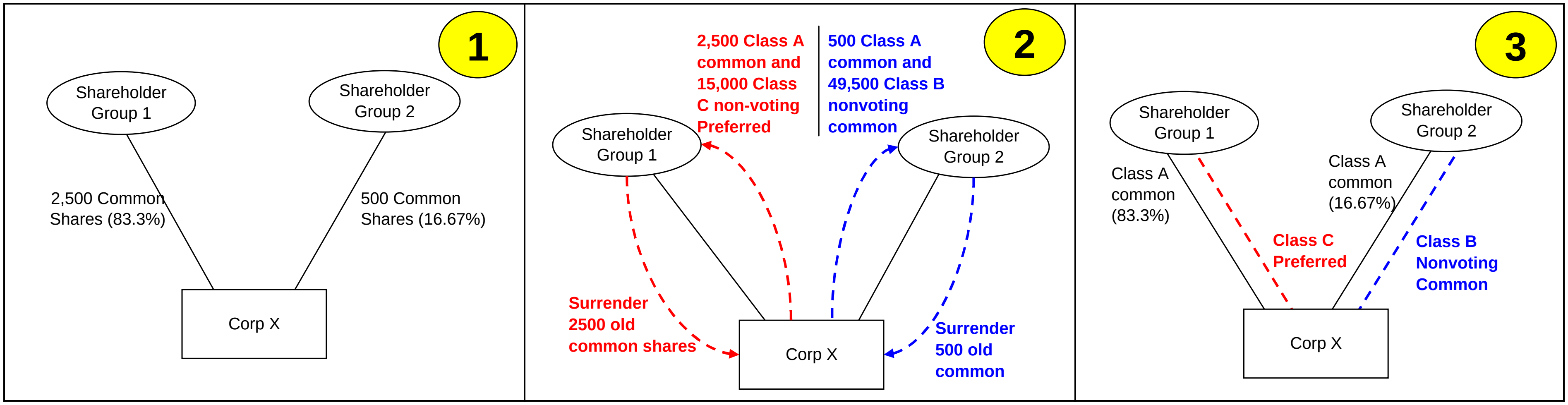
Revenue Ruling 86-25

Recapitalization - Exchange of Common for Common & Preferred

Initial Structure | **Recapitalization** | **Ending Point**



X had 3,000 shares of $100 par value voting common stock ("old common") outstanding. For valid business reasons, a plan of reorganization was adopted pursuant to which X authorized the issuance of a new class A no par value voting common stock, a new class B no par value nonvoting common stock, and a new class C $100 par value nonvoting, nonparticipating, nonconvertible preferred stock. The only difference between the class A and class B common stock was the voting rights of the class A stock, and the only difference between the class A common stock and the old common stock was the par values.

The plan of reorganization provided that each outstanding share of old common stock could be exchanged either for one share of class A common stock plus 99 shares of class B common stock, or for one share of class A common stock plus six shares of class C preferred stock. Pursuant to the plan of reorganization, one group of X shareholders surrendered 2,500 shares of X old common stock in exchange for 2,500 shares of class A common stock and 15,000 shares of class C preferred stock. A second group of shareholders surrendered 500 shares of old common stock in exchange for 500 shares of class A common stock and 49,500 shares of class B common stock. The value of the stock received by each shareholder of X was equal to the value of the stock surrendered by such shareholder in the exchange. The exchange of stock was an isolated transaction and not part of a plan to increase periodically the proportionate interest of any shareholder in the assets or earnings and profits of X.

If X had made an outright distribution of the new preferred stock and new class B common stock on the old common stock, the distribution would have been taxable as a distribution of property under section 301 by reason of the application of section 305(b)(3).

Nevertheless, a transaction that effects a reshuffling of a corporation's capital structure will be respected as a recapitalization exchange to which section 305(b)(3) does not apply so long as it has a bona fide business purpose and is an isolated transaction and not part of a plan to increase periodically the proportionate interest of any shareholder in the assets or earnings and profits of a corporation.