

No. 06-3482

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**IN THE UNITED STATES COURT OF APPEALS  
FOR THE SEVENTH CIRCUIT**

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**TRIBUNE COMPANY, as agent of and successor by merger to  
the former The Times Mirror Company, itself and its consoli-  
dated subsidiaries,**

*Petitioner-Appellant,*

*v.*

**COMMISSIONER OF INTERNAL REVENUE,**

*Respondent-Appellee.*

---

Appeal from the United States Tax Court (Cohen, J.)

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**BRIEF AND REQUIRED APPENDIX FOR  
APPELLANT TRIBUNE COMPANY**

---

Crane H. Kenney  
Karen H. Flax  
*Tribune Company*  
*435 North Michigan Avenue*  
*Suite 600*  
*Chicago, Illinois 60611*

Stephen M. Shapiro  
Joel V. Williamson  
Thomas C. Durham  
*Mayer, Brown, Rowe & Maw LLP*  
*71 South Wacker Drive*  
*Chicago, Illinois 60606*

**CIRCUIT RULE 26.1 DISCLOSURE STATEMENT**

Appellate Court No: 06-3482

Short Caption: Tribune Company v. Commissioner of Internal Revenue

To enable the judges to determine whether recusal is necessary or appropriate, an attorney for a non-governmental party or amicus curiae, or a private attorney representing a government party, must furnish a disclosure statement stating the following information in compliance with Circuit Rule 26.1 and Fed. R. App. P. 26.1.

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(1) The full name of every party that the attorney represents in the case (if the party is a corporation, you must provide the corporate disclosure information required by Fed. R. App. P. 26.1 by completing the item #3):  
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(2) The names of all law firms whose partners or associates have appeared for the party in the case (including proceedings in the district court or before an administrative agency) or are expected to appear for the party in this court:  
Mayer, Brown, Rowe & Maw LLP; Latham & Watkins LLP

(3) If the party or amicus is a corporation:

i) Identify all its parent corporations, if any; and  
None

ii) list any publicly held company that owns 10% or more of the party's or amicus' stock:  
None

Attorney's Signature: \_\_\_\_\_ Date: 9/25/06

Attorney's Printed Name: Stephen M. Shapiro

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Cir. Rule 3(c). Yes \_\_\_ No X.

Address: Mayer, Brown, Rowe & Maw LLP  
71 South Wacker Drive  
Chicago, Illinois 60606-4637

Phone Number: (312) 701-7327 Fax Number: (312) 706-8684

E-Mail Address: sshapiro@mayerbrownrowe.com

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None

Attorney's Signature: \_\_\_\_\_ Date: 9/18/06

Attorney's Printed Name: Joel V. Williamson

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Cir. Rule 3(c). Yes X No \_\_\_.

Address: Mayer, Brown, Rowe & Maw LLP

71 South Wacker Drive

Chicago, Illinois 60606-4637

Phone Number: (312) 701-7229 Fax Number: (312) 706-9204

E-Mail Address: jwilliamson@mayerbrownrowe.com

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None  
\_\_\_\_\_

Attorney's Signature: \_\_\_\_\_ Date: 9/25/06

Attorney's Printed Name: Thomas C. Durham

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Cir. Rule 3(c). Yes \_\_\_ No X.

Address: Mayer, Brown, Rowe & Maw LLP  
71 South Wacker Drive  
Chicago, Illinois 60606-4637

Phone Number: (312) 701-7216 Fax Number: (312) 706-9187

E-Mail Address: tdurham@mayerbrownrowe.com

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None  
\_\_\_\_\_

Attorney's Signature: \_\_\_\_\_ Date: 9/26/06

Attorney's Printed Name: Crane H. Kenney

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Cir. Rule 3(c). Yes \_\_\_ No X.

Address: Tribune Company  
435 North Michigan Avenue, Suite 600  
Chicago, Illinois 60611

Phone Number: (312) 222-2491 Fax Number: (312) 706-4206

E-Mail Address: ckenney@tribune.com

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None

Attorney's Signature: \_\_\_\_\_ Date: 10/3/06

Attorney's Printed Name: Karen H. Flax

Please indicate if you are *Counsel of Record* for the above listed parties pursuant to Cir. Rule 3(c). Yes \_\_\_ No X.

Address: Tribune Company  
435 North Michigan Avenue, Suite 600  
Chicago, Illinois 60611

Phone Number: (312) 222-3969 Fax Number: (312) 222-4206

E-Mail Address: kflax@tribune.com

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## BRIEF FOR APPELLANT TRIBUNE COMPANY

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### JURISDICTION

This case involves an income tax deficiency for 1998 asserted against Tribune Company (“Tribune”), as successor by merger to The Times Mirror Co. (“Times”). The Commissioner issued the Notice of Deficiency on August 14, 2002. Tribune filed a timely Petition with the Tax Court. Doc. 1.<sup>1</sup> Its principal place of business at that time was Chicago, Illinois. The Tax Court had jurisdiction under §6214(a) of the Internal Revenue Code (“Code”).<sup>2</sup>

The Tax Court entered its decision on June 23, 2006. Doc. 95. Tribune filed a timely Notice of Appeal on September 7, 2006. Doc. 96. This Court has jurisdiction and venue under §§7482(a)(1) and 7482(b)(1)(B).

### ORAL ARGUMENT REQUEST

Pursuant to Circuit Rule 34(f), appellant respectfully requests oral argument.

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<sup>1</sup> “Doc.” refers to the Tax Court’s docket sheet.

<sup>2</sup> References are to the 1986 Code, 26 U.S.C. §1 *et seq.*

## ISSUE PRESENTED

The issue in this appeal is whether the Tax Court erred when it rejected Times' contention that its divestiture of Matthew Bender & Co. ("Bender") was a stock-for-stock merger qualifying as a tax-free "reorganization," in which Times gave up stock in Bender in exchange for stock in the company that acquired Bender ("MB Parent").

In resolving this question of law this Court must decide whether the Tax Court erred in disregarding MB Parent's separate corporate existence and in recharacterizing the merger as a cash sale.

## STATEMENT OF THE CASE

The Commissioner determined a \$551,510,819 deficiency in federal income tax arising from Times' divestiture of two subsidiaries, Bender and Mosby, Inc. ("Mosby"). The parties agreed to try the Bender issue first. The Tax Court held that the Bender divestiture was a taxable sale and not a reorganization. 125 T.C. 110 (2005). While reserving their right to appeal, the parties agreed that the Bender opinion controlled the Mosby transaction. The Tax Court so held in a supplemental opinion on January 26, 2006 (T.C. Memo. 2006-12, 91 T.C.M. (CCH) 678 (2006)).

Tribune appeals the court's holding that the Bender and Mosby transactions are taxable sales rather than tax-free reorganizations. While this brief focuses on the Bender transaction, the arguments presented apply equally to the Mosby transaction.

### **STATEMENT OF FACTS**

Times decided to divest Bender for business reasons that are not in dispute. As allowed by the Code, Times and Reed Elsevier ("Reed") negotiated the disposition of Bender as a merger in which Times (through its wholly-owned subsidiary TMD) exchanged its stock in Bender for stock in MB Parent, a subsidiary of Reed that ultimately obtained control of Bender. As a result of this merger, Times and Reed now share control and continuing economic interests in Bender, MB Parent, and an investment company owned by MB Parent.

Under the Code and governing Treasury regulations, the core distinction between a sale, in which the gain is taxable to the seller, and a reorganization, in which tax burdens are allocated to the acquiring party, is whether the disposing party receives stock for the business it is divesting. A transaction of the type chosen by the parties here qualifies as a reorganization so long as 80% of the value of the consideration re-

ceived by the disposing party is stock rather than cash or other property. See pp. 36-38, *infra*. Save for this test (the “80% test”), the Commissioner did not dispute that the merger at issue satisfied the requirements for a reorganization. The Commissioner did dispute, however, whether the stock that Times received in exchange for Bender was worth what the negotiating parties believed it was worth, as set forth in the transaction documents.

Only by recharacterizing the transaction from top to bottom and disregarding the separate existence of corporate entities in violation of controlling law was the court able to hold that this corporate merger was not a reorganization. The court redefined the transaction as a “sale” in which the “seller” received “unfettered control” over the “proceeds of sale” and the buyer received the Bender business without strings attached. The court’s disregard of the form of the Bender merger eviscerates a central objective of the Treasury regulations, which had been modified shortly before the merger to provide certainty as to the tax result and to avoid precisely the type of subjective factual inquiry applied by the court.

The court's reasoning has drawn heavy criticism from leading commentators. See BORIS I. BITTKER & JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS (7th ed., Supp. 2006) Supp. ¶12.23[1] ("BITTKER & EUSTICE") (enumerating "the many troublesome issues raised by the *Tribune* opinion," including "disregarding the transactional form adopted by the parties," giving "undue weight" to the taxpayer's financial accounting, and the court's aversion to ordinary "tax planning"); MARTIN D. GINSBURG & JACK S. LEVIN, MERGERS, ACQUISITIONS, AND BUYOUTS 8-49 to -53 (July 2006) (criticizing the court's "broad and troubling" treatment of issues in this case, its attribution of enormous value to rights that have "minor economic value," its "disregar[d]" of "fiduciary duties," and its "inconsisten[cy]" with normal federal income tax treatment of parent and subsidiary corporations as separate persons"); Robert A. Rizzi, *Tribune Company and the Deconstruction of the Reorganization Rules*, 33 J. CORP. TAX'N 23, 25, 27-28 (Mar.-Apr. 2006) ("RIZZI") (describing the court's ruling as a "radical departure from fundamental assumptions of corporate law" that "invites chaos"). To understand just how mistaken the court's ruling is as a

matter of law, it is necessary to describe the background of the reorganization, the steps it employed, and its consequences for the parties.

**A. Genesis of the transaction.**

Times engaged in legal publishing through Bender. A5-6.<sup>3</sup> In 1997, Times concluded that Bender could no longer compete as a stand-alone entity, in part because Bender's competitors had an "immense" advantage in the critical area of electronic products and distribution. Ex. 115-J, p. 24315. Times accordingly decided to divest Bender. A7.

While cash sales of subsidiaries are taxable, the Code authorizes various nontaxable divestiture methods, such as reorganizations and spin-offs. §§368, 355. Goldman Sachs recommended that Times structure the divestiture of Bender as a reorganization under §368(a)(2)(E), commonly referred to as a reverse triangular merger. Stip. 45-46, 48; Ex. 334-J. Times informed bidders that bids incorporating the merger structure would be preferred. SA57-59.

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<sup>3</sup> "A" refers to the Tax Court's opinion, reproduced in appellant's Short Appendix, "Ex." to trial exhibits, "Stip." to trial stipulations, "Tr." to the trial transcript, and "SA" to appellant's Separate Appendix. The pertinent statutory and regulatory provisions are attached hereto in appellant's Addendum.

In negotiating the divestiture, Times and the potential acquirers had adverse tax interests. Times wanted a tax-free reorganization, but Reed (the winning bidder) would have preferred to structure the acquisition as a taxable purchase of Bender's assets, which would have increased its tax basis in the assets and provided larger tax deductions to Reed on a going-forward basis. SA108-11; Ex. 149-J, pp. 3770-71.

