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## Section 356(a)(2): A Study of Uncertainty in Corporate Taxation

William J. Rands

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# Section 356(a)(2): A Study of Uncertainty in Corporate Taxation

WILLIAM J. RANDS\*

*Section 356(a)(2) of the Internal Revenue Code requires the recipient of boot in a corporate reorganization to treat any gain recognized as a dividend, if the reorganization "has the effect of the distribution of a dividend." This article examines the conflicting interpretations of this section and offers suggested changes in the law. The article also reviews the performance of all three branches of government in developing tax law.*

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## I. INTRODUCTION

Section 356(a)(2) of the Internal Revenue Code (Code) is a bit of the arcanum that constitutes the federal tax treatment of corporate reorganizations. It requires the recipient of boot in a reorganization to treat any gain recognized as a dividend, if the reorganiza-

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\* Professor of Law, University of Cincinnati College of Law; J.D., Tulane University

tion "has the effect of the distribution of a dividend" to him.<sup>1</sup> Its proper construction has engendered conflicting opinions among the circuit courts of appeals<sup>2</sup> and shifting stances by the United States.<sup>3</sup> This conflict must be resolved. The Government<sup>4</sup> and the tax planners alike need to know what this section means. Yet, by examining the conflict over section 356(a)(2), we can achieve more than an understanding of the tax treatment of boot in corporate reorganizations. We can review the performance of all three branches of government in developing tax law; for each has contributed to creating the conflict over section 356(a)(2). Thus, the intent of this article is not only to analyze the narrow issue of what section 356(a)(2) means, but, additionally, to evaluate the aptitude or inaptitude, as the case may be, of Congress, the judiciary, and the Government in the development of section 356(a)(2).

#### A. Section 356(a)(2)'s Role in Corporate Reorganizations

"Reorganization" is part of the lexicon of tax lawyers that refers to transactions that meet the definitional requirements of section 368(a)(1) of the Code. This subsection covers a wide range of

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1. Section 356 of the Internal Revenue Code states in part:

(a) **Gain on Exchanges**

(1) **Recognition of gain**

If-

(A) section 354 or 355 would apply to an exchange but for the fact that

- (B) the property received in the exchange consists not only of property permitted by section 354 or 355 to be received without the recognition of gain but also of other property or money,

then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

(2) **Treatment as dividend**

If an exchange is described in paragraph (1) but has the effect of the distribution of a dividend (determined with the application of section 318(a)), then there shall be treated as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be treated as gain from the exchange of property.

I.R.C. § 356(a)(1)-(2) (1976 & West Supp. 1983).

2. Compare *Wright v. United States*, 482 F.2d 600 (8th Cir. 1973) (adopting hypothetical post-merger redemption test) with *Shimberg v. United States*, 577 F.2d 283 (5th Cir. 1978), cert. denied, 439 U.S. 1115 (1979) (rejecting *Wright* and adopting pre-merger distribution test). For a full discussion of the various tests used by the courts in interpreting section 356(a)(2), see *infra* text accompanying notes 106-40.

3. See *infra* text accompanying notes 203-29.

4. See *infra* note 203.

transactions—corporate amalgamations, corporate divisions, recapitalizations, and changes in identity, form, or place of incorporation.<sup>5</sup> Although exchanges of property generally trigger recognition of gain or loss,<sup>6</sup> section 354(a) provides for nonrecognition of gain or loss to taxpayers who exchange their stock or securities solely for other stock or securities as part of a transaction that qualifies as a reorganization under section 368(a)(1).<sup>7</sup> If the exchange of stock or securities would qualify for nonrecognition under section 354(a), except that the shareholder also receives boot (property other than stock or securities), then under section 356(a)(1) the shareholder recognizes gain equal to the lesser of the gain realized by him or the amount of boot received.<sup>8</sup> Section 356(a)(2) determines the character of the gain recognized. If the exchange has “the effect of the distribution of a dividend,” then the gain recognized is treated as a dividend to the extent of the shareholder’s ratable share of accumulated earnings and profits. The remainder of the gain, if any, is treated as a capital gain.<sup>9</sup>

Concomitantly, in a reorganization, a party receiving nonrecognition treatment substitutes his adjusted basis in the property he gives up for the property he receives, i.e., a shareholder’s adjusted basis in his new stock is the same as his basis in his old stock.<sup>10</sup> When the party receives boot, however, section 358 of the Code adjusts his basis.<sup>11</sup>

The theoretical underpinning for not recognizing realized gain in corporate reorganizations is that the shareholder (or transferor of assets) continues his investment in the corporate assets; thus, he

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5. I.R.C. § 368(a)(1)(A)-(G) (1976, Supp. V 1981 & West Supp. 1983). *See generally* B. BITTKER & J. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* ch. 14 (4th ed. 1979) (a comprehensive discussion of corporate reorganizations); D. KAHN, *BASIC CORPORATE TAXATION*, §§ 10.01-13 (3d ed. 1981) (a discussion on the nature, definition, and significance of classifying a transaction as a reorganization).

6. I.R.C. § 1001 (1976).

7. Section 354(a)(1) of the Internal Revenue Code states:

(a) **General rule**

(1) **In general**

No gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization.

I.R.C. § 354(a)(1) (1976).

8. I.R.C. § 356(a)(1) (1976).

9. I.R.C. § 356(a)(2).

10. I.R.C. § 358 (1976 & Supp. V 1981).

11. I.R.C. § 358(a)(1)(A)-(B).

merely alters the form of his investment, not the substance.<sup>12</sup> The carryover basis serves to defer taxation of an unrecognized gain or loss until a subsequent disposition of the stock. If the shareholder receives boot, however, he does more than continue his investment in an altered form: he has sold part of his stock or property and should be taxed on the gain realized to the extent of the boot received.<sup>13</sup> In some reorganizations, however, there may be a pro rata distribution of boot without an alteration in the proportionate interests of the shareholders, e.g., a recapitalization in which a 75% shareholder and a 25% shareholder receive 75% and 25% of the boot, respectively, and continue their respective percentages of stock ownership after the recapitalization.<sup>14</sup> In such a transaction, the distribution of the boot is indistinguishable from a dividend-type distribution and hence should be treated like a dividend to the extent the corporation has earnings and profits.<sup>15</sup> Section 356(a)(2)'s role is to tax these distributions of boot as dividends.

### B. 356(a)(2)'s Role in Subchapter C

Section 356(a)(2) is one of several sections in subchapter C that characterizes certain extractions from corporations as dividends, even though the transactions effecting the extractions may consist of sales or exchanges of stock and are not typical dividend-type distributions.<sup>16</sup> Similarly, section 356(a)(2) centralizes the

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12. *Shimberg v. United States*, 577 F.2d 283, 288 (5th Cir. 1978), *cert. denied*, 439 U.S. 1115 (1979); *Lewis v. Commissioner*, 176 F.2d 646, 648 (1st Cir. 1949); Golub, "Boot" in *Reorganizations—The Dividend Equivalency Test of Section 356(a)(2)*, 58 TAXES 904, 911 (1980).

13. Golub, *supra* note 12, at 912.

14. Cf. HOUSE COMM. ON WAYS AND MEANS, REPORT ON THE REVENUE BILL OF 1924 [TO ACCOMPANY H.R. 6715], H.R. REP. NO. 179, 68th Cong., 1st Sess. 14-15, 52 (1924), *reprinted in* 96 INTERNAL REVENUE ACTS OF THE UNITED STATES 1909-1950: LEGISLATIVE HISTORIES, LAWS, AND ADMINISTRATIVE DOCUMENTS (B. Reams Jr. ed. 1979) [hereinafter cited as H.R. REP. NO. 179]; SENATE COMM. ON FINANCE STATEMENT OF CHANGES MADE IN THE REVENUE ACT OF 1921 BY H.R. 6715 AND THE REASONS THEREFOR, S. REP. NO. 398, 68th Cong., 1st Sess. 6-7 (1924), *reprinted in* 96 INTERNAL REVENUE ACTS OF THE UNITED STATES 1909-1950: LEGISLATIVE HISTORIES, LAWS, AND ADMINISTRATIVE DOCUMENTS (B. Reams Jr. ed. 1979) [hereinafter cited as S. REP. NO. 398]. The reports contain legislative examples similar to that in the text.

15. The same shareholders own the same corporation in the same proportions before and after the distribution of the boot. For a discussion of what constitutes a dividend, see *infra* text accompanying notes 20, 75 and 163.

16. The other sections are 302(d), 304, 306, 356(b) and 356(e). Section 302(d) treats redemptions not meeting any of the section 302(a) tests as a section 301 distribution. I.R.C. § 302(d) (1976). Section 304 makes the sale of stock by a controlling shareholder to another controlled corporation, a transaction that may be the functional equivalent of a distribution, "run the gauntlet of § 302, with its attendant safeguards against dividend equivalency." B.

conflict between two basic tenets of corporate tax law: (i) distributions to shareholders by corporations with earnings and profits are dividends that result in ordinary income to the shareholders;<sup>17</sup> and (ii) sale or exchange of stock results in capital gain or loss.<sup>18</sup> Shareholders in corporations with earnings and profits constantly try to extract money from the corporation in ways that avoid classifying the extraction as a dividend. The purpose of section 356(a)(2) and these other sections is to exclude from capital gain treatment certain transactions, which, though ostensibly sales or exchanges of stock, nevertheless serve as a device to siphon earnings and profits to the shareholders.<sup>19</sup>

## II. THE BASIC TAX PROBLEMS

Although section 356(a)(2)'s intent is to prevent distributions of earnings and profits from receiving capital gains treatment, the section's ambiguous language has obscured its proper construction. Reorganizations involving boot may involve both a sale or exchange of property and an extraction of earnings and profits; each demands a different tax treatment. Section 356(a)(2)'s use of a dividend-effect test is often incongruous, at least in acquisitive reorganizations, because exchanges involving boot rarely resemble divi-

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BITTKER & J. EUSTICE, *supra* note 4, ¶ 9.31; see I.R.C. § 304 (1976 & West Supp. 1983). Section 306, the preferred stock bail-out section, treats part of the gain from the sale of tainted section 306 stock as ordinary income and treats the amount realized on a redemption of the tainted stock as a section 301 distribution. I.R.C. § 306 (1976, Supp. V 1981 & West Supp. 1983). Section 356(b) treats boot distributed in a section 355 transaction (a corporate division in which the stock of a subsidiary corporation is distributed to the shareholders) as a section 301 distribution. I.R.C. § 356(b) (1976). Section 356(e) treats any property received in exchange for section 306 stock in a reorganization or a section 355 transaction as a section 301 distribution. I.R.C. § 356(e) (1976).

Additionally, Code sections 341 and 1239 turn capital gain into ordinary income, but do not require the presence of earnings and profits. Section 341 denies capital gain treatment to certain distributions from and dispositions of collapsible corporations. I.R.C. § 341(a) (1976, Supp. V 1981 & West Supp. 1983). Section 1239 treats gain recognized on the sale or exchange of property between the shareholder and an 80%-owned corporation as ordinary income. I.R.C. § 1239(a),(b) (1976 & Supp. V 1981).

17. See I.R.C. §§ 301(c), 316(a) (1976).

18. Comment, *Determining Equivalence of "Boot" Received in a Corporate Reorganization*, 32 TAX LAW. 834, 835 (1979). The recognized gain on the sale of securities entitled the trader and investor to capital gain or loss: only the dealer is treated as receiving ordinary income. See 11B M. FRIED, BUSINESS ORGANIZATIONS—TAXATION OF SECURITIES TRANSACTIONS, §§ 2.04[1], 18.02 (1982).

19. H.R. REP. NO. 179, *supra* note 14, at 14-15; S. REP. NO. 398, *supra* note 14, at 6-7; Gerson, *Boot Dividends and the Automatic Rule: Bedford Revisited*, 11 WM. & MARY L. REV. 841, 844-45 (1970); Golub, *supra* note 12, at 905; Shoulson, *Boot Taxation: The Blunt Toe of the Automatic Rule*, 20 TAX L. REV. 573, 579 (1965).

dend-type distributions.<sup>20</sup> This inherent difficulty in applying section 356(a)(2) has led courts and commentators to propose contrived solutions. These solutions generally involve comparing the reorganization using boot with another transaction having an identical economic effect: the comparisons, however, are useless because a reorganization using boot has an economic effect identical to more than one type of transaction, and these comparable transactions often have contradictory tax consequences.

A. *Section 356(a)(2)'s Ambiguity and Lack of a Judicially Ascribed Definitive Meaning*

Section 356(a)(2) differs significantly from each of the other sections in subchapter C that excludes certain sales or exchanges of stock from capital gain treatment. Most of these other sections, excepting sections 302(b)(1)<sup>21</sup> and 302(b)(4) (as defined in 302(e)),<sup>22</sup> mechanically determine whether the gain recognized constitutes a dividend and, if so, the amount of that dividend.<sup>23</sup> Section 356(a)(2), on the other hand, uses "the effect of the distribu-

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20. See *infra* notes 29-35 and accompanying text.

21. I.R.C. § 302(b)(1) (1976).

22. I.R.C. § 302(b)(4), (e) (1976, Supp. V 1981 & West Supp. 1983). See *infra* note 50 for a discussion of partial liquidation as it appeared in section 346 prior to 1982.

23. For example, section 302(b)(2) prescribes percentage reductions in stock ownership, which, if met, result in exchange treatment for the redeemed shareholder. I.R.C. § 302(b)(2) (1976). For a more detailed discussion of section 302(b)(2), see *infra* note 71. Section 302(b)(3) provides exchange treatment for the completely redeemed shareholder. I.R.C. § 302(b)(3) (1976). In addition, section 304 is triggered when stock of one corporation is transferred to another corporation and the transferor controls both corporations; the statute uses the percentage of stock ownership to define control. I.R.C. § 304 (1976 & West Supp. 1983). See generally B. BITTKER & J. EUSTICE, *supra* note 5, ¶¶ 9.30-.32; D. KAHN, *supra* note 5, §§ 2.26, 8.21. Section 306, on the other hand, is a bit more complex. It requires a determination of the fair market value of the different classes of stock at the time the shareholder received the section 306 stock. I.R.C. § 306(a)(1)(A)(ii) (1976). The other key figure for section 306 is the earnings and profits of the corporation, a figure that is routinely computed. I.R.C. § 306(c) (1)(C)(2) (1976); see I.R.C. § 312 (1976, Supp. V 1981 & West Supp. 1983). Like section 304, section 1239's applicability is triggered by the percentage of stock owned. I.R.C. § 1239 (1976 & Supp. V 1981). Section 356(b) treats boot distributed in a section 355 transaction as a section 301 distribution, I.R.C. § 356(b) (1976), and section 356(e) treats any property received in exchange for section 306 stock in a reorganization or a section 355 transaction as a section 301 distribution. I.R.C. § 356(e) (1976).

