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EFFECTS OF TAXATION ON CORPORATE MERGERS. By J. Keith Butters,* John Lintner,** and William L. Cary.*** Boston: Division of Research, Graduate School of Business Administration, Harvard University. 1951. Pp. xviii, 364. $4.25.

The contribution of Messrs. Butters, Lintner, and Cary, although perhaps not based on unassailable scientific methods, persuavisely challenges several heretofore widely held conceptions regarding corporate mergers. The object of this study was to provide "a careful and dispassionate appraisal of the effects of Federal taxation on merger activities and on the continued existence as competitive entities of our independently owned small and medium-size companies."

The authors conducted extensive field interviews with one or more participants in over 100 sales and purchases of business enterprises which occurred during the period 1940 through 1947. Directly considered were the 1,990 mergers uncovered through the field surveys and through analysis of general statistics reported in the various financial journals. This painstaking research and analysis indicates that although tax burdens have been a highly significant motivation in the sale of a considerable number of closely held companies, the role of taxes has been much more limited than frequently supposed. Indeed, it was determined that federal taxation was important in but 9.7% of all corporate mergers involving 27.5% of the total corporate assets included in the survey. The disproportionate amount of assets involved is attributed to the fact that tax motivations were more significant in connection with the merger of the larger closely held companies. Furthermore, the merger movement did not appear to weaken the over-all competitive structure of the economy to any serious degree. The ultimate conclusion, therefore, was that during the 1940's tax pressures on owners of closely held companies did not cause independently owned companies to be sold out

13. Sections 304 and 373-74.
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on such a scale as to warrant a major overhaul of the tax structure on this account.

This examination of the effects of taxation on corporate mergers should prove extremely valuable to lawyers and businessmen who take cognizance of the impact of taxation on business. The authors have included in their study details of illustrative cases of corporate mergers and through these examples have depicted tax motivations for such transactions with interest and clarity. These motivations have been explored from the standpoint of both seller and buyer. The case method employed renders the study readable and enlightening.

Liquidity considerations in the payment of estate taxes and valuation of closely held companies for estate tax purposes received comprehensive treatment. The former normally arise where an individual has his entire wealth centered in one closely held corporation and will be of real concern only where the size of the estate is substantial. This problem has been eliminated almost entirely through the addition of Section 115(g) (3) to the Internal Revenue Code. Nevertheless, the detailed analysis of the many aspects of the problem of liquidity will be of great assistance to the practitioner engaged in will writing or estate planning. Although valuation uncertainties present real difficulties in the handling of estates, the study reveals that there is very little direct relation between such uncertainties for estate tax purposes and a sale or other disposition of the stock of a closely held company.

The income tax impetus on corporate mergers stems from the income tax, capital gains tax, and surtax on corporations improperly accumulating surplus.[1] Through the use of an illustrative case the problem of securing the most money *after taxes* to the individual stockholders of a business is analyzed. By means of a detailed case history of the Toni Company's growth and subsequent sale to the Gillette Safety Razor Company, Professor Butters and his colleagues demonstrate that the transfer by Toni's original proprietors eliminated the risks involved in their continuing ownership of the company and actually netted more money after taxes than was probable through their retention of the enterprise. This analysis illustrates the need for an extensive examination of the many ramifications of such a transaction before it is consummated. The combination of high individual surtax rates, lower capital gains tax rates, relatively low corporate tax rates,[2] and Section 102 surtaxes will

1. Imposed by Section 102, Internal Revenue Code.

2. Of course, since the completion of this study the Excess Profits Tax Act of 1950 and the Revenue Act of 1951 have materially changed this picture. Thus the need is emphasized for business decisions to be predicated on business reasons rather than on possible future tax savings not consistent with those business reasons.

constantly prod the owners of profitable closely-held companies to explore the intricacies of federal tax law for ways of netting more cash after taxes.

The work includes a detailed examination of alternatives to sale or merger, including an analysis of gifts of interests in the corporation prior to the death of the owner, public sales of securities, gifts and sales to philanthropic institutions, survivor purchase and stock retirement plans, and others. The estate planner or practitioner counseling the owner of a closely-held corporation may further his clients interests by a careful perusal of the discussion of tax and non-tax problems in this portion of the study.

Of historical interest is the chapter on the comparisons between the major merger movements. The authors conclude that, as distinguished from the earlier merger movements (1879-1908 and 1922-29) which had the elimination of competition as their primary impetus and result, the merger movement of 1940-47 had relatively little effect on industrial concentration.

As distinguished from the relative unimportance of tax motivation in the current merger movement, taxes are a prime influence on the *form* of the transaction. The authors aptly state that:

> there are, in fact, few areas in which tax considerations more completely dominate business actions and in which the tax penalties for ill-advised decisions are more pronounced. Potential sellers of a successful enterprise, in particular, would be foolhardy to commence negotiations for the sale of their business without first ascertaining the tax consequences of each move and then scrupulously observing the ceremonials prescribed by counsel in carrying out the sale.

Of course, the study does not treat the complex and technical details of the tax law as it applies to mergers. However, the broad outlines of the law are discussed from the standpoint of the buyer as well as the seller. The tax problems with respect to each are outlined. The various forms in which the merger may be cast are set out and their tax consequences considered.

It is particularly gratifying that the authors have maintained a realistic approach to all the tax problems mentioned in the study. For the tax lawyer, the work has its greatest value in summarizing the many practical, non-tax questions surrounding mergers. In addition, for the general practitioner, the tax problems are surveyed in a manner which makes the book a serviceable reference volume. The study particularly indicates that substance will prevail over form and that business exigencies

should be determinative, with the one possible exception of selecting the form of the transaction where more than one form is available. The form which will produce the desired tax result should be selected, but such a choice may be made only after detailed analysis and actual computation of the alternative tax consequences.

This survey provides the practicing lawyer with a useful tool in the everyday analysis of problems inherent in corporate mergers. In addition to clarifying the fact that "strangling taxes" have not been of major importance in the recent merger movement, the authors have provided the profession with a useful volume which highlights the tax problems encountered in the field and points the way towards the solution of practical and legal problems through the application of scientific research.

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