In the end, Reed agreed to a merger in which the stock of Bender would be valued at \$1.375 billion and TMD would receive MB Parent common stock in that amount. A23; Stip. 124. Times conditioned closing the transaction upon a detailed review by its outside counsel, Gibson, Dunn & Crutcher, which opined that the merger structure qualified as a tax-free reorganization. Stip. 174-175.

**B. Implementation of the merger.**

**1. Reorganization law requires the acquiring party to convey a stock interest to the divesting party.**

The basic requirement of reorganization law is simple: the acquiring party (MB Parent) must exchange stock in return for the divested corporation's (Bender's) stock or assets. Receipt of stock is nontaxable to the divesting party (Times' subsidiary TMD) because the divested stock or assets remain in "corporate solution," *i.e.*, held in corporate form.

§§354, 368(a)(1)(A)-(C); BITTKER & EUSTICE ¶12.01[3]. See pp. 31-38, *infra*.

Reorganizations may take several forms. The form at issue here is a reverse triangular merger governed by §368(a)(2)(E). In this type of merger, a “controlling corporation” (MB Parent) causes a corporation under its control to merge into the acquired corporation (Bender), with Bender emerging as the surviving legal entity. As consideration, the “former shareholders” in Bender (TMD) must receive stock in the “controlling corporation” (MB Parent) which acquires the divested corporation (Bender). §§368(a)(1)(A), (a)(2)(E). The merger is “triangular” because three corporations are involved. It is “reverse” because Bender, the divested business, survives the merger.

**2. The Bender merger was a stock transaction.**

Since the steps taken to bring about the merger are neither in dispute nor central to the issues on appeal, they are set forth in Attachment A. Save for the “80% test” (see pp. 36-38, *infra*), the Commissioner does not dispute that these steps satisfy the requirements of the reorganization rules. A107-08.

In summary, Reed formed MB Parent and capitalized it with \$1.375 billion in cash to effectuate the reverse triangular merger. A26, 72-75; Stip. 144-45. Through a series of transactions involving the creation of common and preferred stock in MB Parent, a subsidiary of MB Parent then merged into Bender, with Bender surviving and controlled by MB Parent. See Attachment A.

In exchange for its stock in Bender, TMD, Times' subsidiary, received all of MB Parent's common stock. The sole consideration given for the Bender stock—according to all the transactional documents, public filings, and trial testimony—was MB Parent stock valued by the parties at \$1,375,000,000. Stip. 291-292; Exs. 7-J, 168-J, 515-J, 643-J, 644-J; SA72-74, SA99-100, SA112, SA116-18.

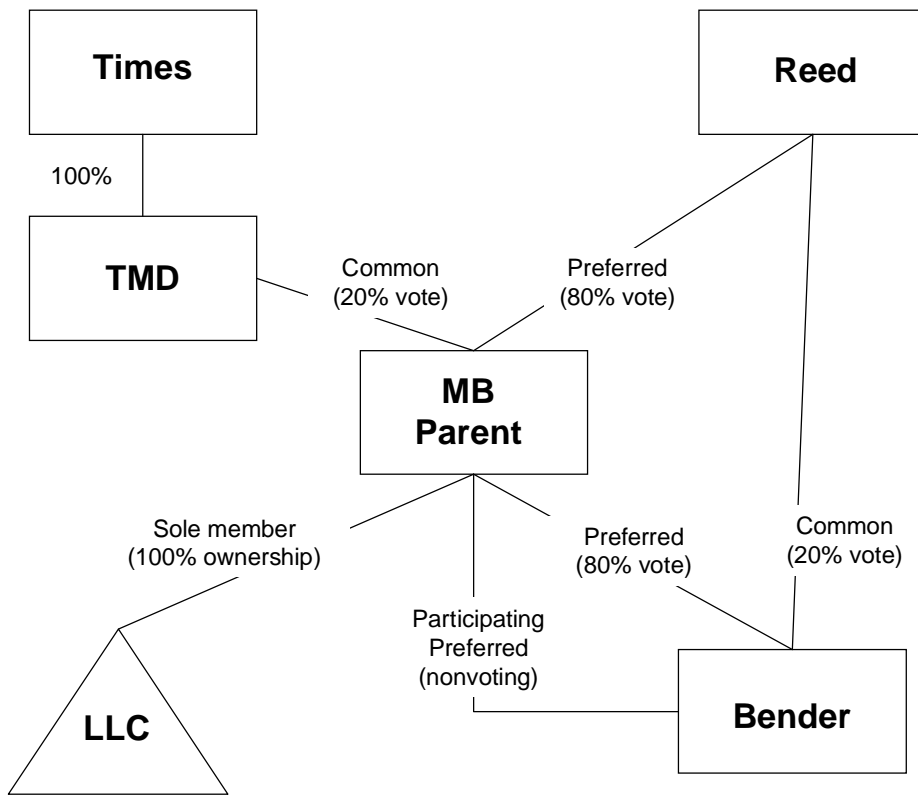
After the merger, MB Parent contributed its \$1.375 billion in cash to Eagle I ("LLC"), a limited liability company of which MB Parent—jointly owned and controlled by Reed and Times—was the sole member. A75. Times was appointed as LLC's manager. Stip. 281.

The results of the merger are shown by the following "before" and "after" charts:

Before Merger



After Merger



After the reorganization, therefore, Reed and Times jointly own MB Parent, and MB Parent and Reed jointly own Bender. A74-75. As described below, Times' ownership of common stock in MB Parent

(through its wholly-owned subsidiary TMD) gives Times the ultimate residual claim to MB Parent's assets, which includes voting preferred and participating preferred stock in Bender. As a result, Times has a continuing economic interest in Bender and a significant voice in its management. Similarly, Reed's preferred stock in MB Parent gives it a continuing economic interest in the funds held in LLC and control over distributions of these funds by MB Parent. Far from being a sale transaction in which the parties walk away from each other after closing and forever part ways, in this case the parties' interests remain intertwined in a manner that imposes significant limitations on each party's rights.

**3. In contrast to a sale transaction, the merged business was expected to operate for at least twenty years.**

The merger structure remains in place today. The merger terms stipulate that Times cannot terminate the joint ownership of Bender and MB Parent until 2018. Thereafter, either Times or Reed may require purchase or redemption of the MB Parent and Bender preferred shares, which would leave Times the sole owner of MB Parent and Reed the sole owner of Bender. SA195, SA213-14, SA220.

Before 2018, Reed may compel termination of the structure only under extraordinary circumstances: if LLC's net worth falls below \$275

million; MB Parent becomes insolvent or bankrupt; or LLC fails to make a distribution required by the LLC agreement. Reed also may end the structure by selling Bender to a third party, but could not do so for five years without Times' consent. SA195, SA229-32.

**4. Unlike a sale transaction, the merger provided for Times and Reed to have continuing economic stakes in LLC and Bender through joint ownership and management of MB Parent.**

**a. After the merger, MB Parent owned LLC and stock that gave it a continuing stake in Bender.**

After the merger, MB Parent was the owner of LLC, an investment company. LLC's controlling agreement provided that "[t]he purpose of the Company is to invest in such property or securities and to conduct such businesses and other legal activities as the Manager determines is in the best interests of the Company." A44.

In 1998-2000, Times, as investment manager, invested LLC's cash as follows: (i) \$946 million in previously issued Times common stock, purchased in the open market (SA87); (ii) \$233 million in a partnership with trusts held by significant Times shareholders; (iii) \$151 million in complete ownership of operating companies Newport Media (shopper publications), ValuMail (mail advertising), and ASAC (airspace use); (iv) \$28 million in minority stakes in eight internet ventures, including

WorldRes (online travel reservations) and ICSA (internet security); (v) \$9 million in APAC Customer Service (call-center management); and (vi) \$16 million in low-income housing investments. Ex. 564-J. Since 2000, LLC has purchased other securities and operating companies, including acquiring Chicago Magazine for \$35 million. Ex. 1013-J.

With the exception of amounts necessary to pay MB Parent's taxes (p. 48, *infra*), to fund preferred dividends that MB Parent was required to pay to Reed (pp. 14-15, *infra*), and to fund a common stock dividend paid to Times on LLC's earnings (pp. 16-17, *infra*), all the assets and earnings of LLC have remained in LLC. LLC's investments have earned 10.5-11% per annum, well above the S&P 500's 2.5% over the same period. SA139. By year-end 2002, LLC's investments had grown by over \$1 billion, exceeding \$2.4 billion. Ex. 1112-J.

In addition to its ownership of LLC, MB Parent also owns preferred stock of Bender, which gives MB Parent a continuing economic stake in Bender. MB Parent is entitled to receive dividends from Bender on that stock at an annual rate of \$3.08 million for twenty years. SA217-18.

**b. Unlike a sale transaction, Reed has a continuing stake in LLC and Times has a continuing stake in Bender.**

Reed owns preferred shares in MB Parent that give Reed a continuing economic stake in LLC's assets. Reed is entitled to receive dividends from MB Parent for twenty years at an annual rate of \$3.78 million. SA185. Because the dividends owed by Bender to MB Parent are less than the dividends owed by MB Parent to Reed, MB Parent must use LLC's funds to pay the additional amount owed to Reed. This amount was initially \$700,000 per year, but increased in 1999 after Reed contributed Lexis assets to Bender, see pp. 16-18, *infra*. From 1999-2004, the total dividends paid to Reed from LLC's funds exceeded \$5 million. Ex. 1254-P.

The LLC Agreement requires LLC to fund distributions to Reed. A46. If Bender cannot pay the required dividends to MB Parent (because of inadequate cash flow), LLC must fund the entire \$3.78 million annual dividend to Reed. Similarly, if MB Parent's preferred stock in Bender becomes worthless and thus provides no funds to MB Parent to redeem Reed's MB Parent preferred shares, MB Parent must pay the full redemption value of the preferred shares—\$68.75 million initially,

increased to \$109 million after the contribution of Lexis assets—out of LLC’s funds. SA187; Ex. 402-J, pp. 30254-61. Due to the deteriorating condition of Bender’s business (which led Times to divest it), Reed’s access to the LLC’s cash provides important financial protection for the value of Reed’s preferred shares in MB Parent.

TMD’s common stock in MB Parent also gives Times a continuing interest in Bender. As MB Parent’s sole common shareholder, Times holds the entire residual claim to MB Parent’s assets, net of the value of Reed’s preferred shares. MB Parent, in turn, holds a continuing interest in Bender through both voting preferred shares with a stated value of \$61.62 million and participating preferred shares, the value of which is tied to the economic performance of Bender. A65-67. Accordingly, through its common shares in MB Parent, Times benefits from any increase in the value of the Bender participating preferred shares. Conversely, if Bender goes broke, Times will suffer the lost value of both the Bender voting preferred and participating preferred shares.