Alternatively, like section 356(a)(2), section 341 is not objective. For example, it requires a finding that the shareholder intended to dispose of his stock before the corporation realized a substantial part of the income attributable to the property it manufactured. I.R.C. § 341(b)(1) (1976). Other parts of section 341 epitomize the incomprehensibility of the Internal Revenue Code. For a discussion of the labyrinth created by section 341, see Rands, *Closely Held Corporations: Federal Tax Consequences of Stock Transfer Restrictions*, 7 J. CORP. L. 449, 449 n.1 (1982).

tion of a dividend" language, an inexact phrase that makes us scurry to the legislative history and case law in an attempt to learn its meaning. Sections 302(b)(1) and 302(e), respectively the redemption and partial liquidation sections, use similar language—"not essentially equivalent to a dividend." Taxpayers and the Government have waged battle over the meaning of these sections for years.<sup>24</sup> Although the courts at last reduced the nebulous "not essentially equivalent" phraseology to definitive tests,<sup>25</sup> interpretation of section 356(a)(2) has not evolved that far. Thus, the courts have yet to agree on the meaning of section 356(a)(2)'s "effect of the distribution of a dividend" language.<sup>26</sup>

### B. *Dichotomous Nature of Reorganizations Using Boot*

A reorganization using boot involves a sale or exchange of property, a transaction that would ordinarily result in a capital gain or loss.<sup>27</sup> A reorganization using boot may, in addition, have the effect of a distribution of a dividend. This occurs when the boot recipient's corporation has earnings and profits, and the boot recipient continues his interest by accepting stock in the acquiring corporation. Accordingly, reorganizations using boot suggest dichotomous tax consequences: both capital gain and dividend treatment. This leaves to the taxpayer and the Government the difficult task of arguing before a court whether the sale or dividend aspect "predominate[s]."<sup>28</sup>

### C. *Incongruous Test of Section 356(a)(2)*

The purpose of section 356(a)(2)'s test is to determine whether boot received in a reorganization should result in ordinary income instead of capital gain.<sup>29</sup> The central problem with using a dividend-effect test to make that determination is that dividends usually involve a single corporation, while reorganizations typically involve at least two corporations. The dividend, as commonly

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24. D. KAHN, *supra* note 5, § 2.23.

25. The Supreme Court in *United States v. Davis*, 397 U.S. 301 (1970), settled the meaning of the "not essentially equivalent to a dividend" language in section 302(b)(1). See *infra* text accompanying notes 74-75 (discussion of *Davis*). Sections 302(b)(4) and 302(e) codify the corporate contraction doctrine that developed in pre-1954 cases, see, e.g., *Imler v. Commissioner*, 11 T.C. 836 (1948). See *infra* text accompanying notes 59-60, 62-63.

26. For an explanation of the current tests and an evaluation of the current cases and tests, see *infra* notes 106-39 and accompanying text.

27. See M. FRIED, *supra* note 18, §§ 2.04[1], 18.02.

28. *Wright v. United States*, 482 F.2d 600, 604 (8th Cir. 1973). See *infra* notes 96-105.

29. See *supra* note 19.



perceived, is a distribution to shareholders by a corporation with earnings and profits without any consequent change in the shareholders' proportionate interest in the corporation.<sup>30</sup> A dividend-effect test is well suited for redemptions, because the benchmark for testing dividend equivalency is whether there has been a meaningful reduction in the shareholders' proportionate interest in a single corporation. As a particular redemption either will or will not cause a meaningful reduction, the dividend-effect test works well in this context.

For most reorganizations, however—especially acquisitive reorganizations involving two corporations with previously unrelated shareholders—the dividend-effect test does not work well.<sup>31</sup> The test is inadequate because acquisitive reorganizations neither reduce nor preserve the shareholders' proportionate interest in a single corporation. Instead, they alter the investment of the shareholders in both corporations. At the very least, the shareholders will own stock—almost always in a lower proportion—in the amalgamated corporation, an entity different from the corporations in which they originally invested.

For example, in *Shimberg v. United States*,<sup>32</sup> the boot recipient was the majority shareholder in "a successful local company operating in several Florida counties."<sup>33</sup> After the reorganization he owned "a miniscule percentage [less than 1%] of the outstanding stock of a huge, publicly held corporation."<sup>34</sup> We cannot properly measure whether the reorganization preserved or reduced the boot recipient's proportionate interest in his corporation because after the reorganization he did not even own stock in the same corporation. Therefore, even though the boot recipient in *Shimberg*

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30. *United States v. Davis*, 397 U.S. 303, 313 (1970); *Hawkinson v. Commissioner*, 235 F.2d 747, 751 (2d Cir. 1956).

31. A dividend-effect test may fit nonacquisitive reorganizations (e.g., E or F reorganizations and even some acquisitive reorganizations (e.g., those between corporations with related shareholders). See *infra* text accompanying notes 117-18 (discussion of the bastardized *Wright* test) and text accompanying notes 122-35 (the discussion of nondivisive reorganizations and acquisitive reorganizations between corporations with a commonality of shareholders). Most of the cases and controversy enveloping section 356(a)(2), however, involve acquisitive reorganizations. Consequently, this article will focus primarily on acquisitive reorganizations.

32. 415 F. Supp. 832, 836 (M.D. Fla. 1976), *rev'd*, 577 F.2d 283 (5th Cir. 1978), *cert. denied*, 439 U.S. 1115 (1979).

33. *Id.* at 836.

34. *Id.*; see also *Sellers v. United States*, 42 A.F.T.R.2d (P-H) ¶ 78-5325, at 78-6197 (N.D. Ala. 1977), *rev'd*, 615 F.2d 1066 (5th Cir. 1980); *McDonald v. Commissioner*, 52 T.C. 82, 87-88 (1969).

did extract some cash from his corporation at a time when it had earnings and profits,<sup>35</sup> the dividend-effect test, relying as it does on either a reduction or preservation of the shareholder's proportionate interest in his corporation, offered no help in deciding whether this boot recipient's gain should have been taxed as a dividend or as a capital gain.

D. *Similarity in Economic Effect Between a Reorganization Using Boot and Other Transactions*

Courts and commentators often compare a reorganization using boot with other transactions having an identical economic effect and posit that section 356(a)(2) should result in the same tax consequences.<sup>36</sup> Using boot, the parties to a reorganization can achieve the same *nontax* consequences in the following transactions: coupling the reorganization with a distribution; coupling the reorganization with a sale of stock; or coupling the reorganization with a redemption.

For example, suppose that X Corp. has issued sixty shares of common stock, all of which are owned by A and which have both a book and a fair market value of \$10 per share.<sup>37</sup> Y Corp. has issued forty shares of common stock, all of which are owned by B and which have both a book and a fair market value of \$10 per share. X Corp. and Y Corp. have agreed to consolidate into XY Corp. with A and B each to own fifty of the 100 authorized shares of XY Corp. common stock. Because A and B will each own 50% of the XY Corp. stock and A has \$200 more invested in X Corp. than B has in Y Corp., the parties want to equalize the amount of money each shareholder will invest in XY Corp. by letting A take \$100 out and making B put \$100 in.<sup>38</sup> They can achieve this goal by using any of the following four transactions.

First, the plan of consolidation could provide that A is to be paid \$100 as part of the consolidation. A and B would each receive

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35. 415 F. Supp. at 834.

36. See, e.g., *Shimberg*, 577 F.2d at 288-89; *Wright v. United States*, 482 F.2d 600, 606-07 (8th Cir. 1973); Levin, Adess & McGaffey, *Boot Distributions in Corporate Reorganizations—Determination of Dividend Equivalency*, 30 TAX LAW. 287, 287-88 (1977) (reorganization coupled with a post-merger redemption); Shoulson, *supra* note 19, at 607-08 (reorganization coupled with a distribution).

37. Fair market value is not an appropriate measure of the shares' value because it is often difficult, if not impossible, to ascertain the fair market value of shares that are not publicly traded.

38. The parties could also require B to contribute \$200 while A refrains from taking out any boot. If they did, section 356(a)(2) would not apply because of the absence of boot.

fifty shares of XY Corp. stock. B would contribute \$100 either to Y Corp. before the consolidation or to XY Corp. after the consolidation. The \$100 paid to A would constitute boot.

Second, X Corp. could make a \$100 distribution to A before the consolidation. Alternately, XY Corp. could make a \$100 distribution to A after the consolidation. Again A and B would each receive fifty shares of XY Corp. stock, and B would contribute \$100 either to Y Corp. before the consolidation or to XY Corp. after the consolidation.

Third, A could sell ten X Corp. shares to B for \$100 before the consolidation. A and B would each receive fifty shares of XY Corp. stock. Alternatively, A and B could receive sixty and forty shares of XY Corp. stock, respectively, and then B could buy ten shares of XY Corp. stock from A for \$100 after the consolidation.

Fourth, X Corp. could redeem ten of its shares from A for \$100 before the consolidation. Again, A and B would each receive fifty shares of XY Corp. stock, and B would contribute \$100 either to Y Corp. before the consolidation or to XY Corp. after the consolidation. Alternatively, XY Corp. could redeem ten of its shares from A for \$100 after the consolidation. A and B would receive sixty and fifty shares of XY Corp. stock, respectively, and B would contribute \$100 either to Y Corp. before the consolidation or to XY Corp. after the consolidation.

The economic consequences of all four of these transactions, before taxation, are identical. X Corp. and Y Corp. are consolidated into XY Corp. A and B each own fifty shares of XY Corp. stock after the transaction. A receives \$100, and B pays \$100. For purposes of analysis, if the payment to A is considered to be separate and independent from the reorganization, the last three transactions result in divergent tax consequences for A. The *distribution* results in a dividend to the extent covered by the earnings and profits of the distributing corporation.<sup>39</sup> The *sale* results in a capital gain or loss.<sup>40</sup> If the *redemption* precedes the reorganization, it results in a dividend to the extent covered by the earnings and profits of X Corp.<sup>41</sup> If the *redemption* follows the reorganization, the change in status from majority to fifty percent shareholder should qualify as a meaningful reduction in the share-

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39. I.R.C. §§ 301(c), 316 (1976 & Supp. V 1981).

40. See M. FRIED, *supra* note 18, at §§ 2.04[1], 18.02.

41. Redemptions of any shares owned by a sole stockholder always result in dividend treatment; the redemption cannot reduce the stockholder's proportionate interest in the corporation. *United States v. Davis*, 397 U.S. 301, 313 (1970).

holder's proportionate interest in the corporation, and thus result in a capital gain or loss.<sup>42</sup>

The focus on the identity in economic effect between reorganizations using boot and one of these other three transactions is scarcely a persuasive ground for adopting any particular approach to section 356(a)(2). A reorganization using boot resembles not just one but all three of these transactions, and each of the three can result in contradictory tax consequences.

### III. THE CONGRESSIONAL ROLE

#### A. *The Statutory Language*

Section 356(a)(2) is an example of a prototypical subchapter C section—unnecessarily vague and cryptic. Some writers suggest that Congress in 1924 misapprehensively drafted this section's limitation on recognized gain to the extent of boot or realized gain, whichever is less.<sup>43</sup> Writers also have characterized the 1954 reenactment of section 356(a)(2) as hasty and without proper consideration of past difficulties, therefore failing to resolve the section's ambiguities.<sup>44</sup> In addition, the confusion and uncertainty in applying the dividend-effect language of section 356(a)(2) has been the subject of continuous litigation and controversy.<sup>45</sup>

Section 356(a)(2) suffers from syntactical as well as semantical errors. Much of the ambiguity in the dividend-effect language of section 356(a)(2) results from violations of the drafting rule of parallelism. According to this rule, when the draftsman uses the same

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42. I.R.C. § 302(b) (1976); see, e.g., Rev. Rul. 78-401, 1978-2 C.B. 127 (although redemption substantially reduced a stockholder's right to participate in current earnings, accumulated surplus, and right to share in net assets in liquidation (from 90 to 60 percent), it did not constitute a meaningful reduction in the interest in the corporation because the voting rights were not reduced to 50 percent or less); see also *infra* note 118.

43. Samansky, *Taxation of Nonqualifying Property Distributed in Reorganizations*, 31 CASE W. RES. 1, 11 (1980); Shoulson, *supra* note 19, at 578-79. A shareholder receiving boot has dividend income only if, and to the extent that, he has realized a gain on the exchange. I.R.C. § 356(a)(2). See B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 14.34; D. KAHN, *supra* note 5, at § 10.51.

44. Samansky, *supra* note 43, at 11, 33; Note, *Boot Hill—Characterizing Property Distributed with Corporate Reorganizations*, 4 J. CORP. L. 711, 722 (1979).

45. Golub, *supra* note 12, at 905. Commentators have noted the confusion surrounding the dividend-effect language. Ayers & Repetti, *Boot Distributions Under the '54 Tax Code*, 32 NOTRE DAME LAW. 414, 422 (1957); Hurley, *Capital Gain Possibilities for Boot in Acquisitive Reorgs Lessened by Shimberg Case*, 50 J. TAX'N 334, 334 (1979) (the "courts have tumbled into confusion and uncertainty"); Note, *Reorganization and Capital Gains—A Forgotten Concept?*, 41 U. PITT. L. REV. 291, 296 (1980) (describes the language as "metaphysical").

language in two different places, the reader assumes that the writer intended the same meaning. When the draftsman uses clearly different language, the reader assumes that the draftsman intended different meanings. When the draftsman merely uses similar language in two places, the reader must speculate whether or not the slight change in language reflects an intentional change in meaning.<sup>46</sup> The reader may or may not think the draftsman intended parallel meanings, but the differing language will leave him with a residue of doubt.

For example, sections 356(a)(2), 302(b)(1), and 302(b)(4) (as defined in section 302(e))<sup>47</sup> resemble one another in purpose, and use similar language. Each section provides a statutory test for characterizing gain recognized on certain exchanges of stock either as a capital gain or a dividend—section 356(a)(2) for reorganizations involving boot,<sup>48</sup> section 302(b)(1) for redemptions,<sup>49</sup> and section 302(b)(4) for redemptions occurring pursuant to partial liquidations. The language of the tests in sections 302(b)(1) and 302(b)(4) states that gain is not a dividend, if it is “not essentially equivalent to a dividend.”<sup>50</sup> This language differs from section 356(a)(2)’s “effect of the distribution of a dividend.” Because of a similarity of language and purpose, however, some writers<sup>51</sup> and

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46. R. DICKERSON, MATERIALS ON LEGAL DRAFTING 168-71 (1981); W. STRUNK & E.B. WHITE, THE ELEMENTS OF STYLE 26-27 (3d ed. 1979); R. WYDICK, PLAIN ENGLISH FOR LAWYERS 57-59 (1979).

47. Section 302(b)(4) provides that redemptions in partial liquidations are treated as exchanges to the shareholder. I.R.C. § 302(b)(4) (West Supp. 1983). Section 302(e) defines partial liquidations by using the “essentially equivalent to a dividend” language. I.R.C. § 302(e) (West Supp. 1983); see *infra* note 50.

48. See *supra* note 1 and text accompanying note 9.

49. Section 302(a)(1) states that the redemption shall be treated as an exchange to the shareholder if it meets any of the tests of section 302(b). I.R.C. §§ 302(a), (b) (1976, Supp. V 1981 & West Supp. 1983). Otherwise, the redemption shall be treated as a distribution. I.R.C. § 302(d) (1976).

50. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in scattered sections of 26 U.S.C.), altered the rules for partial liquidations. The rules in pre-TEFRA section 346(a)(2) are now embodied in section 302(b)(4) and are defined in section 302(e)(1)(A). In addition, there are some changes. These changes include limiting the benefit of this provision only to noncorporate distributees and explicitly distinguishing the application of the semantically identical “essentially equivalent to a dividend” test between subsections (1) and (4) of § 302(b). This latter change mitigates some of the confusion over the parallelism in drafting and incongruity in application. Section 302(e)(1)(A) parenthetically provides that the test is determined at the corporate level rather than at the shareholder level. The explicit statutory distinction between section 302(b)(1)’s test for redemptions and section 302(b)(4)’s test for partial liquidations merely codified the existing law.

