

demption distribution is treated as a section 301 distribution.

Section 305 of the Code does not make the constructive stock ownership rules of section 318(a) applicable to its provisions.

The 16 shareholders of *Z* who did not tender any stock for redemption in 1976 experienced increases in their proportionate interests of the earnings and profits and assets of *Z* (without taking into account constructive stock ownership under section 318 of the Code) as a result of the redemptions. Shareholders *B* and *X*, who surrendered small amounts of their stock for redemption in 1976, also experienced increases in their proportionate interests. The 1976 redemptions were not isolated but were undertaken pursuant to an ongoing plan of annual stock redemptions. Finally, the 1976 redemptions are to be treated as distributions of property to which section 301 of the Code applies.

Accordingly, *B*, *X* and the 16 shareholders of *Z* who did not participate in the 1976 redemptions are deemed to have received stock distributions to which sections 305(b)(2) and 301 of the Code apply. See examples (8) and (9) of section 1.305-3(e) of the regulations for a method of computing the amounts of the deemed distributions.

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26 CFR 1.302-1: General.

**Redemption; charitable contribution followed by prearranged redemption.** A taxpayer with voting control of a corporation and an exempt private foundation who donates shares of the corporation's stock to the foundation and, pursuant to a prearranged plan, causes the corporation to redeem the shares from the foundation does not realize income as a result of the redemption. The Service will treat the proceeds as income to the donor under facts similar to those in the *Palmer* decision only if the donee is legally bound, or can be compelled by the corporation,

to surrender the shares for redemption.

### Rev. Rul. 78-197

In *Palmer v. Commissioner*, 62 T.C. 684 (1974), *aff'd* on another issue, 523 F.2d 1308 (8th Cir. 1975), the United States Tax Court held that the Internal Revenue Service incorrectly treated a gift of stock to an organization exempt from income taxation pursuant to section 511(c)(3) of the Internal Revenue Code of 1954, followed by a prearranged redemption of the stock, as a redemption of the stock from the donor followed by a gift of the redemption proceeds to the donee. The Service will follow *Palmer* on this issue, *acq.*, page 6, this Bulletin.

In *Palmer*, the taxpayer had voting control of both a corporation and a tax-exempt private foundation. Pursuant to a single plan, the taxpayer donated shares of the corporation's stock to the foundation and then caused the corporation to redeem the stock from the foundation. It was the position of the Service that the substance of the transaction was a redemption of the stock from the taxpayer, taxable under section 301 of the Code, followed by a gift of the redemption proceeds by the taxpayer to the foundation. The United States Tax Court rejected this argument and treated the transaction according to its form because the foundation was not a sham, the transfer of stock to the foundation was a valid gift, and the foundation was not bound to go through with the redemption at the time it received title to the shares.

Also see, *Grove v. Commissioner*, 490 F.2d 241 (2nd Cir. 1973); *Behrend v. United States*, No. 72-1153, 72-1156 (4th Cir. 1972); and *Carrington v. Commissioner*, 467 F.2d 704 (5th Cir. 1973).

The Service will treat the proceeds of a redemption of stock under facts similar to those in *Palmer* as income to the donor only if the donee is legally bound, or can be compelled by the

corporation, to surrender the shares for redemption.

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26 CFR 1.302-1: General.

**Redemptions of stock; merger with transitory corporation; minority stockholders eliminated.** The creation, by the majority shareholder of a corporation, of a second corporation followed by a merger of the second corporation into the first with the majority shareholder receiving stock of the second corporation and the minority shareholders receiving cash for their shares, is disregarded and the cash received by the minority shareholders is subject to the provisions and limitations of section 302 of the Code.

### Rev. Rul. 78-250

Advice has been requested concerning the Federal income tax treatment of the transaction set forth below.

Corporation *X* had outstanding only common stock, which was owned 65 percent by individual *A*, president and a director of *X*. The balance of the *X* stock was widely held.

For various business reasons, *X* desired to operate without any ownership of its stock by the public. Under a plan to eliminate the minority stock interests, a new corporation, *Y*, was formed by *A* who received all of the *Y* stock in exchange for *A*'s *X* stock on a share-for-share basis. Upon approval of a plan of merger by the shareholders of both corporations, *Y* was then merged with and into *X* under applicable state law. In the merger each share of *A*'s *Y* stock was converted into a share of *X* stock and the minority shareholders of *X* received cash in exchange for their *X* stock, in an amount equal in value to the stock exchanged.

In Rev. Rul. 67-448, 1967-2 C.B. 144, a series of inter-related steps involving the transitory existence of a newly created corporation is disre-