**c. Unlike buyers and sellers, Reed and Times share control over MB Parent.**

Unlike a seller of assets, Times did not receive the proceeds of the Bender divestiture. To the contrary, under the LLC Agreement, any dis-

tribution of LLC's assets can be made only to MB Parent. SA247. Reed's preferred shares, with 80% voting power, give it control over any subsequent distributions from MB Parent. SA190. For example, in 1999, Times sought a dividend from LLC's earnings. Ex. 488-J. As manager of LLC, Times directed a distribution from LLC to MB Parent, but could not declare a dividend from MB Parent to Times without Reed's approval. Ex. 494-J. Reed approved only after confirming the dividend was limited to the LLC's earnings, not its corpus. Tr. 541-42. The resulting dividend was taxable to Times.

Conversely, Times' 20% vote in MB Parent (through TMD) gives it veto power over significant corporate actions affecting Bender, including dissolution, merger, changes in the terms of or sales of Bender preferred stock, debt guarantees, issuance of new stock, or amendment of the Bender Shareholders Agreement. Reed must secure Times' approval of those corporate actions, which require a unanimous decision of MB Parent's board. SA190-91.

For example, in 1999 Reed sought to contribute assets of Lexis (part of Reed's legal publishing business) to Bender. Ex. 874-J. This action required unanimous board approval, including Times' vote.

Exs. 873-J, 877-J. The contribution changed the economics of the merger structure for both Reed and Times. In exchange for its Lexis contribution, Reed received additional shares of Bender common stock. Reed also contributed an additional \$40 million in capital to MB Parent and received additional shares of MB Parent voting preferred stock. Ex. 883-J. MB Parent, in turn, contributed \$40 million in additional capital to Bender, receiving more shares of Bender voting preferred stock. Ex. 917-J.

These additional shares increased Reed's claim upon LLC's assets. MB Parent's annual Bender dividends increased to \$5.1 million. Reed's annual MB Parent dividends increased to \$6 million. The annual shortfall between those two dividends, required to be paid by MB Parent with LLC's funds, increased from \$700,441 to \$904,296. Further, Reed's MB Parent preferred stock, which MB Parent was obligated to redeem regardless of Bender's performance, increased in value to \$109 million. See pp. 14-16, *supra*.

### **C. The Tax Court's decision.**

The Tax Court (Judge Cohen) held that the Bender merger was not a tax-free reorganization but rather an ordinary "sale" in which

Times received “unfettered control” over the sale proceeds and Reed received complete control over Bender. To reach this conclusion, Judge Cohen recharacterized the transaction from stem to stern, disregarding the parties’ contractual agreements and expressed intent to accomplish a stock-for-stock merger with shared control and economic rights in Bender, MB Parent, and LLC. Because, in the court’s view, the transaction gave Times “unfettered control” over the “proceeds of sale” and Reed complete dominion over Bender, the value of the MB Parent common stock was deemed to be “negligible.” A132-33. The court therefore concluded that the Bender merger failed the “80% test” (A133) which requires that the MB Parent stock received by Times (through TMD) be worth at least 80% of \$1.375 billion. A106-08; see Code §§368(a)(2)(E)(ii), (c).

The court acknowledged that its conclusion regarding the value of the MB Parent common stock rested on its own self-declared “common-sense” (A125), rather than on the testimony of any participant in the transaction, any document that embodied the merger, or either party’s expert testimony. Most remarkable of all, the court’s legal analysis does not cite or refer to the governing Treasury regulations, which provide

detailed standards that distinguish between a “sale” and a “reorganization” for tax purposes.

The practical result of this decision is that the Commissioner has received a windfall by “whipsawing” Times and Reed, *i.e.*, denying to both the tax benefits to which one of them, depending upon the form of their transaction, was certainly entitled. See pp. 28-31, *infra*. This is exactly the result the regulations (which the court ignored) were designed to prevent.

#### **INTRODUCTION AND SUMMARY OF ARGUMENT**

This case presents legal issues affecting every taxpayer planning a business divestiture. The Tax Court’s opinion disregards a detailed set of rules designed to bring certainty to the taxation of corporate reorganizations in favor of a subjective, criteria-free factual analysis that one commentator has described as a “radical departure from fundamental assumptions of corporate tax law.” RIZZI at 28.

Times and Reed negotiated the terms of the Bender transaction as a reorganization, rather than a cash purchase; the parties’ choice of a reorganization offered a tax benefit to Times but imposed a tax burden on Reed. To effectuate the transaction, ownership of Bender was trans-

ferred to MB Parent, a corporation structured to last for at least twenty years, still operating successfully today, and jointly owned and controlled by Times and Reed. MB Parent also became owner of LLC, an investment company capitalized with \$1.375 billion. Due to the interlocking ownership of MB Parent, LLC, and Bender (see pp. 13-18, *supra*), Reed maintains a continuing interest in and control over LLC's assets and Times maintains a continuing interest in and control over Bender.

Given the form of the transaction chosen by the parties, the court should have followed the Treasury regulations, which at that time had been recently amended and which govern whether a merger should be treated as a cash sale or as a tax-free reorganization. As we describe in Part I, those regulations prescribe bright-line criteria under which a transaction will be treated as a reorganization, not a sale, if the transferor receives stock as consideration. The regulations focus solely on whether stock was given as consideration in determining whether a transaction should be treated as a sale or as a reorganization.

In ruling against Times, however, the court did not even cite the controlling regulations. The court instead based its decision on a radical

restructuring of the Bender merger. See BITTKER & EUSTICE Supp. ¶12.23[1], at S12-17 to -18 (it is “quite evident” that the court “disregard[ed] the transactional form adopted by the parties”). The court held that the consideration given for Bender was not stock in MB Parent, as the parties had agreed, but rather “control over the cash” owned by LLC. A120. As a result, the court “disregard[ed] the existence of MB Parent” as a mere “intermediary” because MB Parent purportedly “lacked control over any assets.” A130, 133. Relying upon those recharacterizations, the court concluded that, as a matter of “commonsense,” the value of MB Parent’s common stock “was negligible.” A125, 133. Hence, the court concluded that Times sold Bender for cash. A132-33.

We demonstrate in Part II that this ruling, like the court’s disregard of controlling regulations, was legal error. In applying its subjective analysis, the court failed to mention, much less apply, the governing standards summarized by this Court in *Northern Indiana Public Service Co. v. Commissioner*, 115 F.3d 506 (7th Cir. 1997) (“*NIPSCO*”). Under those standards, MB Parent’s existence and ownership of assets were entitled to respect if, first, the corporation engaged in substantive business activity and, second, the form of the transaction chosen by the

parties resulted in non-tax changes in their economic positions. The record is clear that each of those conditions was satisfied here.

With respect to the first condition, MB Parent has continuously engaged in the substantive business activity of investing its assets for profit. The cash originally held by LLC has been deployed in investments that have greatly appreciated in value and generated significant income.

With regard to the second condition, the transaction continues to affect the economic positions of Times and Reed. Contrary to the court's treatment of MB Parent as a mere conduit, MB Parent's existence is a direct impediment to Times taking possession of MB Parent's assets. Because of its voting control over MB Parent, *Reed must approve any distribution from MB Parent to Times*. When Times requested a dividend out of MB Parent's earnings, Times was required to seek Reed's approval. Also, Reed has a direct economic interest in LLC's assets, because, as the court recognized, distributions from LLC are necessary to pay the dividends to which Reed is entitled on its MB Parent preferred stock. See p. 15, *supra*.

Similarly, as ultimate residual claimant to MB Parent's assets, Times has a continuing interest in Bender's economic performance, which affects the value of MB Parent's preferred stock in Bender. Reed also must secure Times' approval of certain business decisions affecting Bender, such as Reed's contribution of Lexis assets to Bender.

In short, MB Parent is a real entity with real assets and its common stock had the value that the transacting parties agreed it had. Contrary to the court's ruling, Reed's and Times' economic and business relationships are not those of a buyer and seller, but those of shareholders in MB Parent as a result of a reorganization.

Finally, in Part III we show that the court's conclusion that the stock conveyed to Times in the reorganization was worth far less than the \$1.375 billion value of Bender is attributable to the court's faulty legal analysis described in Parts I and II, not to any genuine dispute over the value of the stock. In addition, the Commissioner's valuation theory is directly contrary to this Court's decision in *Estate of Curry v. United States*, 706 F.2d 1424 (7th Cir. 1983), which holds that an integrated bundle of property cannot be bifurcated for valuation purposes. Accord-

ingly, this Court should require entry of judgment in favor of the taxpayer.

### STANDARD OF REVIEW

At issue is whether the Bender transaction should be characterized as a “reorganization” or a “sale.” This Circuit follows the rule that the “general characterization of a transaction for tax purposes is a question of law” subject to *de novo* review. *Frank Lyon Co. v. United States*, 435 U.S. 561, 581 n.16 (1978), followed by *Wellons v. Commissioner*, 31 F.3d 569, 570 (7th Cir. 1994); see *Newman v. Commissioner*, 894 F.2d 560, 562 (2d Cir. 1990).

Under this standard, reversal is required. In holding that MB Parent’s corporate existence should be disregarded, the court ignored the governing law of this Circuit stated in *NIPSCO* and failed to apply Treasury regulations that were specifically drafted to distinguish “reorganizations” from “sales.”

The court sought to evade *de novo* review by labeling its conclusions as “factual analysis.” A109, 120. But merely labeling a legal ruling as one or more “ultimate findings of fact” (A106) does not make it so. See 9A CHARLES ALAN WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE

& PROCEDURE §2579, at 537 (2d ed. 1995) (“An appellate court will regard a finding or conclusion for what it is, regardless of the label the trial court may have put on it.”); *Commissioner v. National Carbide*, 167 F.2d 304, 307 (2d Cir. 1948) (Hand, J.) (refusing to defer to the Tax Court’s characterizations of the legal “issue on which the whole case turned” as a “finding of fact”), *aff’d*, 336 U.S. 422 (1949); see also *Bal-lard v. Commissioner*, 544 U.S. 40, 61-62 (2005) (criticizing Tax Court’s “concealment” of findings of special trial judge); *on remand*, 429 F.3d 1026, 1031-32 & n.7 (11th Cir. 2005) (“collaboration amongst Chief Judge Cohen, Judge Dawson, and Judge Couvillion resulted in consid-erable and fundamental modifications to the original report,” which served to “impede[ ] fully informed appellate review”).

The court’s statement that its “factual analysis” was based on the “totality of the contractual arrangements” between the parties confirms that its ruling was in reality one of law. A111. The terms of the parties’ “contractual arrangements” are undisputed; all relevant agreements were stipulated. The court’s characterization of those agreements is a legal ruling subject to plenary review. See *In re Comdisco*, 434 F.3d 963, 968 (7th Cir. 2006). In particular, whether a “substance over form”

analysis may be applied to recast the parties' transaction (A126) is a legal question subject to *de novo* review. *Frank Lyon*, 435 U.S. at 581 n.16; *Newman*, 894 F.2d at 561 (substance-over-form analysis of contracts subject to *de novo* review).