51. See, e.g., B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 14.34; D. KAHN, *supra* note 5, § 10.51; Moore, *Taxation of Distributions Made in Connection with a Corporate Reorganiza-*

courts<sup>52</sup> apply a similar analysis to construe all three provisions, especially sections 356(a)(2) and 302(b)(1).<sup>53</sup> Yet, why did Congress use language that differs at all, if it meant to say exactly the same thing? The use of different language implies that the sections have somewhat different, even if only slightly different, meanings. If Congress wanted to make the same statement in sections 302(b)(1) and 356(a)(2), why did it not provide explicit statutory coordination between the provisions?

The problems with parallelism in subchapter C stem partly from the patchwork approach of Congress to the Code. The Internal Revenue Service (Service) points out a loophole to Congress, and Congress tries to patch it. Or Congress tries to ameliorate unexpectedly harsh tax consequences occasioned by judicial or administrative interpretation of a single Code section. The result is an ad hoc revision of one or two sections of the Code. Many sections in subchapter C have as their antecedents ad hoc responses by Congress to singular problems.<sup>54</sup> These sections have histories apart from the rest of subchapter C, and Congress has perpetuated these peculiarities through successive reenactments of the Code.

Sections 302(b)(1), 302(b)(4), and 356(a)(2) illustrate this patchwork process for treatment of corporate distributions. Congress first used the "essentially equivalent" language in the Revenue Act of 1921<sup>55</sup> as a response to *Eisner v. Macomber*.<sup>56</sup> At that time, all redemptions resulted in capital gain or loss. Congress feared that corporations would issue stock dividends and then promptly redeem the stock issued, thereby allowing the shareholder to extract earnings and profits at capital gains rates. Congress sought to thwart this scheme by providing statutory author-

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tion, 17 TAX L. REV. 129, 147 (1961); Comment, *Taxation of Boot Received During Acquisitive Reorganization: Dividend v. Capital Gains*, 13 U. RICH. L. REV. 621, 627 n.31 (1979). But see *infra* notes 64-65 and accompanying text.

52. See *Wright v. United States*, 482 F.2d 600, 605 (8th Cir. 1973); *Hawkinson v. Commissioner*, 235 F.2d 747, 751 (2d Cir. 1956); *Ross v. United States*, 173 F. Supp. 793, 797 (Ct. Cl.), cert. denied, 361 U.S. 875 (1959). But see *infra* notes 64-65 and accompanying text.

53. Most writers focus on the § 302 tests in connection with § 356(a)(2), but a few also mention the partial liquidation rules. See, e.g., Samansky, *supra* note 43, at 17; Note, *supra* note 44, at 743-44.

54. For example, Congress enacted section 341 to quash the tax-avoidance device of collapsible corporations. See generally B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 12.01.

55. Revenue Act of 1921, § 201(d), 42 Stat. 227, 228-29.

56. 52 U.S. 189 (1920). This case presented the question whether, by virtue of the sixteenth amendment, Congress has the power to tax, as income to the stockholder, a stock dividend made in good faith against earnings and profits. The *Eisner* court held that receipt of a stock dividend was not a taxable event to the stockholder.

ity for the Government and the courts to denominate such redemptions as dividends.<sup>57</sup> In the 1954 Code, the then existing case law on partial liquidations was codified in section 346(a)(2).<sup>58</sup> Congress intended the "not essentially equivalent to a dividend" language of that section to allow exchange treatment for redemptions accompanied by a contraction of the corporate business.<sup>59</sup> Sympathetic courts had accepted the corporate contraction doctrine to soften the harshness of the aphorism that all pro rata redemptions are dividends.<sup>60</sup> Similarly, section 356(a)(2)'s antecedent was the congressional response to tax avoidance devices fraught with bail-out possibilities.<sup>61</sup>

The parallelism problem also stems partly from the failure of Congress to coordinate the language of proposed Code sections with the language of existing Code sections. Even if the new sections are ad hoc responses to redress singular problems, Congress nevertheless should harmonize the language of the new and old sections. When Congress reenacted the Code in 1939 and again in 1954, it missed the opportunity to correct the ambiguities in the language of subchapter C. For example, the use of "not essentially equivalent to a dividend" in section 302(e) is dumbfounding. Although the legislative history clearly shows that Congress intended to codify the contraction of corporate business doctrine into present section 302(b)(4),<sup>62</sup> the definitional language of section 302(e) in no way connotes this. Furthermore, Congress intended a completely different meaning for that phrase in section 302(e)(1)(A) than it did for the identical phrase in section 302(b)(1).<sup>63</sup>

The inexact resemblance of the language of section 356(a)(2) to that of sections 302(b)(1) and 302(e) has caused a disagreement

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57. See B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 9.02.

58. See *id.* ¶ 9.52; D. KAHN, *supra* note 5, § 2.32.

59. See *supra* note 58.

60. Cf. B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 9.52(1); W. HOFFMAN, WEST'S FEDERAL TAXATION: CORPORATIONS, PARTNERSHIPS, ESTATES, AND TRUSTS 161 (1981).

61. A typical pre-section 356(a)(2) tax avoidance device was a merger of a corporation with high earnings and profits into a newly created corporate shell owned by the same shareholders in the same proportion.

62. See S. REP. NO. 1622, 83d Cong., 2d Sess. 49, 262, *reprinted in* 1954 U.S. CODE CONG. & AD. NEWS 4621, 4680, 4899-900. See generally B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 9.52.

63. Section 302(e)(2)(A) defines the test for section 302(b)(4). For a discussion of 302(b)(4), see *supra* note 50. For a discussion of section 302(b)(1), see *infra* note 73 and the text accompanying notes 69-75. Curiously, sections 302(b)(1) and 302(b)(4), though relying on identical language, make us take differing vantage points to review the transactions. Section 301(b)(1) looks at what happens to the shareholder. Section 302(b)(4) looks at what happens to the corporation. See D. KAHN, *supra* note 5, § 2.23.

among courts<sup>64</sup> and writers<sup>65</sup> as to when, and even whether, the tests developed for sections 302(b)(1) and 302(b)(4) apply to a section 356(a)(2) transaction. This interpretative problem may have even confused the Government, which has taken several different positions.<sup>66</sup>

Section 356(a)(2) exemplifies the drafting technique of "conscious generality."<sup>67</sup> The draftsman knows that the conduct to be regulated consists of so many variants and permutations that detail in description is not merely cumbersome but impossible. Moreover, an attempt to detail every covered situation runs the risk of fitting within the maxim *expressio unius est exclusio alterius*.<sup>68</sup> Instead of detail, the draftsman uses general terminology that, he hopes, is not too indefinite to regulate the proscribed conduct, but is sufficiently flexible to accommodate administrative and judicial treatment of the unforeseen permutations and variants. Conscious generality, however, often provides too little guidance for the administrators and for the persons whose conduct will be regulated. In tax law, this causes the Service to take a stance and some members of the bar to take a counterstance, forcing the courts to flesh out the meaning of the statutory language in common law fashion. These courtroom confrontations may result in stimulating frays for both government and private counsel, and provide for intellectual debate among academics, but they place the taxpayer in the dolorous position of having to litigate how much tax he must pay. After years of confrontations, the courts often forge the general terminology into a term of art with a relatively definitive meaning. In most cases, this clarification occurs too late for the beleaguered taxpayers who are the subjects of the courtroom battles.

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64. Compare *Wright v. United States*, 482 F.2d 600, 605 (8th Cir. 1973) with *Shimberg* 577 F.2d at 287.

65. Compare *Gerson*, *supra* note 19, at 865 and *Levin, Adess & McGaffey*, *supra* note 36, at 307 with *Golub*, *supra* note 12, at 912 and *Samansky*, *supra* note 43, at 48.

66. At various times the Government has espoused the automatic dividend rule, the applicability of the principles of section 302(b), a pre-merger redemption test, and a pre-merger distribution test. See *infra* text accompanying notes 208-09, 222-26, and 228-29. Sometimes the Government has tried to avoid the reapplicability of section 356(a)(2) altogether by characterizing the distribution of boot as being a transaction completely apart from the reorganization. See, e.g., *King Enterprises, Inc. v. United States*, 418 F.2d 511, 512, 518 (Ct. Cl. 1969). For a discussion of the various stances taken by the IRS, see *infra* text accompanying notes 206-33.

67. Professor Irving Rutter used the term "conscious generality" in his seminal work on teaching legal drafting in law schools. See *Rutter, A Jurisprudence of Lawyers' Operations*, 13 J. LEGAL EDUC. 301, 346 (1961).

68. "[T]he expression of one thing is the exclusion of another." BLACK'S LAW DICTIONARY 521 (5th ed. 1979).



Section 302(b)(1), a close cousin of section 356(a)(2), is a prime example of the problem of conscious generality. Section 302(b)(1)'s "not essentially equivalent to a dividend" served as the sole statutory guidance in deciding tax treatment of redemptions for more than thirty years preceding the 1954 Code.<sup>69</sup> This paragraph has spawned a group of more definitive tests that courts have used to decide redemption cases on more than an ad hoc basis. Different courts have considered so many disparate factors in deciding the redemption cases that these tests have been referred to as the "witch's brew."<sup>70</sup> Although in the 1954 Code Congress discarded conscious generality in part by enacting the safe harbors of sections 302(b)(2) and (3)<sup>71</sup> and 346(b),<sup>72</sup> it nevertheless was unable to break with the past completely and retained the ambiguous "not essentially equivalent to a dividend" language.<sup>73</sup> Finally, in 1970, the Supreme Court in *United States v. Davis*<sup>74</sup> held that a redemption is "not essentially equivalent to a dividend," if it results in a "meaningful reduction in the shareholder's proportionate interest in the corporation."<sup>75</sup> Thus, the Court created a uniformly accepted meaning for this phrase.

The status of section 356(a)(2) is similar to that of section 302(b)(1) prior to the *Davis* decision: the circuit courts of appeals

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69. B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 9.01.

70. *Id.* ¶ 9.02.

71. Section 302(b)(2) allows exchange treatment for "substantially disproportionate" redemptions. To qualify, the shareholder must own less than 50% of the total combined voting power of all classes of stock entitled to vote immediately after the redemption; the ratio of voting stock he owns immediately after the redemption must be less than 80% of the ratio of voting stock that he owned immediately before the redemption; and the ratio of common stock he owns immediately after the redemption must be less than 80% of the common stock he owned immediately before the redemption. I.R.C. § 302(b)(2) (1976). Section 302(b)(3) allows exchange treatment for a redemption of all of the shareholder's stock. I.R.C. § 302(b)(3) (1976).

72. Section 331(a) and 346(b) provided for exchange treatment to the shareholder for a redemption accompanied by the termination of an active trade or business by a corporation engaged in two or more active trades or businesses. I.R.C. §§ 332(a), 346(b) (1976). As amended by TEFRA, Pub. L. No. 97-248, 96 Stat. 324 (codified as amended in §§ 331(a) and 302(b)(4) (West Supp. 1983)), section 332(a) and section 302(b)(4), which embodies pre-TEFRA section 346(a), still provide exchange treatment for certain corporate distributions.

73. Congress retained the "not essentially equivalent to a dividend" language in section 302(b)(1) to allow capital gain treatment for redemptions of a part of a preferred shareholder's stock. Section 302(b)(2) does not apply to such redemptions because it is limited to voting stock. See B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 9.24. Section 302(b)(1), however, is not limited to preferred or nonvoting stock. Taxpayers use it as a last resort after failing to meet the mechanical standards of sections 302(b)(2) and (3).

74. 397 U.S. 301 (1970).

75. *Id.* at 313.

are in conflict,<sup>76</sup> and the academic commentators disagree on a resolution.<sup>77</sup> Although the offending phrase—essentially equivalent to a dividend—has been part of the tax law for nearly sixty years,<sup>78</sup> the courts have yet to decipher its full meaning.<sup>79</sup>

### B. Legislative History

In 1945, in *Commissioner v. Estate of Bedford*,<sup>80</sup> Justice Frankfurter sought interpretative guidance from the legislative history of section 356(a)(2)'s predecessor<sup>81</sup> to try to resolve the ambiguity of the statutory language. The Justice ruefully concluded that "[t]he history of this legislation is not illuminating."<sup>82</sup> The legislative history of section 356(a)(2), though now more extensive, remains ambiguous, a fact that is readily apparent when one reviews the varying interpretations it has engendered.<sup>83</sup>

The legislative history of section 356(a)(2) does shed light on the problems Congress encounters in formulating corporate tax laws. Prior to 1924, gains recognized on account of boot were taxed at capital gains rates. This statutory regime left the way open for the distribution of dividends under the guise of boot when the distribution was coupled with reorganization.<sup>84</sup> To explain the prob-

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76. Compare *Wright v. United States*, 482 F.2d 600, 600 (8th Cir. 1973) with *Shimberg*, 577 F.2d at 283.

77. Compare Samansky, *supra* note 43, at 48, with Golub, *supra* note 12, at 911, 913 and Hurley, *supra* note 45, at 338.

78. Section 356(a)(2) embodies section 203(d) of the Revenue Act of 1924, ch. 234, § 203(d), 43 Stat. 253, 257. Samansky, *supra* note 43, at 9-10 & n.38.

79. There remain numerous interpretations of section 356(a)(2)'s "effect of the distribution of a dividend" language. For a discussion of the current interpretations, see *infra* text accompanying notes 96-140.

80. 325 U.S. 283, 290 (1945).

81. See *infra* note 102.

82. *Estate of Bedford*, 325 U.S. at 290.

83. For example, one writer contends that the legislative history "shows that Congress has continually and completely rejected all notions that the receipt of other property in a reorganization should be considered as occurring 'without the reorganization.'" Golub, *supra* note 12, at 906 (footnote omitted). Another commentator, presumably as rational and perceptive as the first, claims that the legislative history shows that Congress intended boot to be viewed as a substitute for distribution by the transferor corporation prior to the reorganization. Samansky, *supra* note 43, at 34-36; see also Shoulson, *supra* note 19, at 579, 608; Note, *supra* note 44, at 720 n.78, 738; Graduate Tax Paper, *Book Distributions in Corporate Reorganizations: Dividend Equivalence and the Continuity of Interest Doctrine*, 32 U. FLA. L. REV. 119, 131 (1979). *Shimberg* stated that "the legislative history of § 356(a)(2)'s predecessor statute makes clear that a distribution that would have been a dividend if made prior to the reorganization is subject to the same treatment when made as part of the transaction." 577 F.2d at 288.

84. Moore, *supra* note 51, at 131.

lem, the committee report on the 1924 legislation offered an illustration:

The necessity for this provision may best be shown by an example: Corporation A has capital stock of \$100,000, and earnings and profits accumulated since March 1, 1913, of \$50,000. If it distributes the \$50,000 as a dividend to its stockholders, the amount distributed will be taxed at the full surtax rates.

On the other hand, corporation A may organize Corporation B, to which it transfers all its assets, the consideration for the transfer being the issuance by B of all its stock and \$50,000 in cash to the stockholders of corporation A in exchange for their stock in corporation A. Under the existing law, the \$50,000 distributed with the stock of corporation B would be taxed, not as a dividend, but as capital gain . . . . The effect of such a distribution is obviously the same as if the corporation had declared out as a dividend its \$50,000 earnings and profits. If dividends are to be subject to the full surtax rates, then such an amount so distributed should also be subject to the surtax rates . . . . [T]his provision prevents evasion.<sup>85</sup>

Accordingly, Congress sought to resolve the problem by taxing as a dividend any distribution connected with the reorganization that had the effect of a dividend. This language remains substantially unchanged in today's statute. The patchwork legislation of section 356(a)(2) did not fully resolve the problem of dividend equivalency, because it taxed only the gain on the transaction as a dividend rather than the full value of the boot to the extent covered by earnings and profits. As one writer suggests,

It should have been apparent that the problems of dividend equivalency could not be met by a statutory amendment directed only toward taxing the *gain* on the transaction as a whole at ordinary rather than capital gains rates. Yet this is precisely what section 203(d)(2) of the 1924 Act [did] . . . .<sup>86</sup>

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85. H.R. REP. No. 179, *supra* note 14, at 15; see also S. REP. No. 398, *supra* note 14, at 7.

