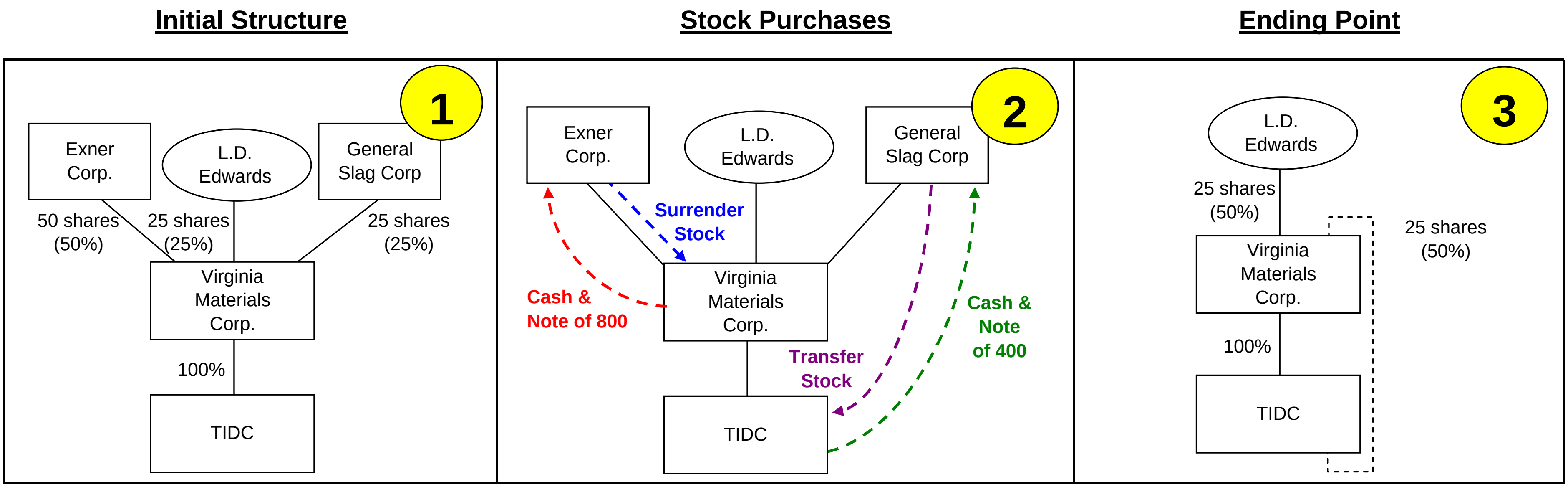
Virginia Materials Corp v. Commissioner
67 T.C. 372 (1976), aff'd without opinion
(4th Cir., June 20, 1978)

304: Subsidiary Purchase of Parent Stock



Virginia Materials Corp ("Virginia") was in the business of processing slag into industrial abrasives. From the time of its incorporation until March 16, 1970, Virginia had issued and outstanding one class of stock, voting common stock, which was owned as follows: Exner Corp. 50 shares (50%), General Slag Corp. 25 shares (25%), and L.D. Edwards 25 shares (25%). Tidewater Industrial Development Corporation ("TIDC") was a corporation with one class of stock, voting common stock outstanding, all of which was owned by Virginia. TIDC engaged in the business of leasing rolling equipment and the business of land development. L.D. Edwards was also the president and a director of TIDC. On March 16, 1970, Virginia redeemed all of its common stock owned by Exner for $800,000, in cash and notes. Simultaneously therewith, TIDC purchased from General Slag for $400,000 in cash and notes, all of Virginia's common stock owned by General Slag. The cash tendered by TIDC was obtained through a loan from Virginia. After these transactions, Virginia's outstanding stock was then owned 50 percent by L.D. Edwards (25 shares) and 50 percent by TIDC (25 shares). All of TIDC's outstanding stock continued to be owned by Virginia.

The IRS asserted that as a result of TIDC's $400,000 purchase of Virginia's stock, Virginia constructively received a $400,000 distribution from TIDC. Virginia contended that it did not constructively receive taxable income by virtue of TIDC's stock purchase. The question was whether a parent corporation constructively receives a taxable distribution from its controlled subsidiary when the subsidiary purchases stock of the parent corporation from a shareholder of the parent. Resolution of the issue turned on whether the application of section 304(a)(2) as supplemented by section 304(b)(2)(B) is limited to determining tax consequences to the selling shareholder, or whether the cited sections, when applicable, also construct a taxable intercorporate distribution from the purchasing subsidiary to its parent.

Webb v. Commissioner, 67 T.C. 293 (1976), involved a controlled subsidiary corporation which purchased from a decedent's estate a portion of the stock of the subsidiary's parent corporation. The Tax Court examined at length the statutory language and legislative history of sections 304(a)(2) and (b)(2)(B) and held, the whole Court sitting, that the parent corporation did not constructively receive a taxable dividend from its subsidiary as a result of the stock purchase.