Beyond this, the present case should be subject to searching review due to the “precedential significance” of the Tax Court’s ruling in an important area of law. See *Malachinski v. Commissioner*, 268 F.3d 497, 510-12 (7th Cir. 2001) (Posner, J.) (dissenting in part, concurring in part); *Nickerson v. Commissioner*, 700 F.2d 402, 408 (7th Cir. 1983) (“when the basic facts are not disputed and the inference drawn from them by the trier of fact is the result of an overly restrictive view of what a party must prove in order to prevail we will not hesitate to exercise our power to reverse”). The Commissioner took the extraordinary step of “designating” this case for litigation, acknowledging the “significant legal issues” involved and the need to “establish judicial precedent.” Internal Revenue Manual §33.3.6.1 (Aug. 11, 2004).<sup>4</sup>

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<sup>4</sup> Former IRS Chief Counsel B. John Williams explained that the designation procedure is designed to resolve cases that “present recurring, significant legal disputes affecting large numbers of taxpayers.” 2003 TNT 82-27 (Apr. 24, 2003) (available on Lexis). Designation is rare; from 2000 to May 7, 2004, (cont’d)

## ARGUMENT

### **I. The Tax Court Erred When It Disregarded the Reorganization Rules and Applied a Subjective Factual Analysis to Recharacterize the Bender Transaction.**

#### **A. Application of the reorganization rules depends upon the form of the transaction.**

There is no dispute that Times divested Bender for legitimate business reasons. A110. Given this business decision, Times and Reed had two choices for structuring the tax aspects of the transaction. They could structure the transaction as a taxable sale of the Bender assets (see Code §1001), as initially sought by Reed. See pp. 6-7, *supra*. Times would then incur taxable gain and Reed would receive additional tax deductions for depreciation and amortization reflecting the cost of the purchased assets, thus reducing its tax liability. Alternatively, they could structure the transaction as a reorganization. See Code §§354, 361, 368. Times would then pay no tax on its gain and Reed would not

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only 10 cases were designated. 2004 TNT 90-9 (May 10, 2004) (available on Lexis). IRS Chief Counsel Donald Korb recently described this case as a “significant development,” the “principles [of which] will be cited 20 years from now” (2006 TNT 205-3 (Oct. 24, 2006) (available on Lexis)), and which “will change the landscape in tax planning” (2006 TNT 208-2 (Oct. 27, 2006) (available on Lexis)).

receive any additional tax deductions. See BITTKER & EUSTICE ¶¶10.42[6] (stock sale implications), 12.01[1] (reorganization implications).

After arm's-length negotiations, Times and Reed chose to structure their transaction as a reorganization. The proper legal characterization of that transaction depends on whether the form the parties negotiated complies with the Code and regulations. As this Court has explained: "When we are dealing with statutory terms of art, the form-substance dichotomy is a false one. 'Substance' can only be derived from forms created by the statute itself. Here substance *is* form and little else; there is no natural law of reverse triangular mergers." *United States v. Howell*, 775 F.2d 887, 890 (7th Cir. 1985) (original emphasis, citation omitted); see *Esmark v. Commissioner*, 90 T.C. 171, 183 (1988) ("Congress enacted a statute under which tax consequences are dictated by form; to avoid those consequences, [the Commissioner] must demonstrate that the form chosen by petitioner was a fiction that failed to reflect the substance of the transaction."), *aff'd*, 886 F.2d 1318 (7th Cir. 1989).

With the advice of experienced legal counsel, the parties carefully negotiated the Bender transaction as a stock-for-stock exchange in which Times gave up stock in Bender in return for stock in MB Parent that the parties valued at \$1.375 billion. The triangular merger form negotiated by the parties is “by far the most frequently used acquisition technique[ ].” BITTKER & EUSTICE ¶12.25[1], at 12-94. The Tax Court did not dispute that the Bender transaction complied with all of the formal reorganization requirements. A110.

Issues of form are particularly important in the field of corporate reorganizations. See BITTKER & EUSTICE ¶12.01[4], at 12-13 (“It cannot be overemphasized that the statutory definition of ‘reorganization’ in §368(a)(1) is entirely formal.”). Structuring a reorganization as a reverse triangular merger requires that the parties take the steps necessary to qualify under §368(a)(2)(E). The form of the transaction, and thus its expected tax consequences, directly influences the parties’ negotiating positions. *Id.* ¶12.01[4]; see *Newman*, 894 F.2d at 562-64.

This case provides a textbook example of how the form of a corporate reorganization affects the parties’ bargain. By structuring the Bender transaction as a reorganization, the parties expected that Times

would not be taxed. This form, however, imposed a significant tax burden on Reed. If Reed, instead of agreeing to a reorganization, had purchased the assets of Bender for \$1.375 billion in cash as it preferred to do, Reed would then have been entitled to claim up to \$1.375 billion in additional depreciation and amortization deductions, thereby decreasing its tax bill over time. By agreeing to a reorganization, however, Reed (through MB Parent) inherited Bender's much lower basis in the assets and thus gave up this significant tax advantage. BITTKER & EUSTICE ¶12.01[4], at 12-14 (conflicting tax outcomes between a sale and a reorganization are "typically reflected in the business bargain").

Here, however, the Commissioner and the Tax Court have "whipsawed" Times and Reed by recharacterizing the form of their transaction, denying the benefits of a reorganization to Times and the benefits of a purchase to Reed, thus denying to both the tax benefit to which one of them, depending upon the form of their transaction, was certainly entitled. See *McDonald's Restaurants v. Commissioner*, 688 F.2d 520, 528 (7th Cir. 1982) (criticizing Commissioner for "heads-I-win, tails-you-lose" approach).

**B. The Bender transaction complied with the requirements of the reorganization regulations.**

Although the reorganization rules are complex, their basic premise is simple: the rules assume that the receipt of stock in the new corporate structure is a continuation of the interest in the old structure and therefore no gain or loss should be recognized. BITTKER & EUSTICE ¶12.01[1]; see *McDonald's*, 688 F.2d at 523. Thus, §354 focuses on the receipt of stock in providing that the shareholders in a reorganization will not recognize gain or loss when they exchange stock with other parties to the reorganization.

Here, it is undisputed that, save for the 80% test, the Bender transaction satisfied all the requirements to qualify as a reverse triangular merger. A general description of the remaining criteria for qualifying as a reorganization can be found in BITTKER & EUSTICE ¶¶12.22, 12.23, 12.25[3], 12.61.<sup>5</sup>

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<sup>5</sup> The Bender merger was a statutory merger (a “Type A” reorganization), as described in §§368(a)(1)(A) and (a)(2)(E). It also qualifies as a “stock-for-stock” exchange as described in §368(a)(2)(B) (a “Type B” reorganization). In this context, the requirements for a Type A and Type B reorganization are effectively the same, except that a Type B reorganization must involve the exchange of stock solely for voting stock, whereas in a reverse triangular Type A reorganization, only 80% of the consideration need be voting stock (*i.e.*, 20% (cont’d))

In reviewing the Tax Court’s conclusion that the Bender merger should be treated as a sale, two tests are relevant: the continuity of interest (“COI”) test, which applies to all acquisitive reorganizations, and the “80% test,” which applies only to reverse triangular mergers.

**1. The Bender transaction satisfied the COI test for a reorganization.**

The COI requirement is intended “to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss.” Treas. Reg. §1.368-1(e)(1)(i); see BITTKER & EUSTICE ¶12.21[6]. COI requires that, in the context of the Bender transaction, TMD, the original shareholder of Bender, “preserve” its “proprietary interest” in Bender following the reorganization. Under the regulations, this continuity of interest is “preserved” by obtaining a proprietary interest in MB Parent, the acquiring corporation:

A proprietary interest in the target corporation is preserved if, in a potential reorganization, it is exchanged for a proprietary interest in the issuing corporation. . . . However, a proprietary interest in the target corporation is not preserved if, in connection with the potential reorganization, it is acquired by the

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can be other consideration). A107-09. For simplicity, Tribune’s argument focuses on the requirements for a Type A reorganization.

issuing corporation for consideration other than stock of the issuing corporation . . . .

Treas. Reg. §1.368-1(e)(1). The regulatory test for COI is thus straightforward: to the extent that the target shareholder (TMD, the shareholder of Bender) receives stock in the issuing corporation (MB Parent), the COI requirement is satisfied.

The COI regulations that govern this case were issued in early 1998, shortly before the Bender transaction. The Treasury Department determined that a change was necessary because prior to this change, application of the COI test by the courts often led to inconsistent results based upon an “intensive inquiry into nearly identical facts.” T.D. 8760, 63 Fed. Reg. 4174, 4175 (Jan. 28, 1998). The uncertainties involved in this intensive factual approach allowed taxpayers to “whipsaw” the Commissioner (and the Commissioner to “whipsaw” taxpayers) by taking inconsistent positions. *Id.* (citing *McDonald’s*, 688 F.2d at 520).

The Treasury thus revised the Regulations to state a bright-line rule—if the target shareholders receive stock, COI is met, but if they receive property other than stock, COI is not met. This change was intended to “greatly enhance administrability” and prevent “whipsaws” resulting from inconsistent treatment by the parties. *Id.*

Because the COI test is mechanical, focusing exclusively upon the form of the consideration received, the economic or financial accounting results of a transaction are irrelevant in judging whether it is a “sale” or a “reorganization.” Thus, even though shareholders may “sell” their shares in an economic sense by exchanging them for marketable stock in a merger transaction, they are treated under the COI rules as “preserving” their original proprietary interest. See BITTKER & EUSTICE ¶12.01[2]. As Bittker and Eustice point out, even the merger of a neighborhood software business with a giant company like Microsoft qualifies as a reorganization, provided the shareholders of the small business receive stock and thereby maintain their proprietary interest in the enterprise—“although the local merchant . . . may feel, quite rightly, that he has sold out.” *Id.* at 12-11. The Code “uses the term ‘reorganization’ in a very special way,” encompassing transactions that involve “a disposition of corporate assets to another corporation”; it does “almost nothing to segregate the transactions according to their economic consequences.” *Id.* at 12-10 to -11.

Another important aspect of the COI rule is that the assets held by the acquiring corporation are irrelevant so long as the transferor re-

ceives stock. Congress specifically allowed an *operating* company, such as Bender, to merge tax-free into a company that holds only cash or a portfolio of investments:

The continuity-of-interest doctrine assumes that the receipt of stock in exchange for stock necessarily ensures a continuing interest, without regard to the economic results of the transaction. . . . [I]f [a] closely held company is merged into an investment company or other corporation with a broad spectrum of business activities, the exchange may be similar to a sale of the original stock coupled with an investment in a diversified portfolio of investments.

*Id.* ¶12.21[9], at 12-45.

Conversely, if a transaction’s “substance” satisfies the “policies of the reorganization regime” but does not comply with the formal rules, it will be subject to tax. *Id.* ¶12.01[4], at 12-13. Thus, a transaction in which the transferor receives preferred stock mandatorily redeemable after five years satisfies the COI test, but receipt of a 100-year bond does not, even though the bond conveys a longer term interest in the corporation. Compare Rev. Rul. 78-142 with *Roebeling v. Commissioner*, 143 F.2d 810 (3d Cir. 1944).