86. Moore, *supra* note 51, at 131 (emphasis added). To illustrate the gain limitation, let us suppose that X Corp. completed a recapitalization that amounted to an E Reorganization under section 368(a)(1)(E) of the Code. As part of the recapitalization, X Corp. distributed boot of \$500 to A, one of its shareholders. A realized a gain of \$100. Before and after the transaction X Corp. had accumulated earnings and profits of \$20,000. According to sections 356(a)(1) and (2), A's recognized gain and, therefore, the amount of the dividend to him is limited by the amount of the boot received. Thus, though he received \$500 from a corporation with earnings and profits of \$20,000, his recognized gain and the dividend to him nevertheless will be only \$100. The other \$400 he received remains unrecognized. If there had been no reorganization and he had received a distribution of \$500 from X Corp., the full

Since boot was taxed only to the extent of gain, and provided that it did not exceed the distributee's ratable share of accumulated earnings and profits, some or all of the boot covered could escape dividend treatment.<sup>87</sup> Further, in 1924 Congress was unaware of the obverse problem of whether the gain recognized on account of boot should be treated as a dividend to the extent of gain merely because of the existence of earnings and profits. This issue arose as a result of the Supreme Court's decision in *Estate of Bedford*.<sup>88</sup>

The 1924 statute and its legislative history left a host of conflicting inferences. The committee reports show that Congress was concerned with the siphoning off of corporate earnings at capital gains rates.<sup>89</sup> Yet the statute's dividend-within-gain limitation and failure to refer to current earnings and profits allowed some corporate earnings to escape dividend treatment. The example in the committee report consists of a transaction clearly designed for tax avoidance. Yet the statute does not limit dividend treatment to tax avoidance schemes or transactions without a bona fide business purpose. Moreover, the example consists of a transaction involving not an amalgamation of unrelated corporations, but a nonacquisitive transaction in which it is possible to measure the reduction of the shareholders' interest. The statute, however, does not distinguish between acquisitive and nonacquisitive reorganizations.

In 1954, the House proposed to remove the limitations based on gain and ratable shares of earnings and profits and to treat the boot as a distribution made to the shareholder prior to the reorganization. The House wanted to "correlate the treatment of such 'boot' distributions to shareholders . . . with other distributions of money or property made directly by the corporation to its shareholders."<sup>90</sup> The House Committee wanted to "'eliminate the inconsistencies existing under present law, between the operations of Sections [301 and 356].'"<sup>91</sup> The House proposed to eliminate the dividend-effect language and to incorporate the disproportionate

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\$500 would have been taxable to A as a dividend under sections 301 and 316.

87. Samansky, *supra* note 43, at 11 n.43.

88. Moore, *supra* note 51, at 130.

89. S. REP. NO. 398, *supra* note 14, at 7 ("The provisions of the reorganization section of the present law have been rewritten to prevent the use of this section to escape proper taxation . . . by distributing as capital gains what are in effect dividends out of earnings.").

90. Golub, *supra* note 12, at 906 (quoting H.R. REP. NO. 1337, 83d Cong., 2d Sess. A119, reprinted in 1954 U.S. CODE CONG. & AD. NEWS 4017, 4257); see also Note, *supra* note 44, at 724.

91. Note, *supra* note 44, at 724 (quoting H.R. REP. NO. 1337, 83d Cong., 2d Sess. A119, reprinted in 1954 U.S. CODE CONG. & AD. NEWS 4017, 4257).

reduction test now a part of section 302(b)(2).<sup>92</sup> The section 302(b)(2) measurement was to be applied by reference to the percentage of stockholdings among the former shareholders of the acquired corporation only, and not among all the shareholders of the amalgamated corporation.<sup>93</sup> The Senate rejected the House proposal, returning to "existing law,"<sup>94</sup> i.e., retaining the law with respect to boot as it had been since 1924. In 1959, Congress again reviewed but rejected a proposed change in section 356(a)(2). This proposed change would have caused the recipient of boot to be "taxed as if the distribution were made by a corporation without a reorganization occurring."<sup>95</sup>

The House proposals reflect a greater understanding of the errors in the original legislation and the problems with the dividend-effect language. Unfortunately, in its haste to enact the 1954 Code, the Senate bypassed the chance for a thorough review of the dividend-effect language. It also bypassed the opportunity to eliminate a longstanding troublespot from subchapter C.

#### IV. THE COURTS: CASE LAW

When reading judicial opinions on tax issues, the perspicacious

92. The language of the proposed subsections was as follows:

(1) DISTRIBUTIONS NOT SUBSTANTIALLY DISPROPORTIONATE—In the case of a distribution not substantially disproportionate within the meaning of section 302(a)(4) [now § 302(b)(2)] the amount of money plus the fair market value of other property distributed shall be treated as provided in section 301 relating to corporate distributions of property.

(2) SUBSTANTIALLY DISPROPORTIONATE DISTRIBUTIONS—In the case of a distribution of property which is substantially disproportionate within the meaning of section 302(a)(4) [now § 302(b)(2)] . . . no loss shall be recognized and gain shall be recognized only to the extent of the amount of money and the fair market value of other property.

Note, *supra* note 44, at 724 n.106 (quoting H.R. 8300, 83d Cong., 2d Sess. § 306 (1954)).

93. The language of the proposed subsection was as follows:

(3) SPECIAL RULE—The determination of whether a distribution is substantially disproportionate within the meaning of section 302(a)(4) [now § 302(b)(2)] shall be made by reference to the shareholders of the corporation in which the shareholder held stock immediately prior to the transaction and by reference to the participating stock received in the transaction (or held, as the case may be) by all of such shareholders.

*Id.*

94. Note, *supra* note 44, at 725 n.107; see S. REP. No. 1622, 83d Cong., 2d Sess. 51, reprinted in 1954 U.S. CODE CONG. & AD. NEWS 4621, 4682; Golub, *supra* note 12, at 906.

95. Golub, *supra* note 12, at 906 (footnote omitted); see STAFF OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 85TH CONG., 2D SESS., SUMMARY OF THE SUBCHAPTER C ADVISORY GROUP RECOMMENDATIONS ON CORPORATE DISTRIBUTIONS AND ADJUSTMENTS 9 (Comm. Print 1959).

cious reader often can detect the opinion writer's lack of comfort with tax law. Sometimes statements such as "this area of the law is especially complex" evince this uneasiness. The opinion writer may award undue deference to commentators,<sup>96</sup> or even to counsel appearing before it ("we would like to thank counsel for their excellent briefs that clarified the issues of this case").<sup>97</sup>

One senses this lack of confidence in the 1945 Supreme Court opinion in *Estate of Bedford*.<sup>98</sup> Justice Frankfurter, writing for the Court, was "thrown back" to the language of the statute when he was unable to gain interpretative help from the legislative history.<sup>99</sup> Immediately following a declaration of the Court's holding, Justice Frankfurter expressed this thought:

As is true of other teasing questions of construction raised by technical provisions of Revenue Acts the matter is not wholly free from doubt. But these doubts would have to be stronger than they are to displace the informed views of the Tax Court. And if the case can be reduced to its own particular circumstances rather than turn on a generalizing principle we should feel bound to apply *Dobson v. Commissioner* . . . and sustain the Tax Court.<sup>100</sup>

Such nonassertive writing hardly instills confidence in the ability of courts to formulate tax law. Yet, despite Justice Frankfurter's reluctance to promulgate a "generalizing principle," *Estate of Bedford* served for many years as authority for the Service's adherence to the automatic dividend rule.<sup>101</sup> According to this rule, if the distributing corporation has earnings and profits, the gain recognized

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96. The Fifth Circuit in *General Housewares Corp. v. United States*, 615 F.2d 1056, 1061 n.10 (5th Cir. 1980), conceded indebtedness to several writers for their "perceptive and comprehensive analysis of the issues before us" and for an "excellent critique of the *FEC* decision."

97. In *Shimberg*, the Fifth Circuit stated that "[t]his case is obviously a complex one, and the court was aided by the excellent briefs and argument of both parties." 577 F.2d at 290-91 n.20.

98. 325 U.S. 283 (1945).

99. *Id.* at 290.

100. *Id.* at 292 (citation omitted).

101. The Government advocated the applicability of the automatic dividend rule in numerous cases. See, e.g., *Wright v. United States*, 482 F.2d 600, 604 n.7 (8th Cir. 1973); *Babcock v. Phillips*, 372 F.2d 240, 243 (10th Cir.), cert. denied, 387 U.S. 918 (1967); *Commissioner v. Morgan*, 288 F.2d 676, 677-78 (3d Cir.), cert. denied, 368 U.S. 836 (1961); *Hawkinson v. Commissioner*, 235 F.2d 747, 750 (2d Cir. 1956); *Estate of Hill v. Commissioner*, 10 T.C. 1090, 1096 (1948). Revenue Ruling 56-220, 1956-1 C.B. 191, espousing the IRS's adherence to the rule, remained the official stance until 1974. See *infra* note 105 and accompanying text.

on account of boot is "automatically" a dividend.<sup>102</sup> Criticized by commentators<sup>103</sup> and ultimately rejected by the courts,<sup>104</sup> the rule was formally abandoned by the Service in 1974.<sup>105</sup> Now in its place are the four rules discussed below, three of them clearly in conflict.

### A. The Current Tests

#### 1. HYPOTHETICAL POST-MERGER REDEMPTION (THE *Wright* TEST)

In *Wright v. United States*,<sup>106</sup> the United States Court of Appeals for the Eighth Circuit used a hypothetical post-merger redemption to decide the character of gain according to section 356(a)(2).<sup>107</sup> The *Wright* test begins with the supposition that the

102. The Supreme Court in *Estate of Bedford*, 325 U.S. at 292, held "that a distribution, pursuant to a reorganization, of earnings and profits 'has the effect of a distribution of a taxable dividend' within § 112(c)(2)" (antecedent of I.R.C. § 356(a)(2)).

103. The following are a few of the many remarks directed at *Bedford* and the automatic dividend rule. The automatic dividend is "now infamous" and "subject to extensive criticism." Graduate Tax Paper, *supra* note 83, at 152 (footnote omitted). It is a "Blunt Toe," and *Bedford* is a "CANNON USED TO KILL A MOUSE." Shoulson, *supra* note 19, at 573. The "obfuscatory opinion" in *Bedford* "led to unresolved controversy." Comment, *supra* note 51, at 625 (citations omitted). *Bedford* led to "harsh results" and may be headed for its overdue demise. Gerson, *supra* note 19, at 841, 850. Ever since *Bedford* "a great deal of confusion has existed as to the proper treatment" of boot. Kennedy, *Boot Received in Acquisitive Reorganizations: What is the Prospect for Capital Gains?*, 41 J. TAX'N 288 (1974). The automatic dividend rule resulted from "loose language in the Supreme Court's *Bedford* opinion." Levin, Adess & McGaffey, *supra* note 36, at 287.

The underlying error in the automatic dividend rule is that the dividend-effect language of section 356(a)(2) and its predecessors obviously requires some analysis other than a mere reference to the earnings and profits. If Congress had wanted an automatic dividend rule, it easily could have provided that boot was to be governed by section 301, thereby pretermittting the dividend-effect analysis required by section 356(a)(2). Section 356(b), for example, mandates that boot received in a section 355 transaction must be treated as a section 301 distribution. I.R.C. § 356(b) (1976).

104. See, e.g., *Wright v. United States*, 29 A.F.T.R.2d (P-H) ¶ 72-1466 (E.D. Ark. 1972), *aff'd*, 482 F.2d 600, 604 (8th Cir. 1973); *Idaho Power Co. v. United States*, 161 F. Supp. 807, 809 (Ct. Cl.), *cert. denied*, 358 U.S. 832 (1958). See generally Samansky, *supra* note 43, at 16 & n.64.

105. Rev. Rul. 74-515, 1974-2 C.B. 118, 120 (the IRS made it clear that Revenue Ruling 56-220, 1956-1 C.B. 191, which espoused the Government's adherence to the rule, did not imply "that cash paid by an acquiring corporation always has the effect of the distribution of a dividend within the meaning of section 356(a)(2) of the Code."); Rev. Rul. 74-516, 1974-2 C.B. 121; see also B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 14.34; D. KAHN, *supra* note 5, § 9.23; Graduate Tax Paper, *supra* note 83, at 133.

106. 482 F.2d 600 (8th Cir. 1973).

107. In *Wright*, the taxpayer, a majority shareholder in three corporations, and Dunn, an employee, wanted to consolidate two of the three corporations. The taxpayer owned 71.5% of the stock of one of the corporations, Danco; Dunn owned 28.5%. The taxpayer and his family owned virtually 100% of the stock of another of the corporations, F & G. The taxpayer and Dunn owned, respectively, about 70% and 30% of the third corporation, World Wide. The taxpayer and Dunn wanted to consolidate F & G and World Wide into a

boot recipient in a reorganization has received shares in the transferee corporation in place of the boot he in fact received. In other words, the *Wright* test deems the boot recipient to own, after the reorganization, shares constructively received in place of the boot, in addition to the shares actually owned by him. The *Wright* test then hypothesizes that the transferee corporation redeemed the shares constructively owned in place of the boot and paid for these shares by conveying the boot to the boot recipient. If the redemption of the constructive shares satisfies any of the tests of section 302(b), the boot recipient treats the gain recognized on account of boot as a capital gain. Otherwise he must treat the gain as a dividend.<sup>108</sup>

To illustrate further,<sup>109</sup> suppose that X Corp. has sixty issued and outstanding shares of common stock, all of which are owned by A. Y Corp. has forty issued and outstanding shares of common stock, none of which are owned by A. X Corp. merges into Y Corp., and the merger qualifies as an A reorganization. As part of the merger, Y Corp. issues thirty-five newly authorized shares of common stock to A. Additionally, Y Corp. pays \$250 to A. Assume that the Y Corp. stock has a fair market value per share of \$10. Using the *Wright* test, if A had received Y Corp. common shares instead of the \$250 boot he in fact received, A would have received an ad-

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new corporation, Omni, in which the taxpayer and Dunn would own the same percentages of stock as they owned in Danco.

A simple consolidation of F & G and World Wide into Omni would have resulted in an 85% stockholding for the taxpayer, however, instead of the 70% agreed upon by the taxpayer and Dunn. In return for a reduction of the taxpayer's percentage of stock in Omni from 85% to 70% (approximately 8% of the 70% to be owned by the taxpayer's relatives), Omni distributed boot to the taxpayer. Applying the hypothetical post-merger redemption test, the Eighth Circuit held that the hypothetical post-merger redemption qualified as a redemption under section 302(b)(1) as "not essentially equivalent to a dividend" and, hence, did not have the "effect of the distribution of a dividend under section 356(a)(2)." The taxpayer's reduction in his interest in Omni from 85% to 61.7% constituted a meaningful reduction under *United States v. Davis*. The court declined to apply the attribution rules. If it had applied them, the taxpayer would have owned approximately 70% after the hypothetical redemption. *Wright*, 482 F.2d at 602-04, 608-10. See generally Fassler, *Fifth Circuit's Shimberg, Jr. Decision—Automatic Dividend Treatment of Boot in Acquisitive Reorganizations*, 57 TAXES 159, 160 (1979); Gately & Pratt, *Dividend Equivalency—Are the Tests Changing?*, 7 J. CORP. TAX'N 53, 57 (1980); Golub, *supra* note 12, at 909; Hurley, *supra* note 45, at 335; Levin, Adess & McGaffey, *supra* note 36, at 289; Samansky, *supra* note 43, at 27; Note, *Taxation of Boot Distributions: A Return to Bedford?*, 7 HOFSTRA L. REV. 987, 994 (1979) [hereinafter cited as Note, *Return to Bedford*]; Note, *supra* note 44, at 729; Note, *supra* note 45, at 302; Graduate Tax Paper, *supra* note 83, at 138; Casenote, *Treatment of Cash Distributions to Shareholders Pursuant to a Corporate Reorganization*, 20 B.C.L. REV. 601, 608 (1979).

