

§ 1.302-3

26 CFR Ch. I (4-1-11 Edition)

(i) *Significant holder* means any person that, immediately before the exchange—

(A) Owned at least five percent (by vote or value) of the total outstanding stock of the issuing corporation if the stock owned by such person is publicly traded; or

(B) Owned at least one percent (by vote or value) of the total outstanding stock of the issuing corporation if the stock owned by such person is not publicly traded.

(ii) *Publicly traded stock* means stock that is listed on—

(A) A national securities exchange registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f); or

(B) An interdealer quotation system sponsored by a national securities association registered under section 15A of the Securities Exchange Act of 1934 (15 U.S.C. 78o-3).

(iii) *Issuing corporation* means the corporation that issued the shares of stock, some or all of which were transferred by a significant holder to such corporation in the exchange described in paragraph (b)(2) of this section.

(4) *Cross reference.* See section 6043 of the Internal Revenue Code for requirements relating to a return by a liquidating corporation.

(c) *Basis adjustments.* In any case in which an amount received in redemption of stock is treated as a distribution of a dividend, proper adjustment of the basis of the remaining stock will be made with respect to the stock redeemed. (For adjustments to basis required for certain redemptions of corporate shareholders that are treated as extraordinary dividends, see section 1059 and the regulations thereunder.) The following examples illustrate the application of this rule:

Example 1. A, an individual, purchased all of the stock of Corporation X for \$100,000. In 1955 the corporation redeems half of the stock for \$150,000, and it is determined that this amount constitutes a dividend. The remaining stock of Corporation X held by A has a basis of \$100,000.

Example 2. H and W, husband and wife, each own half of the stock of Corporation X. All of the stock was purchased by H for \$100,000 cash. In 1950 H gave one-half of the stock to W, the stock transferred having a value in excess of \$50,000. In 1955 all of the stock of H

is redeemed for \$150,000, and it is determined that the distribution to H in redemption of his shares constitutes the distribution of a dividend. Immediately after the transaction, W holds the remaining stock of Corporation X with a basis of \$100,000.

Example 3. The facts are the same as in *Example (2)* with the additional facts that the outstanding stock of Corporation X consists of 1,000 shares and all but 10 shares of the stock of H is redeemed. Immediately after the transaction, H holds 10 shares of the stock of Corporation X with a basis of \$50,000, and W holds 500 shares with a basis of \$50,000.

(d) *Effective/applicability date.* Paragraphs (b)(2), (b)(3) and (b)(4) of this section apply to any taxable year beginning on or after May 30, 2006. However, taxpayers may apply paragraphs (b)(2), (b)(3) and (b)(4) of this section to any original Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006. For taxable years beginning before May 30, 2006, see § 1.302-2 as contained in 26 CFR part 1 in effect on April 1, 2006.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 8724, 62 FR 38028, July 26, 1997; T.D. 9264, 71 FR 30593, May 30, 2006; T.D. 9329, 72 FR 32796, June 14, 2007]

§ 1.302-3 Substantially disproportionate redemption.

(a) Section 302(b)(2) provides for the treatment of an amount received in redemption of stock as an amount received in exchange for such stock if—

(1) Immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock as provided in section 302(b)(2)(B),

(2) The redemption is a substantially disproportionate redemption within the meaning of section 302(b)(2)(C), and

(3) The redemption is not pursuant to a plan described in section 302(b)(2)(D).

Section 318(a) (relating to constructive ownership of stock) shall apply both in making the disproportionate redemption test and in determining the percentage of stock ownership after the redemption. The requirements under section 302(b)(2) shall be applied to each shareholder separately and shall be applied only with respect to stock which is issued and outstanding in the hands of the shareholders. Section

302(b)(2) only applies to a redemption of voting stock or to a redemption of both voting stock and other stock. Section 302(b)(2) does not apply to the redemption solely of nonvoting stock (common or preferred). However, if a redemption is treated as an exchange to a particular shareholder under the terms of section 302(b)(2), such section will apply to the simultaneous redemption of nonvoting preferred stock (which is not section 306 stock) owned by such shareholder and such redemption will also be treated as an exchange. Generally, for purposes of this section, stock which does not have voting rights until the happening of an event, such as a default in the payment of dividends on preferred stock, is not voting stock until the happening of the specified event. Subsection 302(b)(2)(D) provides that a redemption will not be treated as substantially disproportionate if made pursuant to a plan the purpose or effect of which is a series of redemptions which result in the aggregate in a distribution which is not substantially disproportionate. Whether or not such a plan exists will be determined from all the facts and circumstances.

(b) The application of paragraph (a) of this section is illustrated by the following example:

Example. Corporation M has outstanding 400 shares of common stock of which A, B, C and D each own 100 shares or 25 percent. No stock is considered constructively owned by A, B, C or D under section 318. Corporation M redeems 55 shares from A, 25 shares from B, and 20 shares from C. For the redemption to be disproportionate as to any shareholder, such shareholder must own after the redemptions less than 20 percent (80 percent of 25 percent) of the 300 shares of stock then outstanding. After the redemptions, A owns 45 shares (15 percent), B owns 75 shares (25 percent), and C owns 80 shares (26 2/3 percent). The distribution is disproportionate only with respect to A.

§ 1.302-4 Termination of shareholder's interest.

Section 302(b)(3) provides that a distribution in redemption of all of the stock of the corporation owned by a shareholder shall be treated as a distribution in part or full payment in exchange for the stock of such shareholder. In determining whether all of

the stock of the shareholder has been redeemed, the general rule of section 302(c)(1) requires that the rules of constructive ownership provided in section 318(a) shall apply. Section 302(c)(2), however, provides that section 318(a)(1) (relating to constructive ownership of stock owned by members of a family) shall not apply where the specific requirements of section 302(c)(2) are met. The following rules shall be applicable in determining whether the specific requirements of section 302(c)(2) are met:

(a) *Statement.* The agreement specified in section 302(c)(2)(A)(iii) shall be in the form of a statement entitled, "STATEMENT PURSUANT TO SECTION 302(c)(2)(A)(iii) BY [INSERT NAME AND TAXPAYER IDENTIFICATION NUMBER (IF ANY) OF TAXPAYER OR RELATED PERSON, AS THE CASE MAY BE], A DISTRIBUTE (OR RELATED PERSON) OF [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER (IF ANY) OF DISTRIBUTING CORPORATION]." The distributee must include such statement on or with the distributee's first return for the taxable year in which the distribution described in section 302(b)(3) occurs. If the distributee is a controlled foreign corporation (within the meaning of section 957), each United States shareholder (within the meaning of section 951(b)) with respect thereto must include this statement on or with its return. The distributee must represent in the statement—

(1) THE DISTRIBUTE (OR RELATED PERSON) HAS NOT ACQUIRED, OTHER THAN BY BEQUEST OR INHERITANCE, ANY INTEREST IN THE CORPORATION (AS DESCRIBED IN SECTION 302(c)(2)(A)(i)) SINCE THE DISTRIBUTION; and

(2) THE DISTRIBUTE (OR RELATED PERSON) WILL NOTIFY THE INTERNAL REVENUE SERVICE OF ANY ACQUISITION, OTHER THAN BY BEQUEST OR INHERITANCE, OF SUCH AN INTEREST IN THE CORPORATION WITHIN 30 DAYS AFTER THE ACQUISITION, IF THE ACQUISITION OCCURS WITHIN 10 YEARS FROM THE DATE OF THE DISTRIBUTION.

(b) *Substantiation information.* The distributee who files an agreement