or exchange of the David Berwind Trust's BPSI common stock occurred on December 16, 1999, as part of the merger, or on November 25, 2002, as part of the settlement agreement, for the purposes of applying Section 483 of the Internal Revenue Code?

Rule(s) of Law

Section 483 of the Internal Revenue Code applies to payments made on account of the sale or exchange of property, requiring that a portion of the total unstated interest under such a contract be treated as interest. Under the Pennsylvania Business Corporation Law (BCL), a short-form merger between a parent and its 80%-owned subsidiary results in the subsidiary's shares being cancelled and converted into a right to receive payment, subject to dissenters' rights under BCL §§ 1571-1580.

Holding

The Tax Court held that the sale or exchange of the David Berwind Trust's BPSI common stock occurred on December 16, 1999, the date of the merger, and that the payment made by BPSI to the Trust was subject to Section 483 as of that date. The payment, including interest earned while in escrow, was deemed made on December 31, 2002, when it was released from the escrow account to the Trust.

Reasoning

The Court's reasoning was based on the legal effect of the short-form merger under Pennsylvania law, which resulted in the immediate cancellation of the Trust's shares and the establishment of a right to payment. The Court rejected the Trust's arguments that the merger was void or that the payment was for a 2002 sale, emphasizing that the merger's validity was not successfully challenged in court and that the settlement agreement did not rescind the merger. The Court also distinguished previous cases relied upon by the Trust, finding them inapplicable to the specific issue of applying Section 483 to a payment resulting from a corporate merger. The Court applied the mechanistic rules of Section 483, determining that the payment was a deferred payment for the 1999 merger, and therefore subject to imputed interest.

Disposition

The Tax Court's decision affirmed the IRS's position that the payment was subject to imputed interest under Section 483, with the total unstated interest calculated at $31,140,364 based on the payment being made on December 31, 2002, and the sale

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or exchange occurring on December 16, 1999.

Significance/Impact

This case clarifies the application of Section 483 to payments resulting from corporate mergers and settlements, particularly in the context of dissenters' rights under state corporate law. It establishes that a payment made in settlement of a merger challenge can be treated as a deferred payment for the original merger transaction, subject to imputed interest. The decision impacts how corporate mergers and related litigation settlements are structured and taxed, potentially affecting corporate governance and shareholder rights in similar situations.

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