108. 482 F.2d at 606.

109. The facts in this example are taken from Revenue Ruling 75-83, 1975-1 C.B. 112.



ditional twenty-five shares in Y Corp. (\$250 boot received  $\div$  \$10 Y Corp. fair market value per share). A would have received, actually and constructively, sixty shares of Y Corp. stock, thereby making him a 60% owner (sixty of the one hundred issued and outstanding Y Corp. shares). Y Corp. then, hypothetically redeems the twenty-five constructively owned shares, thereby reducing A's percentage of stock ownership from 60% to 46.6%. The reduction in interest effected by the hypothetical redemption satisfies the substantially disproportionate redemption requirements of section 302(b)(2).<sup>110</sup> Thus, according to the *Wright* test, A would treat the gain recognized on account of boot as a capital gain rather than as a dividend.

## 2. HYPOTHETICAL PRE-MERGER REDEMPTION

Revenue Ruling 75-83<sup>111</sup> rejects the hypothetical post-merger redemption test of *Wright*. Instead, the Service applies the section 302(b) tests as if the transferor corporation (the acquired corporation) distributed the boot in redemption of the boot recipient's shares in the transferor prior to the merger. If the hypothetical redemption satisfies one of the tests of section 302(b), then the boot recipient's recognized gain is a capital gain. Otherwise it is a dividend to the extent of earnings and profits.<sup>112</sup>

For example, assume that X Corp. stock is worth \$10 per share. Using the set of facts discussed above, A is treated as having received the \$250 boot in exchange for 25 shares of his X Corp. stock (\$250 boot  $\div$  \$10 X Corp.'s fair market value per share). The redemption does not reduce A's percentage ownership in X at all, because A owned all the X stock both before and after the redemption. And because the redemption does not satisfy any of the other section 302(b) tests,<sup>113</sup> the gain recognized on account of boot

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110. A's 46.6% interest in Y Corp. after the redemption obviously meets the first requirement of section 302(b)(2), that the redeemed shareholder own less than 50% of the votes in the corporation after the redemption. It also meets the second requirement of section 302(b)(2), that the redeemed shareholder own less than 80% of the ratio of voting stock he owned immediately before the redemption. According to the facts in this example, if he had owned exactly 80% of the voting stock immediately after the redemption, he would have owned 48% (60% ratio before redemption  $\times$  80% = 48%). Because Y Corp. issued only one class of voting stock, we have no need to compute the 80% tests separately for both common and voting stock. For a discussion of section 302(b)(2)'s requirements, see *supra* note 71.

111. 1975-1 C.B. 112.

112. *Id.*

113. See *United States v. Davis*, 397 U.S. 301, 313 (1970). In *Davis*, the taxpayer organized a corporation with another person, Bradley, and received 500 shares (250 each for his

is treated as a dividend.

### 3. HYPOTHETICAL PRE-MERGER DISTRIBUTION (THE *Shimberg* TEST)

*Shimberg v. United States*,<sup>114</sup> a Fifth Circuit case, used a hypothetical pre-merger distribution to decide the character of gain according to section 356(a)(2). The *Shimberg* test, developed by the court, is "whether the distribution would have been taxed as a dividend if made prior to the reorganization or if no reorganization occurred."<sup>115</sup> According to the *Shimberg* test, the distribution of boot, if pro rata, is no more than a substitute for a pre-merger dividend-type distribution and is therefore treated as a dividend to the extent covered by earnings and profits (qualified, of course, by the limitations of section 356(a)).<sup>116</sup>

Using the same facts used to explain the *Wright* test, the distribution of the \$250 as boot is deemed to be a distribution from the acquired corporation without reference to the merger. If it would have been a dividend had the merger not taken place, it is considered a dividend. Otherwise it entitles A to a capital gain.

### 4. MEASUREMENT OF PERCENTAGE OF STOCK OWNERSHIP AFTER MERGER COMPARED TO PERCENTAGE OF STOCK OWNERSHIP BEFORE MERGER ("BEFORE AND AFTER TEST" OR THE "BASTARDIZED *Wright* TEST")

Several district courts have altered the *Wright* test into a comparison of the percentage of stock owned by the boot recipient

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wife and himself). Soon after, Davis bought 1,000 more shares at \$25 par value, to allow the corporation to qualify for a loan. Pursuant to agreement, after the loan was repaid, Davis redeemed his stock.

The Supreme Court ruled that the corporate distribution to Davis was a dividend. "If a corporation distributes property as a simple dividend, the effect is to transfer the property from the company to its shareholders without a change in the relative economic interests or rights of the stockholders. Where a redemption has that same effect, it cannot be said to have satisfied the 'not essentially equivalent to a dividend' requirement of § 302(b)(1)." *Id.*

114. 577 F.2d 283 (5th Cir. 1978), *rev'g* 415 F. Supp 832 (M.D. Fla. 1976), *cert. denied*, 439 U.S. 1115 (1979). In *Shimberg*, the taxpayer owned 66.8% of the stock of LSC, a closely held Florida corporation. In 1970 LSC merged into MGIC, a publicly held holding company listed on the New York Stock Exchange. In accordance with the plan of merger, the LSC shareholders received, pro rata, MGIC common stock and cash in exchange for their LSC stock. After the merger the taxpayer owned less than 1% of the shares of MGIC. The taxpayer reported the gain recognized on account of the receipt of the cash as a capital gain. The district court agreed, but the Fifth Circuit reversed, concluding that the boot distribution must be treated as a dividend.

115. 577 F.2d at 288.

116. *Id.*

in the acquiring corporation after the reorganization with the percentage of stock owned by the boot recipient in the acquired corporation before the reorganization.<sup>117</sup> These opinions treat the reorganization like a redemption within the framework of a single corporate shell. If the percentage of stock ownership after the reorganization is sufficiently less than the percentage of stock ownership before the reorganization to meet the meaningful reduction test of section 302(b)(1) or, presumably, any of the other section 302(b) tests, then the boot recipient must treat the gain recognized as a capital gain. Otherwise the gain recognized is a dividend.

Illustrating with the now familiar hypothetical facts, A's percentage of stock ownership under the bastardized *Wright* test has been reduced from 100% in X Corp. to 46.7% in Y Corp. (thirty-five of the seventy-five issued and outstanding shares of Y Corp.). The reduction in interest satisfies either the substantially disproportionate redemption requirements of section 302(b)(2) or the meaningful reduction requirements of section 302(b)(1).<sup>118</sup> Thus, according to this test, A would treat gain recognized on account of boot as capital gain rather than as a dividend under section 356(a)(2).

### B. *Evaluation of the Current Tests*

The dividend-effect language of section 356(a)(2) is so ill-fitting and ambiguous that it is impossible to definitively state whether the statute mandates the use of any one of the four tests for reorganizations involving boot. Nor is it morally mandated to select one of these tests over the other three or even to reject all

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117. See *General Housewares Corp. v. United States*, 488 F. Supp. 926, 943 (N.D. Ala. 1977), *rev'd*, 615 F.2d 1056, 1066 (5th Cir. 1980); *Sellers v. United States*, 42 A.F.T.R.2d (P-H) ¶ 78-5325, at 78-6197 (N.D. Ala. 1977), *rev'd*, 615 F.2d 1066, 1068 (5th Cir. 1980); *cf. Shimberg v. United States*, 415 F. Supp. at 836.

118. A's 46.7% interest in Y Corp. is less than 50% of the total combined voting power of all classes entitled to vote immediately after redemption. His 46.7% is less than 80% of the ratio of voting stock that A owned immediately before the redemption—he had owned 100% of the voting stock before the redemption. Again, the ratio need not be computed for both voting and common stock because Y Corp. had issued only one class of stock. Thus, the transaction meets all three requirements of section 302(b)(2). See I.R.C. § 302(b)(2) (1976). For discussion of the requirements of section 302(b)(2), see *supra* note 71.

Authorities emphasize the loss of control as the key factor for finding a lack of dividend equivalency for redemptions of majority shareholders' stock. If the redemption results in the loss of control, then the majority shareholder has sustained a meaningful reduction in his proportionate interest in the corporation. See, e.g., *Davis*, 397 U.S. 302 (1970); Rev. Rul. 78-401, 1978-2 C.B. 127. In the example in the text, A went from a 100% shareholder to a minority shareholder. Obviously, this reduction in interest satisfies the meaningful reduction test of section 302(b)(1).

four. For these reasons, the jurisprudential abilities of a court, the Service, or a commentator who advocates any of the four tests should not be denigrated, unless, perhaps, the advocacy is so dogmatic as not to admit the unsure footing of the position taken. Yet, all four of the tests suffer from infirmities.

Critics carp that the *Wright* test does not address the abuse that section 356(a)(2) was enacted to prevent—the siphoning off of corporate profits at capital gains rates<sup>119</sup>—and that it vitiates the effectiveness of section 356(a)(2). Indeed, the greater the withdrawal of corporate profits (i.e., the larger the boot), the more likely the boot recipient will receive exchange treatment. There will be a greater number of constructive shares to redeem and, hence, the hypothetical post-merger redemption will cause a greater reduction in the boot recipient's proportionate stock interest.<sup>120</sup> Moreover, at the heart of the *Wright* test is the suspect proposition that section 356(a) should be read *in pari materia* with section 302, the redemption section.<sup>121</sup> At best, the language and purpose of the two sections are similar. Though many Code sections incorporate the rules of other Code sections by express reference, section 356(a)(2) does not refer to section 302(b) at all. Indeed, Congress twice considered but failed to enact alternative language for section 356(a)(2) that would have incorporated the “not substantially disproportionate” test used in section 302(b)(2).<sup>122</sup>

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119. See *Shimberg*, 577 F.2d at 289.

120. Suppose the familiar example in the text is slightly changed, so that Y Corp. paid \$350 to A instead of \$250. Using the *Wright* test, if A had received Y Corp. common shares, instead of the \$350 boot he in fact received, A would have received 35 shares in Y Corp. (\$350 boot received ÷ \$10 fair market value per Y Corp. share). A would have received, actually and constructively, 70 shares of Y Corp. stock, thereby making him a 63.6% owner (70 of the 110 issued and outstanding Y Corp. shares). The hypothetical redemption of the 35 constructively owned shares would have reduced A's percentage of stock ownership by 17%, from 63.6% to 46.6% (35 of the 75 issued and outstanding shares of Y Corp.). In the original example in the text, the hypothetical redemption reduced A's interest by 13.4%, from 60% to 46.6%. Because the extraction of earnings and profits is greater in the instant example (\$350 compared to \$250), the hypothetical redemption reduces a greater percentage of A's stock and, hence, is more likely to satisfy one of the section 302(b) tests.

121. See *Wright*, 482 F.2d at 605; see also Levin, Adess & McGaffey, *supra* note 36, at 289; Comment, *supra* note 18, at 838.

122. H.R. 8300, 83d Cong., 2d Sess., §§ 302, 306 (1954); S. REP. NO. 1622, 83d Cong., 2d Sess. 51, reprinted in 1954 U.S. CODE CONG. & AD. NEWS 4621, 4682 (rejecting the House proposal); STAFF REPORT OF JOINT COMM. ON INTERNAL REVENUE TAXATION, 86TH CONG., SUMMARY OF THE SUBCHAPTER C ADVISORY GROUP RECOMMENDATIONS ON CORPORATE DISTRIBUTIONS AND ADJUSTMENTS 449, 451 (Comm. Print 1959); see also Golub, *supra* note 12, at 906; Samansky, *supra* note 43, at 11-12; Note, *supra* note 44, at 737 & n.211.

More importantly, as discussed earlier,<sup>123</sup> the benchmark for testing equivalency for redemptions is whether the redemption causes a meaningful reduction in the shareholder's proportionate interest in the corporation. This is an appropriate measure when used within the framework of a single corporation, but this measure cannot be used for acquisitive reorganizations between two distinct corporations with previously unrelated shareholders, because such reorganizations neither reduce nor preserve the shareholders' proportionate interest in their corporation. Rather, the reorganization changes the corporation in which the shareholders own stock, making the shareholders' part in the transaction resemble an exchange of their stock.

Proponents of the *Wright* test claim that a reorganization using boot resembles a reorganization coupled with a post-merger redemption.<sup>124</sup> But this resemblance weakly supports the *Wright* test, because a reorganization using boot also resembles a reorganization coupled with a distribution and a reorganization coupled with a pre-merger redemption. These transactions can result in tax consequences often contradictory to those that result from the *Wright* test.

Finally, advocates of the *Wright* test deprecate the artificial bifurcation of the reorganization and the boot under the *Shimberg* and pre-merger redemption tests.<sup>125</sup> Yet, the *Wright* test also bifurcates the reorganization using boot into two transactions: the reorganization itself and the hypothetical post-merger redemption.<sup>126</sup>

Like the *Wright* test, the *Shimberg* and hypothetical pre-merger redemption tests stand on unsure footing.<sup>127</sup> As noted ear-

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123. See *supra* text accompanying notes 29-36.

124. See, e.g., Note, *Return to Bedford*, *supra* note 107, at 1004.

125. *Wright*, 482 F.2d at 607.

126. *Id.*

127. The *Shimberg* and pre-merger redemption tests are sufficiently similar to be evaluated together. Given the tax treatment for pro rata redemptions and boot distributions, the two tests frequently result in the same tax consequences. The Supreme Court in *United States v. Davis*, 397 U.S. 301, 312 (1970), declared that all pro rata redemptions must be treated as distributions. Because the pre-merger redemption test treats the distribution of boot like a redemption and because *Davis* treats pro rata redemptions like distributions, the pre-merger redemption test would treat a pro rata distribution of boot as a distribution. See also *Shimberg*, 577 F.2d at 290.

The hypothetical pre-merger redemption test and the *Shimberg* test might produce divergent results for non-pro rata boot distributions. Presumably, a non-pro rata distribution of boot might constitute a disproportionate redemption under the hypothetical pre-merger redemption test, thereby allowing capital gain treatment for the boot recipient. On the other hand, though the *Shimberg* court stated in dicta that a non pro rata distribution of boot

lier, proponents argue that the congressional purpose for section 356(a)(2) was to eliminate differential treatment between nonreorganization and reorganization situations; therefore, the boot should be viewed as a substitute for a distribution by the transferor corporation prior to the reorganization.<sup>128</sup> If this is a correct interpretation of congressional intent, Congress acted mysteriously in using the nebulous "dividend-effect" language instead of an explicit declaration that the boot should be treated as a distribution by the transferor corporation. Congress made such an explicit declaration in sections 356(b) and 356(e).<sup>129</sup>

The framework of the acquired corporation is as artificial as the *Wright* test's characterization of the reorganization as a redemption.<sup>130</sup> The *Shimberg* and hypothetical pre-merger redemption tests ignore what the transaction really is, a reorganization, and instead treat the distribution of boot like it is a transaction standing alone, recharacterizing the distribution of the boot, which is one of the reorganization's smallest components, into something that it isn't—a distribution or a pre-merger redemption. These two tests emphasize that the reorganization using boot is like a reorganization coupled with the distribution, or a reorganization coupled with a pre-merger redemption. It is, however, also like a reorganization coupled with a post-merger redemption—a transaction likely to result in contradictory tax consequences.