The COI rule confirms this Court’s observation that “taxation is full of cases in which economically-identical things receive different tax treatment because done in a different form.” *Grimes v. Commissioner*,

851 F.2d 1005, 1010 (7th Cir. 1988). Here, parties with adverse interests negotiated the transaction as a stock-for-stock exchange, not as a sale of assets for cash. Under the COI rule, the Tax Court should have respected the negotiated form of the transaction.

**2. The Bender transaction satisfied the 80% test for a reorganization.**

In the case of a reverse triangular merger, the 80% rule places a further refinement upon the COI requirement that the transferor receive stock. Under the 80% test, the divesting party must transfer stock representing “control” of the corporation to be acquired, *i.e.*, 80% voting power and 80% of each class of nonvoting shares, in exchange solely for *voting* stock given by the acquiring party. Code §§368(a)(2)(E)(ii), (c). The remaining 20% of the consideration may be in the form of “boot,” *i.e.*, cash or other consideration. The Commissioner and Tribune have agreed that the “80% test” requires that the MB Parent common stock received by Times in exchange for 100% of the Bender stock be worth at least 80% of \$1.375 billion. A106-08.

As negotiated by the parties, the form of the Bender merger plainly satisfied this requirement. The sole consideration received by Times was MB Parent common stock, which the parties valued at

\$1.375 billion. In applying the 80% test, the Tax Court should have accepted the form of the transaction negotiated by the parties at arm's length.

The “form chosen” by the parties—a stock-for-stock merger—was not a “fiction” and the Tax Court therefore had no authority to recharacterize the merger as a cash sale. See *Esmark*, 90 T.C. at 183. Times received stock in MB Parent and the assets held by MB Parent remained in corporate solution. Although Times had the obligation to manage LLC's assets, Times' access to these assets, owned by MB Parent, was controlled by Reed and thus Times could not treat the assets as its own. Since Times did not receive cash, but instead received stock which “preserved” its proprietary interest in the continuing enterprise as required by the COI regulations, the Bender transaction carried out the purpose of the reorganization regulations. See BITTKER & EUSTICE ¶12.01[3], at 12-12 (“The traditional theory of the reorganization provisions is that gain or loss should not be recognized on changes of form when the taxpayer's investment remains in corporate solution.”); *Helvering v. Minnesota Tea Co.*, 296 U.S. 378, 384-86 (1935) (“The transaction here was no sale, but partook of the nature of a reorganiza-

tion, in that the seller acquired a definite and substantial interest in the purchaser” through conveyance of stock); *John A. Nelson Co. v. Helvering*, 296 U.S. 374, 376-77 (1935) (it was legal error to recharacterize a merger as a cash “sale” where the divesting party acquired a “substantial interest in the affairs of the purchasing corporation”).

**C. The Tax Court erred when it gave weight to factors unrelated to the objective criteria of the reorganization regulations.**

Measured against the standards set forth in the applicable regulations, the Tax Court’s ruling was plainly in error. The issue in this case is whether the Bender transaction should be treated as a “sale” or a “reorganization.” The regulations explicitly provide that this issue is controlled by the COI test, which focuses solely upon the consideration received by the transferor. The court, however, ignored the COI requirement. By its own admission, the court applied a “factual analysis of the totality of the Bender transaction” which included the parties’ “contemporaneous statements,” their “subsequent conduct,” the financial accounting for the transaction, and representations to “shareholders and to regulatory bodies.” A109, 111. The court’s opinion adopts the very

type of “intensive inquiry” into the facts which the regulations had recently rejected as arbitrary and too difficult to administer.

The court’s erroneous reliance upon extraneous, irrelevant evidence is most apparent in its discussion of the financial accounting for the transaction, which treated it as a sale and allowed Times to consolidate LLC’s assets in Times’ financial statements. As Bittker and Eustice have observed, the accounting for the Bender transaction is irrelevant to its status as a reorganization. See BITTKER & EUSTICE Supp. ¶12.23[1], at S12-18 (criticizing court’s “undue” reliance on taxpayer statements and the “highly questionable” but “significant weight” it gave to “accounting treatment”). *All* transactions qualifying as reverse Type A reorganizations are “sales” in a business and accounting sense insofar as the statute requires the transfer of at least 80% of the Target’s shares (under the 80% test), meaning that a large controlling block of shares will change hands. Such reorganizations are treated as “sales” *for financial accounting purposes*, regardless of their tax treatment. Hence, it is unsurprising—and irrelevant—that businessmen and financial accountants would refer to such transactions as a “sale.” See *id.* at S12-18 n.163.6 (“The term ‘sale’ is frequently used in the financial

press to mean disposition (either taxable or tax-free as the case may be).”).

It was legal error for the court to rely on financial accounting rules because financial accounting does not govern characterization for tax purposes. *Thor Power Tool v. Commissioner*, 439 U.S. 522 (1979). As this Court has recognized, this is especially true in the reorganization context, where financial accounting imposes standards that have no bearing on tax treatment. *McDonald's*, 688 F.2d at 522 n.6.

Nevertheless, the court believed that the treatment of LLC’s cash on Times’ consolidated financial balance sheet meant that Times owned LLC’s cash. A116. Consolidation accounting for financial purposes, however, depicts consolidated entities as though they were a single enterprise and their separate accounts were single consolidated accounts. Since LLC’s cash constitutes its own working capital, it is included in the Times *group’s* consolidated working capital account. Ex. 1356-P, pp. 11-13. However, this accounting treatment does not mean that Times owns the assets of its affiliates or that a consolidated affiliate’s working capital constitutes Times’ working capital. Before consolida-

tion, Times' accounts show that LLC's cash is an asset of LLC, not Times or TMD. Exs. 368-J, p. 11795; 369-J, p. 11816; 1352-R (Ex. F).

## **II. The Tax Court's Subjective Factual Analysis Is Contrary to the Law of this Circuit.**

As described in Part I, the Tax Court disregarded both the form of the parties' transaction and the comprehensive regulations designed to provide certainty to parties negotiating complex corporate reorganizations. In their place, it substituted a subjective "I know it when I see it" approach to defining corporate reorganizations that is directly contrary to the analysis set forth by this Court in *NIPSCO*, 115 F.3d 506. The reorganization negotiated by Times and Reed was sound in substance as well as form under the principles set forth in *NIPSCO* and was far from the sort of "fiction" that may be disregarded. *Esmark*, 90 T.C. at 183.

The court's deconstruction of the Bender transaction began with the assumption that, contrary to the actual transactional form, the "consideration received" by Times "was not common stock in MB Parent" but "control over the cash deposited in the LLC." A120. The court thus adopted the Commissioner's claim that the "substance of the Bender Transaction" was a "swap" of Bender for \$1.375 billion in cash.

A110, 132-33. As a result, the court held that the stock in MB Parent that Times received had “negligible” value and the Bender transaction therefore failed the “80% test.” A133.

Critical to this reasoning is that the court treated Times as having received “all incidents of ownership of the \$1.375 billion.” A119. But it is undisputed that LLC owned these funds and that LLC was owned by MB Parent, *a separate corporation that Reed (not Times) controlled for purposes of declaring common stock dividends*. Times cannot receive LLC’s assets except through the payment of common stock dividends from MB Parent, and such dividends cannot be paid to Times without Reed’s agreement. See pp. 13, 16-17, *supra*. Thus, the funds can be treated as having been “received” by Times only if MB Parent’s separate corporate existence is completely ignored.

That is precisely what the court did. It held that MB Parent was a mere “intermediary” and that its separate corporate existence and “bare title in the LLC” should be disregarded. A126-27, 130-31. Having ignored MB Parent’s existence and ownership of LLC, which actually owned the funds, the court then treated Times as if it had directly “receive[d] the proceeds of [a] sale” (A132) with “unfettered control over

\$1.375 billion in cash.” A133. Ignoring MB Parent’s existence also led to the court’s conclusion that the MB Parent common stock was not the consideration received for the merger and that such stock had “negligible” value. A120-21, 133.

The court’s decision thus turns on whether MB Parent’s separate corporate existence and the form of the parties’ transaction can be disregarded. The Tax Court’s ruling on these points is contrary to well settled law summarized by this Court in *NIPSCO*, which the Tax Court inexplicably failed to address, though *Tribune* cited and relied upon the case. Under *NIPSCO*, MB Parent carried on (and continues to carry on) independent business and economic activity, and its existence and the form of the parties’ transaction therefore cannot be disregarded.

**A. Because MB Parent is engaged in substantive business activity, the Tax Court erred in disregarding its existence.**

**1. The Tax Court failed to apply this Court’s controlling precedent.**

Synthesizing a long line of cases beginning with *Gregory v. Helvering*, 293 U.S. 465 (1935), *aff’g* 69 F.2d 809 (2d Cir. 1934), this Court explained in *NIPSCO* that two legal standards control whether the separate existence of a corporation must be respected: whether the corpora-

tion has engaged in “substantive business activity,” and whether the form of the transaction chosen by the parties resulted in “actual, non-tax-related changes in economic position.” 115 F.3d at 511-512 (citing *Moline Properties v. Commissioner*, 319 U.S. 436 (1943), and its progeny, for the rule that “a corporation *and the form of its transactions* are recognizable for tax purposes, despite any tax-avoidance motive, so long as the corporation engages in *bona fide* economically-based business transactions”) (original emphasis). Applying this standard, and in sharp contrast to the Tax Court’s approach here, this Court in *NIPSCO* recognized the separate corporate existence of a short-lived subsidiary created to avoid taxes on a transaction.

In *NIPSCO* the U.S. taxpayer formed a Netherlands Antilles subsidiary (“Finance”) to borrow funds in Europe free of withholding tax. Finance issued to European lenders \$70 million in Euronotes, which NIPSCO guaranteed. Finance then loaned the Euronote proceeds to NIPSCO in return for NIPSCO’s \$70 million note. Under U.S. tax treaties, NIPSCO would have been subject to withholding tax on interest paid directly to European lenders, but was not subject to withholding

tax on payments made to Netherlands Antilles lenders, such as Finance.

The interest NIPSCO paid to Finance was 1% more than Finance paid on the Euronotes. As a result, Finance earned an annual profit of \$700,000. After four years, NIPSCO repaid its loan from Finance and Finance repaid the Euronotes. NIPSCO liquidated Finance a year later and received its assets.

This Court rejected the Commissioner's argument that Finance was a "mere 'conduit'" whose existence could be disregarded. 115 F.3d at 509, 512. That it was "undisputed" the transaction was structured "to obtain a tax benefit" was not controlling, for "[a] taxpayer has a legal right to conduct his business so as to decrease (or altogether avoid) the amount of what otherwise would be his taxes." *Id.* at 511. Summarizing a large body of precedent, this Court instead held that so long as a "subsidiary conducts substantive business activity—even minimal activity—the subsidiary will not be disregarded for federal tax purposes, notwithstanding the fact that the subsidiary was created with a view to reducing taxes." *Id.* at 506. Interpreting *Gregory*, this Court explained that transactions involving a corporation "are to be disregarded for lack of

meaningful economic activity if the corporation is merely transitory, engaging in absolutely no business activity for profit—in other words, it is a mere skeleton.” *Id.* at 513-14.

