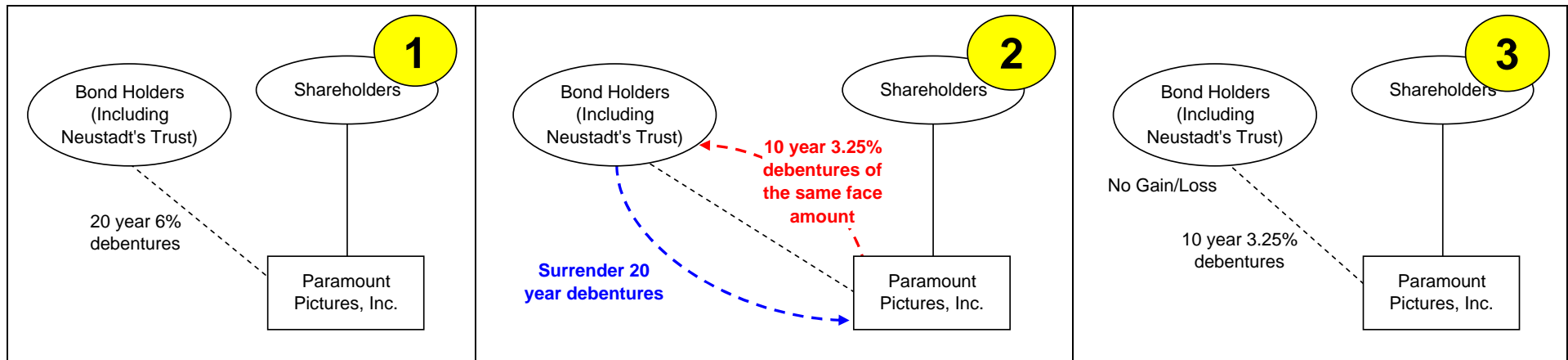


Initial Structure

Recapitalization

Ending Point



In 1937 the taxpayers, trustees of a testamentary trust for the benefit of Agnes Neustadt, exchanged their holdings of 20 year 6% debentures of Paramount Pictures, Inc., for a like face amount of 10 year 3 1/4% convertible debentures of the same company, pursuant to a formal offer of exchange addressed by the company to all holders of the 20 year debenture bonds. The Commissioner contended that this resulted in a taxable gain. The Tax Court held and the Second Circuit affirmed that no taxable gain was recognizable because the transaction constituted an exchange of securities in pursuance of a plan of reorganization.

The first question was whether the debentures were "securities" within the meaning of the reorganization section. The word is used in contrast to "stock"; it necessarily refers to bonds of some sort, since bonds are the most usual, if not the only, form of corporate securities to contrast with stock. Conceivably the word might be construed to include mortgage bonds but to exclude debentures. But it is usual financial practice to speak of debentures as "securities" and the term should be given its ordinary meaning. In *Helvering v. Watts*, 296 U. S. 387, bonds with a maximum maturity of seven years were held to be "securities."

In *LeTulle v. Scofield*, 308 U.S. 415, it was held that continuity of proprietary interest must be found if the transaction is to be deemed within the definition of reorganization contained in the predecessor to section 368 and that a transfer of all the assets of one corporation to another in exchange for cash and bonds of the latter did not fall within such definition. It was not held that an exchange of bonds for bonds pursuant to a plan of reorganization is not an exchange of "securities" within the meaning of section 112(b)(3). In *Helvering v. Southwest Consolidated Corp.*, 315 U. S. 194, 202, it was stated that "recapitalization" contemplates a "reshuffling of a capital structure within the framework of an existing corporation." In common financial parlance the long term funded debt of a corporation is usually regarded as forming part of its capital structure.