Furthermore, *Shimberg* offered the continuity of interest principle as part of its test. The court opined that the distribution of boot during a corporate reorganization is like the distribution of a dividend without a corporate reorganization, because the reorganization is "merely 'a continuance of the proprietary interests in the continuing enterprise under modified corporate form.'"<sup>131</sup> The continuity of interest principle underlies the basic statutory approach to reorganizations; nonrecognition of realized gain or loss and deferral of realized gain or loss through the carryover basis

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lacked the hallmark of dividend equivalence, see *Shimberg*, 577 F.2d at 290, a literal application of *Shimberg*'s pre-merger distribution test might produce a contrary result. Sections 301 and 316 denominate all distributions of property by a corporation to its shareholders as dividend, regardless of the proportionality of the distribution, so long as the distribution is covered by earnings and profits. See Gately & Pratt, *supra* note 107, at 54.

128. See *supra* text accompanying notes 114-16; Golub, *supra* note 12, at 905-06; Moore, *supra* note 51, at 129-33, 137-41; Note, *supra* note 45, at 297.

129. I.R.C. § 356(b), (e) (1976).

130. See Samansky, *supra* note 43, at 29-31.

131. *Shimberg*, 577 F.2d at 288.

rules.<sup>132</sup> Many reorganizations in fact are no more than a change in form, and the shareholders indeed continue their proprietary interest in virtually the same company (e.g., reincorporation in another state).<sup>133</sup>

Yet, acquisitive reorganizations are often much more. An amalgamation between a small and a large corporation usually is an absorption of the small corporation by the large corporation. The shareholder in the small concern is likely to relinquish his status as a proprietor and accept marketable securities and perhaps some boot in exchange. Professors Bittker and Eustice offer a hypothetical set of facts almost identical with the facts in *Shimberg* to illustrate: "[T]he merger of an independent corner grocery store into a national food chain [is a "reorganization"], although the local merchant who has exchanged his stock for the marketable stock of the surviving corporation may feel, quite rightly, that he has 'sold out.'"<sup>134</sup>

When the amalgamation involves distinct corporate entities of relatively equal size and power, the reorganization effects a substantive change in the two entities rather than a metamorphosis of each. The continuity of interest principle, thus, is often more dogma than fact and is not a persuasive reason for accepting the *Shimberg* test. Moreover, the acceptance of *Shimberg's* reliance on the continuity of interest principle leads to discrediting the automatic dividend rule.<sup>135</sup> If the constituent corporations are treated like one big corporate enterprise modified only in form, then the mere existence of accumulated earnings and profits turns the boot distribution automatically into a dividend.

The *Shimberg* test leads to a further anomaly. If a shareholder disposes of all of his stock for cash, he receives capital gain treatment. If he disposes of all his stock for cash and stock, but not enough stock to meet the continuity of interest requirement, he receives capital gain treatment.<sup>136</sup> The existence of earnings and

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132. B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 14.04.

133. *Id.*

134. *Id.* ¶ 14.01, at 14-5.

135. See *infra* text accompanying notes 186-91.

136. The continuity of interest doctrine does not derive from any particular language in the reorganization sections, but is wholly a doctrine of judicial origin based on what is conceived to be the unstated but fundamental statutory purpose of providing for nonrecognition of gain or loss only if the reorganization exchange is distinguishable from a sale. B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 3.05.

Factors to be taken into consideration in determining continuity of interest include "the nature of the consideration received in the transaction . . . , the remoteness of the ownership interests from the underlying assets of the business, the proportion of old owners

profits in his corporation is irrelevant in both of these situations. If he disposes of all of his stock for cash and enough stock to meet the continuity of interest requirement, however, the *Shimberg* test results in treating the recognized gain as ordinary income (provided, of course, it is covered by accumulated earnings and profits).<sup>137</sup>

The emphasis the *Shimberg* court placed on the proportionality of the boot distribution is questionable. The distribution was not pro rata to all of the shareholders in the continuing enterprise; it was pro rata only to the shareholders of the corporation that ceased to exist.<sup>138</sup> Moreover, the proceeds from the sale of a business are likely to be distributed pro rata to the sellers. A pro rata distribution of the proceeds is not at all inconsistent with the characterization of the transaction as a sale. For example, under the *Zenz v. Quinlivan*<sup>139</sup> rationale, a pro rata redemption coupled with a sale of some or all of the remaining stock may entitle the redeemed shareholder to capital gain treatment.<sup>140</sup>

The bastardized *Wright* test is perhaps appropriate for non-divisive D, E, and F reorganizations (and even for amalgamating reorganizations between affiliated corporations) because these transactions resemble redemptions. The shareholders own stock in the same corporation, or in affiliated corporations, before and after the reorganization. They surrender some of their stock in exchange for boot. Because these transactions take place within the framework of a single corporation, it is possible to measure whether the reorganization reduced the shareholders' proportionate interest in the corporation—the benchmark for testing dividend equivalency.

On the other hand, the bastardized *Wright* test is completely inappropriate for amalgamating reorganizations between previously unrelated corporations for the same reasons posited above with respect to the *Wright* test. The single corporation framework of the redemption test is ill-fitted for amalgamating reorganizations that neither reduce nor preserve the shareholders' proportionate interest in their corporation. The amalgamating reorganization provides the shareholder with a new interest in a new corporation. Moreover, the bastardized *Wright* test is the most ar-

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who continue their participation after the transaction, [and] the length of time the investor interests continue." *Id.* ¶ 14.11, at 14-18.

137. Fassler, *supra* note 107, at 161.

138. Samansky, *supra* note 43, at 32-33.

139. 213 F.2d 914 (6th Cir. 1954).

140. Samansky, *supra* note 43, at 34 n.136.



tificial of all the tests. At least the *Wright*, *Shimberg*, and pre-merger redemption tests are correct that reorganizations using boot resemble a reorganization coupled with, respectively, a post-merger redemption, a pre-merger distribution and a pre-merger redemption. An acquisitive reorganization, however, is a multicorporate transaction involving several sets of shareholders. It is unlike a redemption: a single corporate transaction involving one set of shareholders. Furthermore, by casting the reorganization as a redemption, the bastardized *Wright* test ignores completely the essence of the reorganization—the fusion of previously distinct corporations into one.

### C. *Evaluation of the Jurisprudential Quality of the Case Law*

A basic constraint imposed on judges in our court system is that the parties to the controversy formulate the issues for the court. Judges rarely stray outside the parameters of the issues as set by the parties. Often judges decide cases by selecting between the arguments of one side or the other. Indeed, on appeal, the reviewing court will not hear arguments advanced by the parties unless previously advanced at trial.<sup>141</sup> Similarly, judges are reluctant to look beyond the briefs of counsel to resolve the tax law controversy before them. As a result of this dependence, judges in section 356(a)(2) cases have followed counsels' lead and have tried to force the redemption rules of section 302(b) on reorganizations involving boot. Because these rules do not fit, and because courts have accepted the artificial rules previously discussed, section 356(a)(2) is ambiguous and allows for no definitive explanation of its meaning.

The district court opinions in *Shimberg*<sup>142</sup> and *Sellers v. United States*,<sup>143</sup> both reversed by the Fifth Circuit, illustrate the difficulty and deserve thorough review. The district court judge in *Shimberg* is the author of the bastardized *Wright* test,<sup>144</sup> which another district court followed in *Sellers*. These two district courts egregiously misconstrued *Wright*.<sup>145</sup> As discussed above,<sup>146</sup> to apply

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141. For example, in *Wright* the circuit court refused to consider whether the attribution rules of section 318 applied because the issue was not raised at the trial level. *Wright*, 482 F.2d at 610; see *id.* at 612, 613 (dissent).

142. 415 F. Supp. 832 (M.D. Fla. 1976), *rev'd*, 577 F.2d 283 (5th Cir. 1978), *cert. denied*, 439 U.S. 1115 (1979).

143. 42 A.F.T.R.2d (P-H) ¶ 78-5325 (N.D. Ala. 1977), *rev'd*, 615 F.2d 1066 (5th Cir. 1980).

144. For a discussion of the bastardized *Wright* test, see *supra* notes 117-18 and accompanying text.

145. For commentary critical of the *Shimberg* district court opinion, see Golub *supra*

the meaningful reduction test, *Wright* compared the percentage of the acquiring corporation's stock actually received by the boot recipient to the percentage of the acquiring corporation's stock he would have received if the acquiring corporation had distributed stock in place of boot.<sup>147</sup> The *Wright* court, in effect, focused on percentages of ownership in the acquiring company. Though trying to apply *Wright*, the *Shimberg* and *Sellers* courts instead compared the percentage of stock owned by the boot recipient in the acquired corporation before the reorganization to the percentage of stock owned by him in the acquiring corporation after the reorganization.<sup>148</sup> Their analyses shifted from the acquiring corporation to the before-and-after approach. Because in both cases the boot recipients had been majority shareholders in closely held corporations and, as a result of the reorganization received a miniscule percentage of stock in much larger corporations,<sup>149</sup> the district courts held that the reduction in the percentage of stock ownership from a majority to less than one percent satisfied the meaningful reduction test of section 302(b)(1) and, therefore, did not have the effect of a distribution of a dividend under section 356(a)(2).<sup>150</sup> Considering the tests they adopted for section 356(a)(2), the earth might have shaken if they had not so held.

We can trace the jurisprudential error in *Shimberg* to the court's reasoning in footnote five of the opinion.<sup>151</sup> There, the district court accurately recounted the hypothetical post-redemption test used in *Wright*.<sup>152</sup> For some unknown reason, however, the

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note 12, at 911 (noting that the post-merger test applied by the district court was a misapplication of the *Wright* holding, but postulating that the rationale behind the Fifth Circuit's reversal may presage a return to the automatic dividend rule); Hurley, *supra* note 45, at 335, 337 n.6 (noting that the district court in *Shimberg* simply misapplied the *Wright* analysis); Samansky, *supra* note 43, at 23-27 (noting that the "before and after" test applied by the district court in *Shimberg* would, in effect, legitimize bail-out of earnings and profits at capital gains rates); Comment, *supra* note 18, at 842 (noting that the "meaningful reduction of . . . interest" that formed the basis of the district court's decision was the relationship between the percentage of stock of the target company owned before merger compared with the percentage of stock of the acquiring corporation owned post-merger; the author hypothesizes that the errors of both the district and appellate courts could have been avoided by comparing the percentage of stock of the acquiring company that *Shimberg* would have received had boot not been distributed to the percentage he actually received).

146. See *supra* text accompanying notes 106-08.

147. 482 F.2d at 607.

148. *Shimberg*, 415 F. Supp. at 836; *Sellers*, 42 A.F.T.R.2d (P-H) at 78-6197.

149. *Shimberg*, 415 F. Supp. at 836; *Sellers*, 42 A.F.T.R.2d (P-H) at 78-6197.

150. *Shimberg*, 415 F. Supp. at 837; *Sellers*, 42 A.F.T.R.2d (P-H) at 78-6197.

151. 415 F. Supp. at 836 & n.5.

152. See *supra* text accompanying note 147.

district court in *Shimberg* thought that *Wright's* discussion of the constructive post-merger redemption was merely a part of *Wright's* discussion of section 302(b)(2) unconnected with the rest of the *Wright* opinion. The district court in *Shimberg* discarded as "dubious dictum"<sup>153</sup> *Wright's* discussion of section 302(b)(2), and, most importantly, the constructive post-merger redemption along with it. Footnote five was incorrect. After determining that section 302 principles could properly be applied to section 356(a)(2), *Wright* devoted considerable analysis to the conclusion that it should apply the meaningful reduction test to the surviving corporation.<sup>154</sup> It explicitly rejected a contention that it should look at the percentage of stock ownership in the acquired corporation.<sup>155</sup> The opinion clearly did not limit the constructive post-merger redemption to section 302(b)(2).<sup>156</sup>

The characterization of *Wright's* discussion of section 302(b)(2) as dictum by the district court in *Shimberg* underscores its failure to understand corporate tax law. Perhaps the court thought that only section 302(b)(1) should apply because, of the three subsections in section 302(b), only section 302(b)(1) has language resembling that of section 356(a)(2).<sup>157</sup> Section 302(b)(1), however, completely overlaps the other subsections of section 302(b), which provide safe harbors for transactions that would also satisfy the "not essentially equivalent to a dividend" language of section 302(b)(1).<sup>158</sup> Logically, assuming the redemption rules apply to section 356(a)(2), a court would first apply section 302(b)(2) before resorting to section 302(b)(1). Section 302(b)(2) is a mechanical test that gives a definitive answer; by contrast, section 302(b)(1) is a qualitative test that requires subjective evaluation.

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153. *Id.*

154. *See Wright*, 482 F.2d at 606-10. The court agreed with the Commissioner's interpretation "that § 356(a)(2) should be read *in pari materia* with § 302 for the purpose of determining whether a distribution [has] the effect of a dividend." *Id.* at 605 (footnote omitted). Its reasoning seems well supported by the authorities cited in the footnote. *See id.* at 605 n.11. Once the court seized this basic premise, it was then necessary to apply the section 302 tests to the redemption. The "dubious dictum" language of the district court in *Shimberg* is caused by that court's failure to understand that section 302 principles may properly be applied to the section 356(a)(2) situation.

155. *See id.* at 607-08.

156. *See id.* at 608. (Because the *Wright* court analyzed the boot-in-connection-with-reorganization transaction under section 302, it was forced to look at percentages of stock owned before and after the redemption—necessarily an analysis of the surviving company).

157. *Cf. supra* text accompanying notes 51-66. (As noted there, because of piecemeal drafting, it is not clear that Congress intended the provisions of section 302 to apply to the section 356(a)(2) situation.)

158. *Cf. supra* note 73.

The *Wright* court considered section 302(b)(2), but quickly recognized that the taxpayer failed the fifty percent stock ownership requirement. After dispensing with section 302(b)(2), the *Wright* court proceeded to a section 302(b)(1) determination.<sup>159</sup>

The *Sellers* district court relied completely on the *Shimberg* district court opinion. It excised a part of the *Shimberg* district court opinion, plugged in different names and numbers to fit its own fact pattern and adopted the bastardized *Wright* test as it had been devised by the *Shimberg* district court.<sup>160</sup> Although *Wright* was the seminal case for the line of authority the *Shimberg* district court purported to follow, *Sellers* contained no evaluation or discussion of the *Wright* test. The *Sellers* court was oblivious to the misconstruction of *Wright* by the *Shimberg* district court and thereby unwittingly perpetuated the interpretative error. The *Sellers* district court judge apparently did not even read the important cases on the issues before him.