Applying these principles, this Court agreed that “Finance engaged in the business activity of borrowing and lending money at a profit,” and that while this was “concededly minimal activity” it was “business activity nonetheless.” *Id.* at 512-13. Finance’s existence and participation in the transactions therefore could not be ignored.

Here, the Tax Court failed to apply the controlling standards of *NIPSCO* and thus committed legal error in concluding that MB Parent’s existence could be disregarded. A130-31. MB Parent owns assets and uses them in business activity to earn a profit. Immediately after the merger, MB Parent owned voting preferred and participating preferred stock in Bender and subsequently acquired an interest in Lexis through its interest in Bender. As described at pp. 14-16, *supra*, MB Parent will profit from any growth in value of Bender. MB Parent also owned LLC and its \$1.375 billion, which was profitably invested.

It is well-established that investing for a profit is “business activity” sufficient to uphold MB Parent’s separate existence. That is pre-

cisely the holding in *NIPSCO*, where Finance’s sole asset was its investment in its parent’s note. Engaging in investment activity is sufficient to be recognized as a party to a reorganization. *Gregg Co. v. Commissioner*, 239 F.2d 498 (2d Cir. 1956).

It is undisputed that MB Parent earned significant profits from its business activity and paid taxes (with LLC funds, see SA247) on those profits in the following amounts:

|      | <u>Income</u> | <u>Tax</u>  |
|------|---------------|-------------|
| 1998 | \$25,822,167  | \$7,778,725 |
| 1999 | 63,589,617    | 7,836,257   |
| 2000 | 22,356,590    | 1,213,278   |
| 2001 | 25,277,069    | 1,398,271   |
| 2002 | 32,193,754    | 2,094,528   |

Exs. 266-J, 267-J, 269-J, 271-J, 273-J. Further, MB Parent followed all of the normal corporate formalities: it adopted by-laws, appointed officers, opened bank accounts in its own name, and reviewed LLC’s financial statements. Ex. 402-J.

Indeed, the facts here are much stronger than those of *NIPSCO*. MB Parent owned a greater variety of assets, earned more income, and has already continued in existence 3 years longer than the subsidiary in *NIPSCO*. Further, MB Parent was owned not by a single corporation

but was jointly controlled by both Reed and Times, and could only declare common dividends with Reed's approval.

In light of these undisputed facts, the Tax Court's statement that MB Parent "had no business" (A127, 130) is demonstrably false, indeed, baffling. Contrary to *NIPSCO*, the court simply ignored MB Parent's assets, business activity, and taxable profits. By so doing, it failed to apply controlling law and committed legal error.

## **2. The Tax Court misunderstood conduit precedent.**

Rather than apply the controlling legal standards stated in *NIPSCO*, the Tax Court relied upon *West Coast Marketing v. Commissioner*, 46 T.C. 32 (1966), to support its erroneous ruling that MB Parent was a mere "intermediary." A126, 130. Like *NIPSCO*, *West Coast Marketing* interprets *Gregory*, which is the source of the "substance over form" doctrine. A126. But *West Coast Marketing* and *Gregory* rest on facts plainly distinguishable from those at issue here.

In *Gregory*, the taxpayer owned United Mortgage, which owned 1,000 shares of Monitor. Gregory wanted to sell the Monitor stock and receive the proceeds in cash without being taxed. To achieve this result, Gregory caused United to transfer the Monitor shares to the newly

formed Averill Corporation, which then issued its stock directly to Gregory. Averill then dissolved and distributed the Monitor stock (its only asset) to Gregory, who promptly sold it. Gregory claimed that receipt of the Averill stock was pursuant to a “plan of reorganization” and therefore tax-free. 69 F.2d at 810.

Averill served no function other than to act as a “conduit” for the conversion of the Monitor shares to cash. *Id.* It existed for only six days and did not transact any business or own any assets other than the Monitor shares. To qualify as a “reorganization,” there had to be a plan “to reorganize a business or any part of a business.” 293 U.S. at 469. But Gregory had no plan to reorganize a business; her only plan was to receive cash for the Monitor shares using Averill as a “contrivance” to that end. *Id.*

The facts of *West Coast Marketing* are similarly remote from those here. The taxpayer owned interests in land which Universal offered to buy. The taxpayer transferred its land to a newly created corporation, Manatee, in return for its stock. To carry out the sale to Universal, the taxpayer then transferred the Manatee stock to Universal in return for stock in Universal. Universal liquidated Manatee seven months after

its formation. Manatee never carried on any business activity. All it did was hold the land designated for sale to Universal. 46 T.C. at 33-39.

The taxpayer claimed that the transfer of the Manatee shares to Universal in return for stock qualified as a reorganization. The Tax Court held, however, that Manatee “served no [business] purpose” and “engaged in no business” other than “being used as a conduit for passing title” to the land. *Id.* at 40-41. As in *Gregory*, Manatee did not conduct business in a reorganized form.

Times’ case bears no resemblance to *West Coast Marketing* or *Gregory*. Unlike Manatee or Averill, MB Parent has retained its assets, not passed them on to another party. It is undisputed that LLC has retained ownership of the \$1.375 billion received in the merger and that MB Parent has retained ownership of LLC. Other than limited distributions of earnings necessary to pay dividends to Reed and Times and to pay MB Parent’s taxes, none of LLC’s assets has been transferred to Times or any other entity. See p. 14, *supra*. By definition, MB Parent cannot be a “conduit” because it has not passed its assets to Times or any other party.

Furthermore, in contrast to *Gregory* and *West Coast Marketing*, MB Parent engages in extensive business activity, as described at pp. 46-48, *supra*. And in contrast to those cases, in which Averill existed for six days and Manatee for seven months, MB Parent has been in existence for 8 years—3 years longer than Finance in *NIPSCO*. It continues to hold assets for the production of profit, successfully increasing the value of those assets by \$1 billion.

The Tax Court ignored LLC’s—and MB Parent’s—continued ownership of the \$1.375 billion on the ground that it reflected “tax advice.” A116; see BITTKER & EUSTICE Supp. ¶12.23[1], at S12-17 to -18 (court “disregard[ed] the transactional form” because of evidence of “tax planning”). But every reorganization, by definition, will contain restrictions based on “tax advice”; the choice to engage in a reorganization will necessarily impose restrictions the parties would not have encountered had they engaged in a taxable sale. If restrictions resulting from “tax advice” are fatal, *all* reorganizations will be taxed as sales. As stated in *Gregory*, it is of “no consequence” that Times sought to avoid tax if MB Parent actually conducted a business in reorganized form. 69 F.2d at 810. Similarly, the use of Finance in *NIPSCO* was respected because

Finance “was managed as a viable concern,” even though it was created solely as the result of “tax advice.” 115 F.3d at 513.

**B. The Bender transaction had economic effects upon all parties involved.**

In *NIPSCO*, this Court explained that business transactions which “result in actual, non-tax-related changes in economic position” must be respected in accordance with their form. 115 F.3d at 512; see also *Frank Lyon*, 435 U.S. at 583-584. Under that standard it is clear that the “economic positions” of Reed and Times reflect those of parties to a reorganization, not to a sale.

The paradigm of a sale is a transaction in which the seller transfers property in exchange for cash, after which the buyer and seller go their separate ways. To the extent that Times’ and Reed’s “economic positions” do not match this paradigm, the transaction cannot be recharacterized as a sale. See *Frank Lyon*, 435 U.S. at 581-84. The parties’ “economic positions” in this case are nothing like those of parties engaged in a sale, but rather reflect the continued joint ownership of an ongoing business. See *Gregory*, 293 U.S. at 267-68. In particular, the undisputed terms of the parties’ contractual arrangements gave Times a continuing role in Bender’s management and a share in its economic

fortunes. Conversely, Reed had absolute control over Times' access to the funds held in the LLC, and Reed also depended on those funds for the payment of dividends it was owed. In short, Times did not give up its interest in Bender, and Reed did not give up its interest in the cash. Those assets were instead invested in a reorganized business owned by MB Parent and MB Parent was jointly owned by Times and Reed.

Undisputed facts regarding Times' economic position, evident on the face of the parties' agreements, show that Times did not "sell" Bender for cash:

- Times did not have possession of the \$1.375 billion; LLC did. Though Times was appointed as an uncompensated manager of LLC, Times could not obtain ownership of the money except through MB Parent dividends, which Reed had to approve. See pp. 13, 16-17, *supra*.
- Times' ultimate residual interest in the \$1.375 billion was limited by the necessity of paying dividends to Reed and eventually retiring Reed's preferred stock. See pp. 14-15, 18, *supra*.
- Times did not completely dispose of Bender, but rather maintained a continuing economic interest in Bender's growth. See p. 16, *supra*.
- The contribution of Lexis to Bender, which required Times' approval, increased the value of Times' interest in Bender, but also increased Reed's claim upon LLC's assets through Reed's right to larger preferred dividends and ultimate repayment of the increased value of its preferred stock. See p. 14-15, 18, *supra*.

- Times retained veto authority over significant changes in Bender's operations and could prevent Reed from selling Bender for five years. See p. 12, 17, *supra*.

The Tax Court believed that Reed's control over the payment of dividends to Times was irrelevant because Reed purportedly had "no interest" in LLC's funds. A84. Even if this were true, it would not negate Reed's absolute control over Times' ability to possess LLC's assets. This fact alone prevents Times' exercise of complete dominion over those assets.

Most importantly, however, the Tax Court's own opinion demonstrates that Reed depended upon LLC's funds for dividends, and thus the court's claim that Reed had "no interest" in LLC is demonstrably wrong. The dividends that Bender owed to MB Parent were less than the dividends that MB Parent owed to Reed. See pp. 14-15, *supra*. Thus, to pay Reed's required dividends, LLC was required to pay the difference between the two to MB Parent. The LLC Agreement contained a specific provision authorizing distributions for this purpose. SA247. Furthermore, if Bender could not pay dividends to MB Parent, *the entire amount owed to Reed would have to come from LLC*. Similarly, upon any dissolution of the merger structure, MB Parent would be required

to redeem Reed's preferred stock with LLC's funds if the MB Parent preferred stock in Bender could not be redeemed for full value.

The Tax Court's own opinion confirms that LLC's funds were necessary to pay Reed's dividends. The court found that Reed received \$642,070 in dividends from LLC in 1999 (A86), which disproves the court's claim that Reed had "no interest" in LLC. The total amount paid to Reed from LLC's funds was \$5,436,782 as of 2004. Ex. 1254-P.

The parties' decision to enter into a reorganization rather than a sale also had many important economic effects upon Reed. Reed's rights and obligations under the reorganization structure are the mirror image of Times' rights and obligations:

- Reed controlled the payment of MB Parent common stock dividends to Times. See pp. 13, 16-17, *supra*.
- Reed had a continuing interest in LLC's assets because distributions from LLC were necessary to pay Reed's dividends from MB Parent. See p. 14-15, *supra*.
- Because Reed had an interest in LLC's funds, it initially resisted Times' request to pay a common dividend and agreed only after ensuring that the dividend would be limited to LLC's earnings, not its corpus. See p. 16-17, *supra*.
- In order to contribute Lexis to MB Parent, Reed was forced to give Times a share in Lexis through its interest in Bender, but Reed also obtained a greater share of LLC's assets through increased preferred dividends and the increased

value of its preferred stock claim to those assets. See pp. 17-18, *supra*.

