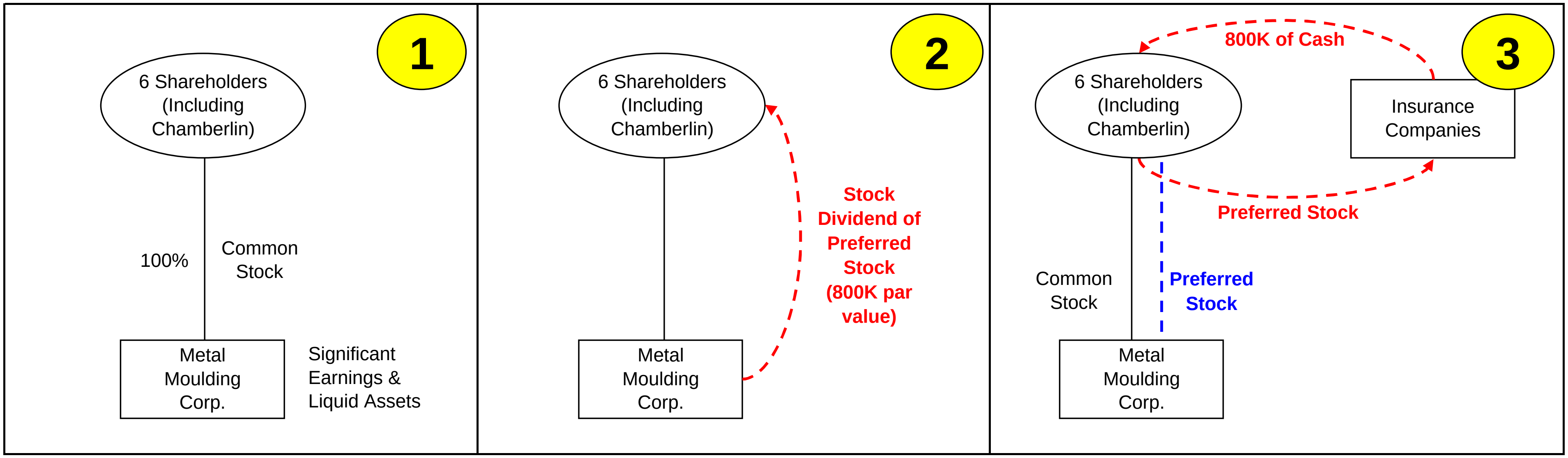
# Chamberlin v. Commissioner
# 207 F.2d 462 (6th Cir. 1953)

**Preferred Stock Bail-Out**



**Initial Structure** | **Preferred Stock Dividend (12/28/46)** | **Sale of Preferred Stock (12/30/46)**




The corporation had large accumulated earnings, large liquid assets, and was concerned about being subject to the accumulated earnings tax. However, "Chamberlin, the majority stockholder, was not willing to have the Corporation distribute any substantial portion of its earnings as ordinary dividends because his individual income was taxable at high surtax rates."

The stock dividend was non-taxable to the shareholders. Eisner v. Macomber. 252 U.S. 189 (1920) and Section 305. The preferred stock 1) paid cumulative dividends of 4.5%, 2) was subject to redemption in whole or in part at par plus specified premiums and accrued dividends, and 3) was subject to mandatory retirement over a period of 7.5 years.

The shareholders claimed that the stock dividend was nontaxable and that capital gain should be recognized on the sale of the preferred stock. The Commissioner argued that the receipt of the preferred stock constituted a dividend taxable as ordinary income. The Tax Court held for the Commissioner. The Sixth Circuit reversed, holding that the stock dividend was nontaxable and that the subsequent sale did not change the legal effect of the stock dividend. Congress reacted to this case by enacting section 306, which severely limits the ability to obtain capital gain treatment on a preferred stock bail-out.

**Ending Point**