Despite their misconstructions of *Wright*, the district court opinions in *Shimberg* and *Sellers* display an attractive spark of layman's perceptiveness. The *Shimberg* district court opinion stated:

Prior to the merger in this case, Plaintiff was the president, chief executive officer and owner (directly or indirectly) of approximately 66% of the stock of LSC. As a result, under Florida law he could effectively control the corporation. Subsequent to the merger the Plaintiff owned (directly and indirectly) less than 1% of the outstanding common stock of MGIC, a large publicly-held corporation whose stock was traded on the New York Stock Exchange and was held by approximately 5,200 shareholders. His former rights to direct the affairs of LSC were extinguished. His interest in MGIC afforded him no control whatsoever over the destiny of the large national corporation. No longer was he the major "owner" of a successful local company operating in several Florida counties. He was then the holder of a miniscule

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159. 482 F.2d at 608. The taxpayer in *Shimberg* argued in the district court that the scope of inquiry "should be restricted to a post-merger comparison between what the taxpayer's interest in the resulting consolidated corporation would have been with and without the boot payment," i.e., the *Wright* test. The *Shimberg* district court retorted, "*Wright* does not support such a myopic view of the consequences of the transaction in determining Section 302(b)(1) 'dividend equivalence' in resolving the parallel issues presented under Section 356(a)(2)." *Shimberg*, 415 F. Supp. at 837 n.6.

160. Compare *Sellers*, 42 A.F.T.R.2d (P-H) at 78-6197 ("[b]ased upon the Supreme Court decision of *Commissioner of Internal Revenue v. Bedford's Estate*") with *Shimberg*, 415 F. Supp. 832, 835-37 ("[b]ased upon the Supreme Court decision in *Commissioner of Internal Revenue v. Bedford's Estate*").

percentage of the outstanding stock of a huge, publicly-held corporation. It is clear that the merger resulted in a radical change and meaningful reduction in the nature of the Plaintiff's interest in the continuing business. The net effect of the transaction was a sale by the Plaintiff and the other LSC stockholders of their LSC stock to MGIC for cash and marketable securities in a publicly owned corporation.<sup>161</sup>

The district court judge in *Shimberg* was perceptive. He viewed the transaction as a whole and characterized it for what it really was—a sale by the shareholder of the closely held corporation. Unfortunately, he cluttered his opinion with a discussion of the redemption rules of section 302(b).<sup>162</sup> He should not have attempted to force the facts to fit under section 302. Rather than using the unnecessary “meaningful reduction” language, he should have used the “radical change” in the “nature” of the shareholder's interest<sup>163</sup> as the keystone of his analysis. When the shareholder's interest has changed so much, he should not be deemed to have received a dividend: a dividend is a distribution by a corporation with earnings and profits *without a substantial change* in the shareholder's interest in the corporation.<sup>164</sup> In reversing, the Fifth Circuit in *Shimberg* observed that the bastardized *Wright* test used by the district court renders section 356(a)(2) “virtually meaningless when a large corporation swallows a small one in a reorganization, for there will always be a marked decrease in control by the small corporation's shareholders, unless the same shareholders control both corporations.”<sup>165</sup> This observation is correct.<sup>166</sup> But when a publicly held corporation acquires the closely held corporation, have not the shareholders in the closely held corporation “sold out”?<sup>167</sup> Certainly laymen connected with either of the corporations would believe that the shareholder had sold his closely held concern for widely held stock and cash. They would view the characterization of boot as a dividend to be a feat of

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161. 415 F. Supp. at 836-37 (footnote omitted).

162. *Id.* at 835-36.

163. *Id.*

164. Bittker and Eustice note that the continuity of interest doctrine operates “more as a blunt instrument than as a scalpel” in reorganizations. B. BITTKER & J. EUSTICE, *supra* note 5, ¶ 14.11, at 14-29. See also, Gately & Pratt, *supra* note 107, *passim*; Golub, *supra* note 12, *passim*; Hurley, *supra* note 45; Peterson, *Determining Dividend Equivalence of Boot Received in a Corporate Reorganization*, 32 TAX LAW. 834 (1979).

165. *Shimberg*, 577 F.2d at 288.

166. Fassler, *supra* note 107, at 161; Comment, *supra* note 18, at 844; see *supra* notes 133-34 and accompanying text.

167. Golub, *supra* note 12, at 913; Graduate Tax Paper, *supra* note 83, at 140.

legerdemain.

The sale analysis has adherents. For example, one commentator, eschewing section 302 principles, contends that dividend treatment should never be applied in true acquisitive reorganizations because "in all instances" the boot recipient sells a part of his stock for the boot he receives.<sup>168</sup> This commentator bases his argument partly on "economic reality"<sup>169</sup> and partly on legislative history.<sup>170</sup> Although his remarks reflect keen analysis, his position has weaknesses and is especially lacking in statutory support. Though an early congressional report<sup>171</sup> used a nonacquisitive reorganization with an obvious tax avoidance purpose as an example to justify the enactment of the earliest version of section 356(a)(2), section 356(a)(2) does not distinguish between acquisitive and nonacquisitive reorganizations. It applies literally to both. Furthermore, it is not limited to controlling tax avoidance schemes.<sup>172</sup> This analysis also fails to counter the contrary inferences in the legislative history that the purpose of the statute is to equalize the treatment of distributions in reorganizations with distributions outside of reorganizations.<sup>173</sup>

The Fifth Circuit's opinion in *Shimberg*<sup>174</sup> is partly insightful. *Shimberg* correctly observed that a reorganization between two corporations with common ownership may be the functional equivalent of a redemption in a single corporation. In that circumstance a court correctly might apply the meaningful reduction test of section 302(b)(1)<sup>175</sup> by comparing the percentage of stock ownership of the boot recipient after the reorganization to his percentage of stock ownership in the corporation before the reorganization. If the reorganization resulted in a meaningful reduction, capital gain treatment of the distribution would be appropriate. *Shimberg* noted further that the transaction before the court was a reorganization between two different corporations of different sizes and with different shareholders.<sup>176</sup> Unlike the district courts in *Shim-*

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168. Golub, *supra* note 12, at 912.

169. *Id.* at 913.

170. *Id.* at 912.

171. See *supra* text accompanying note 85.

172. Certain Code sections and tax doctrines have been specifically developed to control tax avoidance schemes, e.g., the doctrines of assignment of income, substance over form, business purpose, step transactions, accounting methods, and allocation to properly reflect income. I.R.C. §§ 357(b), 368, 446(b), 482 (1976).

173. See *supra* text accompanying note 83.

174. 577 F.2d 283 (5th Cir. 1978), *cert. denied*, 439 U.S. 1115 (1979).

175. *Id.* at 287.

176. *Id.*

*berg* and *Sellers*, the appellate court in *Shimberg* properly distinguished the "fundamental differences"<sup>177</sup> between bona fide acquisitive reorganizations involving unrelated corporations and readjustments among related corporations that might amount, as a practical matter, to a redemption. Because the transaction in *Shimberg* was not a readjustment among commonly controlled corporations, and more closely resembled a reorganization than a redemption, the Fifth Circuit declined to apply the redemption rules.<sup>178</sup>

Despite these virtues, *Shimberg* is partly sophistic. *Shimberg* accurately recounted the section 356(a)(2) tests as applied by the *Wright* circuit court<sup>179</sup> and by the *Shimberg* district court<sup>180</sup> (the *Wright* test and the bastardized *Wright* test, respectively). Yet *Shimberg* failed to notice, or at least failed to discuss, that the *Shimberg* district court misapplied the *Wright* test. The *Wright* test does not liken a reorganization using boot to a redemption, as does the bastardized *Wright* test. Instead, it treats the transaction as a post-reorganization redemption, a transaction far different from a redemption standing alone. This misperception vitally undermines much of *Shimberg's* reasoning for rejecting the "meaningful reduction" analysis of *Wright*. *Shimberg* criticized *Wright* on the theory that the *Wright* test would always result in a "meaningful reduction" and hence a capital gain under section 302(b) because "a majority shareholder in a small corporation will always become a minority shareholder in a large corporation that acquires a small one."<sup>181</sup> This criticism is apt for the bastardized *Wright* test that compares the interest in the acquiring corporation to the interest in the acquired corporation. The court completely missed the point of the *Wright* test, which measures holdings in the acquiring corporation only. In *Wright*, the boot recipient's holdings in the acquired corporation and his status as a majority shareholder in it are irrelevant.

*Shimberg* also relied heavily on the resemblance between a reorganization using boot and a reorganization coupled with a premerger distribution.<sup>182</sup> If the *Shimberg* court had analyzed *Wright* correctly, it would have noticed that the reorganization using boot

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177. *Id.* at 290.

178. *Id.*

179. *Id.* at 287.

180. *Id.* at 286.

181. *Id.* at 290.

182. *Id.*

also resembles a reorganization coupled with a post-merger redemption, a transaction likely to result in tax consequences contradictory to the pre-merger distribution. *Shimberg*, however, did not analyze *Wright*, but rather reviewed the district court's misapplication of *Wright*. The court, therefore, rejected the *Wright* test because of the results it would have obtained upon its misapplication by the district court.

Furthermore, *Shimberg* manipulated the legislative history of section 356(a)(2). That history is rife with conflicting inferences, some of which may support *Shimberg*'s basic proposition that the boot should be treated as a pre-reorganization distribution. Nevertheless, it is beyond the pale to say, as does *Shimberg*, that "the legislative history of § 356(a)(2)'s predecessor . . . makes clear that a distribution that would have been a dividend if made prior to the reorganization is subject to the same treatment when made as part of the transaction."<sup>183</sup> The example in the legislative history<sup>184</sup> involves a distribution of boot as part of the merger of a corporation with earnings and profits into a newly created corporate shell owned by the same shareholders in the same proportion—an obvious tax avoidance scheme. The example in the legislative history was "a transaction very different from" the bona fide acquisitive reorganization of *Shimberg*.<sup>185</sup> It is this troubling comment in *Shimberg* that smacks of sophistry. It does not seem possible that federal court judges so misunderstand corporate tax law that they fail to discern differences between bona fide acquisitive reorganizations and the shell game portrayed in the legislative history.

Further, though the court disavowed it, *Shimberg* may signal a return to the automatic dividend rule.<sup>186</sup> The court expressed its belief that a non-pro rata distribution of boot would not be treated as a dividend under section 356(a)(2). It also left open the possibility that it might apply section 302 principles in reorganizations involving corporations with common shareholders.<sup>187</sup> Yet, the *Shimberg* test treats the gain recognized on the account of boot as a "distribution" by the acquired corporation.<sup>188</sup> If the boot is deemed a pre-merger distribution, it is also a dividend unless there

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183. *Id.* at 288 (citations omitted).

184. See *supra* text accompanying note 85.

185. Samansky, *supra* note 43, at 33.

186. At least some commentators assert that *Shimberg* constitutes a return to the automatic dividend rule. See Fassler, *supra* note 107, at 161; Golub, *supra* note 12, at 911.

187. 577 F.2d at 290.

188. *Id.* at 288-89.



are no earnings and profits. The theory that the Fifth Circuit has returned to the automatic dividend rule is buttressed by its opinion in *General Housewares Corp. v. United States*.<sup>189</sup> *General Housewares* interpreted *Shimberg* as follows:

In *Shimberg v. United States* . . . we held that *Wright's* "meaningful reduction" test should not apply where, as here, the "boot" paid would have been taxed as a dividend if made prior to the reorganization. Since at the time of this distribution [the acquired company's] accumulated earnings and profits exceeded the cash distributed to [the acquired company's] stockholders, under *Shimberg* the cash "boot" so distributed to them had "the effect of the distribution of a dividend," section 356(a)(2) (see also section 316(a)), and was thus includable in gross income, section 301(c).<sup>190</sup>

The *Shimberg* court also rejected the taxpayer's argument that its analysis abrogates the "step transaction" doctrine.<sup>191</sup> Technically, *Shimberg* is correct. Reorganizations using boot are not multistep transactions. They are unitary transactions with the boot representing part of the consideration transferred to one group of shareholders. *Shimberg* does violate, however, the spirit of the step transaction doctrine, which requires that we should analyze the entire transaction as a whole and not in fragments. There may be cogent reasons for adopting a rule that approximates the automatic dividend rule or that analyzes reorganizations in fragments. Instead of disavowing its actions like they were unclean, however, the Fifth Circuit should have affirmatively stated its reasons for adopting the rule.

The Eighth Circuit's opinion in *Wright* is more difficult to evaluate. It begins well by noting that the determination of whether boot has the effect of a dividend under section 356(a)(2) is "not without difficulty since the distribution has some but not all the characteristics of either a sale or a dividend."<sup>192</sup> It then states that section 356(a)(2) should be read *in pari materia* with section 302.<sup>193</sup> Considering the transactions involved in *Wright*, this reading of the Code was eminently sensible. The transaction was a consolidation of two affiliated corporations. The majority shareholder agreed to accept boot in exchange for a reduction in the percentage

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189. 615 F.2d 1056 (5th Cir. 1980).

190. *Id.* at 1066 (citation omitted).

191. 577 F.2d at 289-90.

192. *Wright*, 482 F.2d at 604.

193. *Id.* at 605.

of stock ownership in the consolidated corporation that he otherwise would have received. Much like a disproportionate redemption, the consolidation rearranged the proportionate interests of the shareholders. Hence, the use of the redemption tests made sense. *Wright*, however, did not thoroughly analyze the redemption test in this situation. It should have emphasized that the affiliation between the corporations made the redemption tests appropriate. And it should have expressly reserved its opinion about the appropriate test for reorganizations involving unaffiliated corporations. It did neither. Instead, the *Wright* court supported its position by merely citing several cases and secondary authorities.<sup>194</sup>

*Wright's* reasoning is analytically sound for rejecting the Commissioner's argument for a pre-merger redemption test. When a transaction rearranges stock interests in multiple corporations and combines them into a new single corporation, the redemption analysis should not isolate just one of the constituent corporations.<sup>195</sup> *Wright* further stated that redemption tests, based as they are on a reduction of interest, "make sense only in relation to a corporation that will continue to exist."<sup>196</sup> Finally, *Wright* noted that it makes no sense to measure hypothetically what the reduction in interest would have been in one of the dissolved corporations when what is "significant" is the "change in ownership" in the consolidated corporation.<sup>197</sup>

The bastardized *Wright* test would have been inappropriate in the *Wright* case. Though the constituent corporations to the consolidation were affiliated, they were not owned in the same proportions by the shareholders. The largest minority shareholder in the consolidated corporation did not own any stock in one of the constituent corporations. The boot recipient owned different proportions in the constituents.<sup>198</sup> If the boot recipient had owned the same proportion in both constituents, the bastardized *Wright* test might have been appropriate. Because the boot recipient did not, a comparison between his stock interest in the constituents and his stock interest in the consolidated corporation would not have been helpful. To illustrate, in *Wright* the boot recipient owned approximately ninety-nine percent of one constituent and fifty-six percent

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194. *Id.* at 605 n.11.

195. *Id.* at 607.

196. *Id.*

197. *Id.* at 608.

198. *Id.* at 607.

of the other.<sup>199</sup> The consolidation left him with approximately sixty-two percent ownership in the consolidated corporation,<sup>200</sup> which was less than his interest in one constituent but more than his interest in the other.

*Wright* is an adequate case. Its hypothetical post-merger redemption test is well suited to its unique fact pattern, the disproportionate distribution of boot in a consolidation of affiliated corporations. *Shimberg* even concedes this point.<sup>201</sup> In fact, *Shimberg* and *Wright* are not necessarily inconsistent.<sup>202</sup> A court could choose the *Wright* test in cases matching the *Wright* fact pattern and the *Shimberg* test for pro rata distributions. *Wright* would have been much better if the court had explained why it was applying redemption principles. Because it did not, it is not great jurisprudence.