- Reed did not own the complete economic interest in Bender. Reed required Times' cooperation in significant changes in Bender's operations and could not sell Bender without Times' agreement in the first five years. See p. 12, 17, *supra*.

These economic relationships are radically different from those following a sale, in which Reed would have walked away with absolute control over Bender and Times would have walked away with sole possession of \$1.375 billion. In uncontradicted trial testimony, negotiators from both sides explained this very point. Mark Willes, Times' CEO, explained that LLC's cash was "not going to be our cash" and "could not be used" for "normal corporate purposes," such as working capital, payment of dividends to Times shareholders, payment of taxes or salaries, or construction of new facilities. SA97, 104. Charles Fontaine, Reed's tax vice president, noted that, unlike a cash purchase, "there was going to be an ongoing relationship with Times Mirror." SA119.

In other words, under the structure adopted by the parties, MB Parent, controlled by Reed, held the purse strings to the \$1.375 billion. Times could not access these funds without Reed's approval. Thus, Times did not have "complete dominion" over these funds and they can-

not be treated as belonging to Times. *Commissioner v. Indianapolis Power & Light*, 493 U.S. 203, 209-10 (1990).

Undisputed facts show that Reed and Times agreed to a continuing relationship resulting from the conduct of business in reorganized corporate form, not the parting of ways that results from a cash sale. Because the Tax Court’s theory of the Bender transaction does not account for the actual events, it must be rejected as a matter of law. *Frank Lyon*, 435 U.S. at 581-84.

**C. The corporate agreements prevent Times from diverting LLC’s funds for its own use.**

If MB Parent’s separate existence is respected, as controlling precedent requires, Times cannot be viewed as having “received” the \$1.375 billion merely because it has the authority to *manage* LLC’s investments, as the Tax Court reasoned here. A120. Under *Moline*, the ability to manage a separate corporation’s “affairs down to the minutest detail” is no basis for attributing ownership of assets to the manager. *National Carbide*, 167 F.2d at 307 (Hand, J.), *aff’d*, 336 U.S. 422, 431-33 (1949) (quoting lower court with approval). Because Times lacked complete dominion over LLC’s assets—the right to use those assets for any purpose it desired—it cannot be viewed as owning the assets. See

*id.*, 336 U.S. at 434 (the fact that a sole shareholder “continued to manage and regard the property as his own individually” did not lead the Court in *Moline* to treat the property as the shareholder’s).

In holding that Times could be treated as if it had received \$1.375 billion in cash, the Tax Court concluded that the governing agreements placed no restrictions on Times’ “use of the LLC’s cash.” This interpretation of the agreements is directly contrary to both their plain terms and the parties’ actions. As manager of LLC, Times was contractually required “to effectuate and carry out the purposes and business of the [LLC].” SA242. The “purpose” of LLC, in turn, was “to *invest* in such property or securities and to conduct such businesses and other legal activities as the Manager determines *is in the best interests of the Company.*” *Id.* (emphasis added). In managing LLC’s investments, Times had broad discretion to make investment decisions. To allow such broad discretion, the parties, as permitted by Delaware law, limited Times’ fiduciary duties by providing that the duty owed to MB Parent was owed solely to Times as owner of MB Parent’s common stock. SA243. The court erroneously concluded—without any citation to the record—that

this limitation meant there was no restriction on Times' use of LLC's assets.

Both the parties' agreements and Delaware law impose such restrictions. First, the agreements do not alter the Manager's fiduciary duty to LLC itself; the Manager was still required to act "in the best interests" of LLC. SA242. Second, LLC's purpose was still that of an investment company and Times' management of LLC had to "effectuate and carry out" that purpose. *Id.* Third, the LLC agreement provides no mechanism by which Times could divert LLC's funds to itself. The LLC agreement allocates profit and loss from LLC's operations in proportion to the percentage interest held by each member, and MB Parent was LLC's sole member. SA247. Further, the LLC agreement only allowed distributions to MB Parent, the sole party to which profits and losses are allocated. *Id.* There is absolutely no provision in the agreements that allows direct distributions from LLC to Times or TMD.

Once the funds are distributed to MB Parent, the funds cannot be distributed to Times except through a duly authorized common stock dividend from MB Parent. Because Reed controls the MB Parent board,

Times cannot distribute money from LLC to itself without Reed's consent. SA190-91.

The limitations on Times' fiduciary duty do not allow it to divert LLC's funds to itself. While Delaware law allows parties to limit fiduciary duties, no limitation on fiduciary duty permits one member to "misappropriate property from another member." *Walker v. Resource Dev. Co.*, 791 A.2d 799, 817 (Del. Ch. 2000). Times was required to provide MB Parent with quarterly and annual financial statements so that Reed, which controlled MB Parent, could "monitor[ ] and enforce[ ] . . . [its] rights" (SA246), including its right to terminate the business structure if LLC's assets fall below \$275 million or LLC fails to make required distributions.

Further, all parties to the LLC agreement are bound to act in good faith. Section 18(a) limits the liability of the Manager only to the extent that the Manager acted "in good faith on behalf of the [LLC] and in a manner reasonably believed to be within the scope of the authority conferred on" it. SA248. Delaware law confirms that all agreements are subject to an unwaivable duty of good faith. *Katz v. Oak Indus.*, 508 A.2d 873, 880 (Del. Ch. 1986).

Hence, if Times attempted to expropriate LLC's assets, MB Parent, controlled by Reed, could bring an action against Times on behalf of LLC. DEL. CODE. ANN. tit. 6, §18-1001 (2006). Even though a manager's liability may be limited for selection of investments, a member can still bring suit to *enjoin* managerial actions that would breach the manager's fiduciary duties. *Solar Cells v. True North Partners*, 2002 WL 749163, at \*4 (Del. Ch. 2002) (limitation of liability of LLC managers did not prevent a suit to enjoin improper action).

The uncontroverted testimony and factual record confirm that all parties understood that their agreements limited Times' role as manager to investing LLC's funds. Thomas Unterman, CFO of Times and an officer of LLC, explained Times' two investment principles for LLC funds:

The first principle was that every investment the LLC made had to have a good business purpose and be designed to create value for the LLC itself.

The second was that . . . there be no question as to the appropriate use of LLC funds, and in that regard making sure that it could not be contended that we had by the back door distributed some of the funds, either earnings or principal, to Times Mirror. Our only authorization was to invest money for the LLC.

SA83-84.

Unterman explained that distributions had to be made in accordance with the LLC agreement: “The path out of the LLC would have been a distribution of earnings to MB Parent, which may or may not decide to declare dividends to Times Mirror.” SA80-81. All of the other witnesses agreed that Times was required to invest the funds in a responsible manner and could not divert the funds for use by Times. SA74, SA80-81, SA103-04, SA118, SA131.

In the eight years since the Bender merger, Times (and subsequently Tribune) has managed LLC in a manner consistent with these legal obligations. To the benefit of LLC and MB Parent, the investments in LLC have significantly outperformed the S&P 500. SA139. LLC’s funds have never been used to pay Times’ or Tribune’s operating expenses; nor has the corpus of LLC’s assets ever been disbursed to Times or Tribune. SA81, SA135-38. The Commissioner did not allege, and the Tax Court did not find, that any of these events took place.

Because LLC owned the funds and could not and did not divert them to Times, Times did not have the “ultimate incident of ownership, *viz.*, the power simply to pick up [its] money, put it into [its] pockets, and spend it at will and for whatever [it] deemed advisable.” *Anderson*

*v. Commissioner*, T.C. Memo. 1961-139, 20 T.C.M. (CCH) 697, 701 (1961); see *United States v. Toushin*, 899 F.2d 617, 622-23 (7th Cir. 1990). Times could not use the funds for its own corporate purposes. See pp. 57-63, *supra*. The Tax Court was wrong as a matter of law when it claimed that Times “receive[d] the proceeds of sale.” A132.

### **III. There Is No Legal or Factual Support for the Tax Court’s Ruling That the MB Parent Common Stock Was Worth Less Than \$1.375 Billion.**

#### **A. The Tax Court’s conclusion that the stock was of negligible value rests on its legally erroneous bifurcation of the stock from the management authority.**

The Tax Court’s conclusion that the Bender transaction failed the 80% test arises solely from the Commissioner’s novel and unsupported assertion that Times’ appointment to manage LLC created an additional “asset”—equivalent to ownership of LLC’s cash assets—that was “constructively” exchanged for the Bender stock. But if, as required by this Court’s decision in *Estate of Curry*, 706 F.2d 1424 (1983), the management authority is not treated as a separate “asset,” the Bender transaction passes the 80% test by definition, because 100% of the Bender stock was exchanged solely for MB Parent stock.

The Commissioner’s unprecedented theory simply plucks out a provision of an integrated transaction and labels it as separate prop-

erty. However, the LLC Agreement shows that Times' appointment as manager was *not* separate consideration. The agreement provides the manager no compensation, allocations of income, or distributions. SA244, SA247. The fiduciary duty limitation relied upon so heavily by the Tax Court (A114-18) creates no claim to LLC's assets. It merely protects the manager's broad investment discretion.

Thus, the LLC Agreement is nothing more than an uncompensated management *obligation* that Times assumed in order to preserve its ultimate interest in the MB Parent common stock. No party would assume this uncompensated obligation unless it had such an interest. The management authority therefore cannot be regarded as property separate from the MB Parent common stock. Indeed, the Tax Court itself agreed it would be "unrealistic" to separate the two. A132. Where contract rights are economically inseparable from stock, they do not constitute a separate asset. See Rev. Rul. 2003-97 (contract right is not a separate asset when holder is "economically compelled" to keep it coupled with stock).

Parties to stock transactions routinely enter into ancillary agreements—such as management agreements, shareholders agreements,

voting rights agreements, and corporate bylaws—that protect the value of the stock exchanged in the transaction. The court’s conclusion that an ancillary contractual agreement, rather than the stock itself, constitutes the transactional consideration is literally unprecedented. See RIZZI at 23, 27-28 (the Tax Court’s novel “assumption that the Service can separate stock from certain underlying rights associated with that stock” will sow “confusion in the corporate tax arena”); Richard M. Lipton, *Taxable Sale or Nontaxable Reorganization? The Tax Court Draws a Line in Tribune Company*, 103 J. TAX’N 261, 270 (Nov. 2005) (“[A] managerial right with respect to an LLC usually is viewed by the parties to the transaction as not having significant value. . . . It is easy to see how Times Mirror believed that its tax planning should be respected, because the factual assumptions on which it was based appear to be consistent with longstanding practice.”).

The court suggested that Times was appointed manager to avoid a claim that TMD had received additional consideration. A124. But Times’ appointment had nothing to do with the reorganization rules. As explained in uncontested testimony, Times was appointed manager merely because it, rather than TMD, had the employees who could per-

form the managerial functions. SA73. Tribune waived the attorney-client privilege and put Times' tax lawyer on the stand. Neither the Commissioner nor the court asked him about the rationale for appointing Times manager of LLC. Rather, his testimony supported the parties' uncontested testimony that the appointment was never contemplated as separate consideration. Tr. 164-66. No evidence suggests otherwise.

