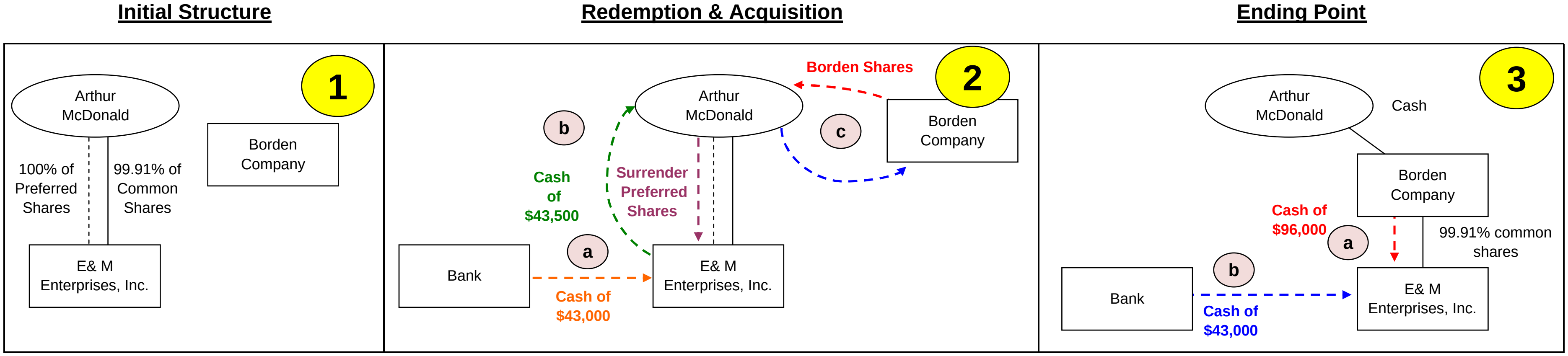
Revenue Ruling 75-360

Cash Redemption & Share Acquisition Treated as Busted B Reorganization



The purpose of this Revenue Ruling was to explain the position of the Internal Revenue Service with respect to the decision of the Tax Court of the United States in Arthur D. McDonald, 52 T.C. 82 (1969). This Revenue Ruling was published in lieu of the publication of an acquiescence or nonacquiescence in the McDonald decision.
In that decision, the Tax Court held that a redemption of the petitioner's stock pursuant to a plan for acquisition of the redeeming corporation by another corporation was not essentially equivalent to a dividend within the meaning of section 302(b)(1), and therefore qualified for exchange treatment under section 302(a).

Arthur McDonald owned all the outstanding preferred stock of E & M Enterprises, Inc. ("E & M") and ten of the eleven shares of its outstanding common stock. Borden Company ("Borden") made an initial verbal offer to exchange 5,500 shares of its common stock for all the preferred and common shares of E & M. In the next month Borden submitted a substitute offer in the form of a proposed "Plan of Reorganization." This plan, which was executed, provided that E & M would redeem all of McDonald's preferred stock for $43,500 in cash and that Borden would acquire all of the common stock of E & M in exchange for 4,839 shares of Borden voting common stock. The difference between the 5,500 shares of Borden common stock originally offered for the business and the 4,839 shares agreed on in the plan represented the amount of $43,500 to be paid to the petitioner by E & M in redemption of his preferred stock. Upon the recommendation of Borden, E & M acquired the cash to carry out the redemption by obtaining a short-term bank loan. A week later E & M common stock was exchanged for Borden stock, and Borden, on the same day, paid E & M $96,000, a portion of which was used by E & M to pay off the bank loan.

According to the ruling, the IRS treated the redemption of McDonald's stock and the exchange of E & M stock for Borden stock as separate transactions, and therefore conceded that the exchange constituted a tax-free reorganization within the meaning of section 368(a)(1)(B). Thus, there was presented for determination by the Tax Court only the issue of whether the redemption, when viewed as a separate transaction, was substantially pro rata and should be treated as a distribution subject to section 301. The Tax Court correctly found a single integrated transaction, stating, "The record in this case establishes clearly that the redemption was merely a step in the plan of Borden for the acquisition of E & M, so that it is the results of the plan that are significant to us." Viewing the redemption and reorganization together, the court concluded that McDonald's interest in E & M had been substantially changed, so that the redemption was not essentially equivalent to a dividend. In reaching this conclusion, the court refrained from comment concerning the propriety of treating the exchange as tax-free because that issue was not before it.

According to the ruling, the IRS recognizes it was in error in arguing the various steps were separate transactions thereby affording tax-free treatment on the stock exchange. Accordingly, since the acquisition was not solely for voting stock of the acquiring corporation but partly for cash, it is the position of the IRS that the acquisition of stock of E & M did not constitute a reorganization. Therefore, under the factual situation presented in McDonald, the entire transaction is considered a taxable sale or exchange.