#### V. THE EXECUTIVE (THE "GOVERNMENT")<sup>203</sup>

When the Government acts as tax collector, it is never popular. Yet commentators<sup>204</sup> and even courts<sup>205</sup> have launched more than the usual number of attacks at the Government for its handling of section 356(a)(2). Does it deserve them?

The nebulosity of section 356(a)(2) necessarily generates differing interpretations of its meaning. Some of the criticisms directed at the Government may reflect no more than the critic's disagreement with the Government's interpretation—an interpretation usually no better and no worse than the critic's. We have already reviewed the varying interpretations, i.e., the tests the courts have used, and shall not repeat that review. Instead, the

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199. *Id.* at 602.

200. *Id.* at 607.

201. 577 F.2d at 287.

202. See Comment, *supra* note 18, at 844.

203. The United States Government disperses responsibility for tax litigation and statements of position on tax issues among different offices. The Department of Justice represents the United States in the district courts and the Court of Claims, and represents the Commissioner of the Internal Revenue Service in appeals from the Tax Court. Additionally, it handles all other appellate work. The Chief Counsel for the Internal Revenue Service represents the Commissioner of the Internal Revenue Service in the Tax Court. The Chief Counsel is answerable to the General Counsel for the Treasury Department, who has general oversight of litigation in the Tax Court. The Commissioner of the Internal Revenue Service is responsible for issuing revenue rulings and revenue procedures. For convenience, the term "Government" will be used rather than referring to the particular office handling the litigation or issuing the revenue ruling or procedure.

204. Golub, *supra* note 12, at 910.

205. See, e.g., *Wright*, 482 F.2d at 604; *Hawkinson v. Commissioner*, 235 F.2d 747, 751 (2d Cir. 1956).

Government's performance as an administrator will be examined.

Commentators waged a sustained battle against the Government's dogged adherence to the automatic dividend rule. Because the Government conceded the issue in 1974,<sup>206</sup> we need not resurvey the battleground, except to suggest that the Government reacted more out of adversarial zeal than ministerial disinterest. While its steadfastness should be admired, its protracted advocacy of an unreasonable position impeded a reasonable evaluation of alternative readings of section 356(a)(2). Instead of trying to resolve the meaning of section 356(a)(2), commentators and courts expended most of their intellectual energy attacking the automatic dividend rule.<sup>207</sup>

Current critics especially complain that the Government is inconsistent in its treatment of section 356(a)(2), applying the step transaction doctrine for most transactions, especially when it helps collect more taxes, but rejecting it for reorganizations using boot because fragmenting the reorganization into components (i.e., treating the boot like a pre-organization distribution or redemption) results in dividend treatment instead of capital gain. Critics claim that Revenue Ruling 75-83,<sup>208</sup> which promulgates the pre-merger redemption test, is inconsistent with Revenue Rulings 55-745,<sup>209</sup> 75-447<sup>210</sup> and 75-360.<sup>211</sup> Revenue Rulings 55-745 and 75-447 both concern situations resembling the fact pattern of *Zenz v. Quinlivan*,<sup>212</sup> an integrated transaction wherein a sale and a redemption are coupled to terminate or reduce a particular shareholder's interest in the corporation. Acknowledging the correctness of the rationale of *Zenz*, the revenue rulings opine that the trans-

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206. Rev. Rul. 74-515, 1974-2 C.B. 118; Rev. Rul. 74-516, 1974-2 C.B. 121.

207. Samansky, *supra* note 43, at 16; see Gerson, *supra* note 19, at 847-52; Moore, *supra* note 51, at 141-44; Shoulson, *supra* note 19, at 573-77.

208. 1975-1 C.B. 112 (when a sole shareholder of a corporation owns 100% of the stock both before and after a hypothetical pre-merger redemption, his percentage ownership has not been diluted; therefore, the redemption is "essentially equivalent to a dividend").

209. 1955-2 C.B. 223 (facts and circumstances are similar to *Zenz v. Quinlivan*, 213 F.2d 914 (6th Cir. 1954), hereinafter discussed).

210. 1975-2 C.B. 113 (involving situations in which a third shareholder is brought into a two-shareholder corporation with an equal stock interest by coordinated sales and redemptions).

211. 1975-2 C.B. 110. Golub supports this view. See Golub, *supra* note 12, at 910 (purpose of which was to explain the position of the IRS regarding *McDonald v. Commissioner*, 52 T.C. 82 (1969), hereinafter discussed).

212. 213 F.2d 914 (6th Cir. 1954) (involving a sole shareholder of a corporation selling part of her stock to a competitor and shortly thereafter redeeming the remainder of her stock for an amount of cash and property approximately equal to the corporation's earned surplus).

action should be "viewed as a whole,"<sup>213</sup> "effect [should] be given only to the overall result,"<sup>214</sup> and the "fragmenting of the whole transaction into its component parts" is "proscribe[d]."<sup>215</sup> Revenue Ruling 75-360 acknowledges that the Government had incorrectly treated a redemption and a reorganization as separate transactions in *McDonald v. Commissioner*,<sup>216</sup> a 1969 Tax Court case, and that the Tax Court correctly had found a single integrated transaction.<sup>217</sup> In a similar vein, Revenue Procedure 77-37 states that sales and redemptions of stock occurring prior to or subsequent to a reorganization, which are part of the plan of the reorganization, will be considered in the fifty percent continuity test.<sup>218</sup> In summary, the critics complain that it is "clearly unreasonable and arbitrary" for the Government to fragment the distribution of the boot for reorganizations, as it does in Revenue Ruling 75-83 and in *Shimberg*, but to step together the redemption and reorganization in Revenue Ruling 75-360, the redemption and sale in Revenue Ruling 75-447, and various other transactions throughout all areas of tax law.<sup>219</sup>

These criticisms are perhaps persuasive reasons for rejecting the Government's position that reorganizations using boot should be the one transaction that is fragmented in our tax analysis. Yet, the Government's positions are not necessarily inconsistent. The Government believes that the purpose of section 356(a)(2) is to equalize the tax consequences of distributions within and without corporate reorganizations. If the statute requires nonreorganization distributions and reorganization distributions (distributions of boot) to be treated equally, then both the pre-merger redemption test of Revenue Ruling 75-83 and the pre-merger distribution test of *Shimberg* make sense. According to this view of the legislative intent, Congress was concerned with the extraction of earnings and profits; like redemptions and nonreorganization distributions, the distribution of boot is an extraction. The Government can argue

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213. Rev. Rul. 75-447, 1975-2 C.B. at 114; see also Rev. Rul. 55-745, 1955-2 C.B. at 224 (acknowledging that *Zenz* is correct under 1954 Code).

214. Rev. Rul. 75-447, 1975-2 C.B. at 114.

215. *Id.*

216. 52 T.C. 82 (1969) (pursuant to a plan of reorganization, 100% of the acquired corporation's preferred stock was redeemed for cash and its common stock was exchanged for the acquiring corporation's common stock).

217. Rev. Rul. 75-360, 1975-2 C.B. 110.

218. 1977-2 C.B. 568, § 3.02.

219. See Golub, *supra* note 12, at 910; Levin, Adess & McGaffey, *supra* note 36, at 291-92; Comment, *supra* note 51, at 635.

that its fragmentation of reorganizations using boot is mandated by the statute, which requires the Government to view the boot as an extraction of earnings and profits apart from the reorganization.

The Government, however, has acted inconsistently in other instances. Prior to 1974, its official position was the automatic dividend rule. It even urged the rule on the district court in *Wright*.<sup>220</sup> Yet, it sometimes departed from this position when it was to its advantage. For example, in *Idaho Power Co. v. United States*<sup>221</sup> the Government temporarily abandoned the automatic dividend rule in favor of a section 302(b)<sup>222</sup> analysis. There, the taxpayer was the corporation distributing the boot, and it wanted the boot to be deemed a dividend so that it would be entitled to the tax credit granted to public utility corporations by section 26(h) of the 1939 Code.<sup>223</sup> Again, in *King Enterprises, Inc. v. United States*<sup>224</sup> the Government conveniently discarded the automatic dividend rule when it wanted to deny the boot recipient, a corporation, the eighty-five percent dividend deduction of section 243.<sup>225</sup> The ulterior motive for this change in position seems obvious: The Government wanted to collect more taxes.<sup>226</sup>

Furthermore, the Government apparently posited a slightly different test in *Shimberg* than it did in Revenue Ruling 75-83. At least *Shimberg*, a Government victory, used a pre-merger distribution test rather than the pre-merger redemption test of Revenue Ruling 75-83.<sup>227</sup> As discussed above, both tests treat pro rata distributions of boot as distributions, but the two tests might lead to

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220. 482 F.2d at 604.

221. 161 F. Supp. 807 (Ct. Cl. 1958), *cert. denied*, 358 U.S. 832 (1958).

222. The applicable provision under the 1939 Code is § 15(g).

223. 161 F. Supp. at 808.

224. 418 F.2d 511 (Ct. Cl. 1969).

225. *Id.* For reference to the inconsistency in *Idaho Power*, see Samansky, *supra* note 43, at 15 n.58.

226. Courts are not always obtuse to the relative position of the private sector and the Government in tax cases. The Third Circuit recently noted that taxpayers like to characterize a transaction as a reorganization when there is no boot, because they can postpone payment of tax. When there is boot, however, they might prefer to denominate the transaction as a liquidation, thereby receiving capital gain treatment and avoiding dividend treatment under section 356(a)(2). Inferring that the Government takes positions based more on the amount of revenue that it can collect than on matters of tax administration, the Third Circuit concluded: "The subjective motivation of neither the taxpayer nor the Commissioner is relevant." *Atlas Tool Co. v. Commissioner*, 614 F.2d 860, 867 (3d Cir. 1980), *cert. denied*, 449 U.S. 836 (1980); *see also Wright*, 482 F.2d at 604 n.7 (noting that it was to the Commissioner's advantage to argue against the application of the automatic dividend rule); Samansky, *supra* note 43, at 15 n.58 (similar observation).

227. For an explanation of these tests, see *supra* text accompanying notes 111-17.

different results for non-pro rata distributions of boot.<sup>228</sup> The variation in stances most likely is the result of the lack of coordination between the Justice Department and Counsel for the Commissioner<sup>229</sup>—hardly a legitimate justification for this inconsistency.

The Government's greatest transgression has been in its failure to act as a leader in resolving the uncertainty and conflict enveloping the tax treatment of boot. Undoubtedly, it had a hand in the 1954-1959 proposals to eliminate the dividend-effect language from section 356(a)(2).<sup>230</sup> Beyond that, it has done little. It let the revenue ruling espousing the automatic dividend rule stand from 1956 through 1974,<sup>231</sup> despite overwhelmingly critical commentary<sup>232</sup> and adverse judicial reaction.<sup>233</sup> It discarded the automatic dividend rule temporarily when convenient for maximizing its revenues. Currently, it apparently has advanced a pre-merger redemption test and a pre-merger distribution test, two similar but slightly different tests. It has not let us know which it prefers or even if it believes they would produce different results. Revenue Ruling 75-83 offers citations in lieu of any cogent analysis for its pre-merger stances. The Revenue Ruling also offers support from the legislative history of section 356(a)(2), but, as discussed above, the legislative history supports conflicting inferences.<sup>234</sup>

The Government should take some initiative in resolving section 356(a)(2)'s conflict. First, the Government should settle on one approach for bona fide acquisitive reorganizations. Should the principles of section 302(b) apply? Should the boot be treated as a pre-merger distribution? Should there be a different test for acquisitive reorganizations involving corporations with a commonality of shareholders? Second, it should not alter the stance just to maximize the amount of revenue it can collect. Third, it should offer cogent analysis in support of the tests it espouses. Fourth, it should seek legislative rewriting of section 356(a)(2) to eliminate its obfuscatory language.

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228. See *supra* note 133.

229. See *supra* note 203.

230. For a discussion of these proposals, see *supra* text accompanying notes 91-95.

231. Rev. Rul. 56-220, 1956-1 C.B. 191; Rev. Rul. 74-515, 1974-2 C.B. 118; Rev. Rul. 74-516, 1974-2 C.B. 121; see Golub, *supra* note 12, at 910.

232. See authorities cited *supra* note 103.

233. See cases cited *supra* note 104.

234. See *supra* text accompanying notes 82-83.

## VI. CONCLUSION

Obviously, Congress must redraft section 356(a)(2). Section 356(a)(2) is basically an anti-bailout section. Bailout opportunities in reorganizations exist mainly in two situations: when there is an amalgamation of two or more corporations with a commonality of shareholders, and when the same group of shareholders who owned the corporation before the reorganization owns the corporation after the reorganization (e.g., a nondivisive D reorganization). Congress might properly exclude bona fide acquisitive reorganizations between corporations with unrelated shareholders from section 356(a)(2)'s coverage, because the boot recipient in fact has sold his stock for new stock and boot. In this situation, his recognized gain should be capital gain. Section 356(a)(2) might qualify this exclusion with an exception for transactions in which the distribution of boot is motivated by a tax avoidance purpose or at least is not supported by a business purpose. This exception would eliminate the back-scratching potential of a merger between two companies that both have earnings and profits. For nondivisive D, E, and F reorganizations and acquisitive reorganizations between corporations whose stock is owned by identical shareholders in identical proportions, section 356(a)(2) might provide for a "before and after test" with mechanical standards like section 302(b)(2). These transactions are rearrangements of the shareholders' interest within the context of a single corporate framework, much like a redemption. Acquisitive reorganizations between corporations that share a commonality of shareholders but whose shareholders own stock in different proportions resist easy analysis.<sup>235</sup> Perhaps a hypothetical post-merger redemption test with mechanical standards like section 302(b)(2) would work. Most importantly, Congress should make section 356(a)(2) explicit. Indeed, even the automatic dividend rule might be preferable to the current confusion over section 356(a)(2). Although it is hard to see why we should treat as a dividend the boot received by a shareholder in a small, local concern gobbled up by a public corporation, at least the shareholder in the small concern would know what to expect when he agreed to take the boot.

None of the three branches of government has effectively dealt with section 356(a)(2) and its predecessors. The statutory language not only is the product of drafting errors,<sup>236</sup> but is also unclear<sup>237</sup>

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235. Such was the situation involved in *Wright*. See 482 F.2d at 602.

236. See *supra* text accompanying notes 43-47.



and ill-fitting for many reorganizations.<sup>238</sup> We should not be too severe, for when Congress first enacted the provision in 1924, United States income tax law was in its infancy. Moreover, corporate reorganizations are complex. Congress has had numerous opportunities since 1924, however, to amend the offensive dividend-effect language and has failed to do so. The problems with section 356(a)(2) add cumulatively to the other uncertainties in corporate tax law, inherently an abstruse area anyway.

The courts at least should receive some sympathy. They have encountered difficulties in applying section 356(a)(2) because the section is so ambiguous and ill-fitting. Still, we should not blithely disregard the misconstruction of precedent by the district courts in *Shimberg* and *Sellers*.<sup>239</sup> Nor should we countenance the flagrant misuse of an example in the legislative history by the Fifth Circuit in *Shimberg*.<sup>240</sup> Should we remove tax cases from the federal district and circuit courts? Some of the opinions construing section 356(a)(2) do evidence an ineptness for corporate tax issues.

Unlike Congress and some of the courts the Government has not demonstrated an inability to understand the problems of section 356(a)(2); but it has not shown much leadership in resolving the issues. It has acted too much as an advocate and too little as an administrator. Furthermore, it has not offered a complete analysis to support its interpretation of section 356(a)(2), as it should.

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237. *Id.*

238. *See supra* text accompanying notes 31-35.

239. *See supra* text accompanying notes 145-60.

240. *See supra* text accompanying notes 183-85.