**B. The Tax Court's valuation analysis is contrary to the law of this Circuit and unsupported by the record.**

The Tax Court relied on its own "commonsense" notions of value (A125) because the court apparently recognized the Commissioner's expert's valuation theory was legally invalid under this Court's decision in *Estate of Curry*, 706 F.2d 1424 (1983), which holds that it is improper to bifurcate portions of an integrated bundle of rights. A brief examination of the Commissioner's theory confirms why there is no "valuation" question at issue.

At trial, the only dispute between the parties' experts arose from the Commissioner's instructions to his experts. The Commissioner instructed each of his witnesses to adopt a premise ("the bifurcation premise") in which, as a result of a hypothetical sale, the management authority was held by a party *unrelated* to the party owning the MB

Parent common stock. Exs. 1351-R, pp. 26-27; 1353-R, p. 36; Tr. 633-34. Following the Commissioner's instructions, these experts valued the MB Parent common stock as if the manager were an unrelated, hostile party. Exs. 1351-R, pp. 27-35; 1353-R, pp. 26-27, 35, 37; Tr. 640-41, 875-77, 890-93. They opined that the MB Parent common stock would be worth little, because this hypothetical unrelated manager could enrich itself at the common shareholder's expense by "diverting" or looting assets from the LLC. Without this ability to divert assets for its own use, the separated management authority could have no value because the manager was uncompensated.

For example, the Commissioner's expert Michael Barclay opined that an unrelated party would pay at least \$550 million for the separated management authority based upon the present value of the amount that the hypothetical manager could "extract," "expropriate," and "divert" from LLC through such unlawful activities as "excessive compensation, the hiring and excessive compensation of friends and family members, and the pricing of transactions made with customers, suppliers, or other parties in which the manager may have a financial interest." Ex. 1351-R, pp. 29, 35. The Commissioner's second expert,

Alan Shapiro, theorized that the unrelated manager's ability to loot LLC's funds would create a "deadweight loss," *i.e.*, "a cost with no offsetting benefits," that would cause a purchaser of the common stock to discount it at least 75%-85% for lack of control. Ex. 1353-R, pp. 35, 37. Finally, William Zame theorized about a hostile manager's ability to "remove any impediments . . . to divert the resources of the LLC to the Manager." Ex. 1354-R, p. 2.

The bifurcation premise suffers from two insurmountable flaws. First, it is contrary to *Curry*, which holds that the fair market value standard forbids "the hypothetical bifurcation of an otherwise integrated bundle of property for valuation purposes." 706 F.2d at 1428. As Tribune argued, *and the court agreed* (A121, 132), the common stock and management authority were an integrated bundle of rights. Hence, the Commissioner's bifurcation instructions to his experts were contrary to law.

Second, each of the Commissioner's experts *agreed* with Tribune that bifurcation was *an irrational theory* because no one would ever separate the management authority from the common stock. Shapiro explained that bifurcation "would have intentionally destroyed value,"

would be “completely inefficient,” and that neither Reed nor Times (nor any other parties bargaining at arm’s length) “would have agreed to such a deal.” Ex. 1353-R, pp. 41-42; SA151-57. Barclay acknowledged that separation of management authority from the stock “is inefficient and should not occur.” Ex. 1351-R, p. 26. Michael Jensen, a leading theorist on corporate control, agreed that the bifurcation premise was completely inconsistent with economic teaching. Ex. 1362-R, p. 6; SA158.

The taxpayer relied upon the opinion of Michael Bradley, an investment banking professor at Duke University, who was the only expert to offer an opinion consistent with the facts. Bradley valued the MB Parent common stock at \$1.375 billion based upon the net asset value method (SA159-66), a method commonly used to value investment companies. See *Estate of Jephson v. Commissioner*, 87 T.C. 297, 303-304 (1986). Bradley refuted the Commissioner’s bifurcation premise, explaining that the common stock and management authority were part of an integrated bundle of rights that would never be separated and held by unrelated parties. SA166-80. The court agreed, holding it would be “unrealistic” to separate the two. A132. Finally, Bradley explained

that the management authority could have no value when separated from an interest in the common stock because the manager was uncompensated. The Commissioner waived cross-examination of Bradley.

Significantly, *the Commissioner did not offer a single witness willing to testify that the common stock was worth less than \$1.375 billion if, as is actually the case, the manager was a related party.*

Given *Curry* and the acknowledgment of the Commissioner's experts that bifurcation was irrational, the court rejected the bifurcation premise, agreeing with the taxpayer that the common stock and management authority would never be held by unrelated parties. A121, 132. But the court then ignored the legal consequences of this conclusion and simply asserted that the common stock had "negligible" value (A133)—the very conclusion that the Commissioner had been able to support *only* by directing his experts to adopt the bifurcation premise. Once the court rejected the bifurcation premise, however, Bradley's testimony stood uncontested: the common stock was worth \$1.375 billion, exactly what the contracting parties thought it was worth.

## CONCLUSION

For over a century, Tribune has served as a vital institution providing news and editorial viewpoint to readers in Chicago and other parts of the nation. It should not be exposed to this staggering liability—which now amounts to approximately one billion dollars in taxes and interest—based on a judgment of the Tax Court that is arbitrary and contrary to law.

The judgment of the Tax Court should be reversed, with instructions to enter judgment in Tribune's favor.

Respectfully submitted,

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Mayer, Brown, Rowe & Maw LLP  
71 South Wacker Drive  
Chicago, Illinois 60606  
(312) 782-0600

Attorneys for Appellant  
Tribune Company

## ATTACHMENT A

### **The Bender Transaction (Steps Required by the Internal Revenue Code and Treasury Regulations to Execute the Reverse Triangular Merger)**

- Reed creates MergerSub, capitalizing it with \$1.375 billion in cash in exchange for 990 shares of voting common stock (20% vote), 3,960 shares of voting preferred stock (80% vote) and 10 shares of non-voting participating preferred stock. A72.
- Reed contributes both classes of MergerSub preferred stock (80% vote) to MB Parent in exchange for 400 shares of MB Parent voting preferred stock. A73.
- MergerSub contributes \$1.375 billion to MB Parent in exchange for 100% of its common stock. A73.
- As required by section 368(a)(2)(E), MB Parent now “controls” MergerSub (80% vote and 100% of nonvoting shares). A72-74.
- MergerSub merges into Bender with Bender surviving and assuming the MergerSub capital structure; as required by section 368(a)(2)(E)(ii), TMD exchanges “control” of Bender (100% stock ownership) for all of MB Parent’s common stock. A74.
- MB Parent contributes \$1.375 billion to LLC. A75.
- Final stock ownership is set forth at A74-75.

**ADDENDUM CONTAINING PERTINENT STATUTORY AND REGULATORY  
PROVISIONS**

(As of the date of the Bender transaction)

**§ 354. Exchanges of stock and securities in certain reorganizations**

(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.

**§ 356. Receipt of additional consideration**

(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.

**§ 368. Definitions relating to corporate reorganizations**

(a) Reorganization.—

(1) In general.—For purposes of parts I and II and this part, the term “reorganization” means—

(A) a statutory merger or consolidation;

(B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immedi-

ately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);

(C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other or the fact that property acquired is subject to a liability shall be disregarded;

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

(E) a recapitalization;

(F) a mere change in identity, form, or place of organization of one corporation, however effected; or

(G) a transfer by a corporation of all or part of its assets to another corporation in a title 11 or similar case; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356.

(2) Special rules relating to paragraph (1).—

\* \* \*

(E) Statutory merger using voting stock of corporation controlling merged corporation.—A transaction otherwise qualifying under paragraph (1)(A) shall not be disqualified by reason of the fact that stock of a corporation (referred to in this subparagraph as the “controlling corporation”) which before the merger was in control of the merged corporation is used in the transaction, if—

(i) after the transaction, the corporation surviving the merger holds substantially all of its properties and of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction); and

(ii) in the transaction, former shareholders of the surviving corporation exchanged, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation which constitutes control of such corporation.

\* \* \*

(c) Control defined.—For purposes of part I (other than section 304), part II, this part, and part V, the term “control” means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

### **Treas. Reg. § 1.368-1(e)(1)**

(e) *Continuity of interest.*—(1) *General rule.*—(i) The purpose of the continuity of interest requirement is to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations. Continuity of interest requires that in substance a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization. A proprietary interest in the target corporation is preserved if, in a potential reorganization, it is exchanged for a proprietary interest in the issuing corporation (as defined in paragraph (b) of this section), it is exchanged by the acquiring corporation for a direct interest in the target corporation enterprise, or it otherwise continues as a proprietary interest in the target corporation. However, a proprietary interest in the target corporation is not preserved if, in connection with the potential reorganization, it is acquired by the issuing corporation for consideration other than stock of the issuing corporation, or stock of the issuing corporation furnished in exchange for a proprietary interest in the target corporation in the potential reorganization is redeemed. All facts and circumstances must be considered in determining whether, in substance, a proprietary interest in the target corporation is preserved. For purposes of the continuity of

interest requirement, a mere disposition of stock of the target corporation prior to a potential reorganization to persons not related (as defined in paragraph (e)(3) of this section determined without regard to paragraph (e)(3)(i)(A) of this section) to the target corporation or to persons not related (as defined in paragraph (e)(3) of this section) to the issuing corporation is disregarded and a mere disposition of stock of the issuing corporation received in a potential reorganization to persons not related (as defined in paragraph (e)(3) of this section) to the issuing corporation is disregarded.

## **CERTIFICATE OF COMPLIANCE**

Pursuant to Fed. R. App. P. 32(a)(7)(C), the undersigned hereby certifies that the foregoing brief of appellant Tribune Company complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B)(i) and contains 13,976 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

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One of appellant's attorneys

**CIRCUIT RULE 31(e)(1) CERTIFICATION**

The undersigned attorney hereby certifies that he has filed electronically, pursuant to Circuit Rule 31(e), a digital version of the foregoing brief and all of the appendix items that are available in non-scanned PDF format.

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One of appellant's attorneys

## **CERTIFICATE OF SERVICE**

The undersigned attorney hereby certifies that he: (i) caused two copies each of this Brief and Required Appendix for Appellant Tribune Company, along with the accompanying Separate Appendix, to be served on counsel for appellee, the Commissioner of Internal Revenue, by Express Mail to the following address:

Judith A. Hagley, Esq.  
U.S. Department of Justice  
Tax Division, Appellate Section  
Post Office Box 502  
Washington, D.C. 20044

and (ii) caused a digital version of the foregoing brief and all of the appendix items that are available in non-scanned PDF format to be served on counsel for appellee at the email address

Judith.A.Hagley@usdoj.gov.

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Mayer, Brown, Rowe & Maw LLP  
71 South Wacker Drive  
Chicago, Illinois 60606  
(312) 782-0600

Attorneys for Appellant  
Tribune Company