

50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock. Section 304(c)(3) makes section 318(a) (relating to constructive ownership of stock), as modified by section 304(c)(3)(B), applicable to section 304 for purposes of determining control under section 304(c)(1).

(b) *Effect of section 304(c)(2)(B)*—(1) *In general.* In determining whether the control test with respect to both the issuing and acquiring corporations is satisfied, section 304(a)(1) considers only the person or persons that—

- (i) Control the issuing corporation before the transaction;
- (ii) Transfer issuing corporation stock to the acquiring corporation for property; and
- (iii) Control the acquiring corporation thereafter.

(2) *Application.* Section 317 defines property to include money, securities, and any other property except stock (or stock rights) in the distributing corporation. However, section 304(c)(2)(B) provides a special rule to extend the relevant group of persons to be tested for control of both the issuing and acquiring corporations to include the person or persons that do not acquire property, but rather solely stock from the acquiring corporation in the transaction. Section 304(c)(2)(B) provides that if two or more persons in control of the issuing corporation transfer stock of such corporation to the acquiring corporation, and if the transferors are in control of the acquiring corporation after the transfer, the person or persons in control of each corporation include each of those transferors. Because the purpose of section 304(c)(2)(B) is to include in the relevant control group the person or persons that retain or acquire acquiring corporation stock in the transaction, only the person or persons transferring stock of the issuing corporation that retain or acquire any proprietary interest in the acquiring corporation are taken into account for purposes of applying section 304(c)(2)(B).

(3) *Example.* This section may be illustrated by the following example.

Example (a) A, the owner of 20% of T's only class of stock, transfers that stock to P sole-

ly in exchange for all of the P stock. Pursuant to the same transaction, P, solely in exchange for cash, acquires the remaining 80% of the T stock from T's other shareholder, B, who is unrelated to A and P.

(b) Although A and B together were in control of T (the issuing corporation) before the transaction and A and B each transferred T stock to P (the acquiring corporation), sections 304(a)(1) and (c)(2)(B) do not apply to B because B did not retain or acquire any proprietary interest in P in the transaction. Section 304(a)(1) also does not apply to A because A (or any control group of which A was a member) did not control T before the transaction and P after the transaction.

(c) *Effective date.* This section is effective on January 20, 1994.

[T.D. 8515, 59 FR 2960, Jan. 20, 1994]

§ 1.305-1 Stock dividends.

(a) *In general.* Under section 305, a distribution made by a corporation to its shareholders in its stock or in rights to acquire its stock is not included in gross income except as provided in section 305(b) and the regulations promulgated under the authority of section 305(c). A distribution made by a corporation to its shareholders in its stock or rights to acquire its stock which would not otherwise be included in gross income by reason of section 305 shall not be so included merely because such distribution was made out of Treasury stock or consisted of rights to acquire Treasury stock. See section 307 for rules as to basis of stock and stock rights acquired in a distribution.

(b) *Amount of distribution.* (1) In general, where a distribution of stock or rights to acquire stock of a corporation is treated as a distribution of property to which section 301 applies by reason of section 305(b), the amount of the distribution, in accordance with section 301(b) and § 1.301-1, is the fair market value of such stock or rights on the date of distribution. See *Example (1)* of § 1.305-2(b).

(2) Where a corporation which regularly distributes its earnings and profits, such as a regulated investment company, declares a dividend pursuant to which the shareholders may elect to receive either money or stock of the distributing corporation of equivalent value, the amount of the distribution of the stock received by any shareholder electing to receive stock will be

considered to equal the amount of the money which could have been received instead. See *Example (2)* of § 1.305-2(b).

(3) For rules for determining the amount of the distribution where certain transactions, such as changes in conversion ratios or periodic redemptions, are treated as distributions under section 305(c), see *Examples (6), (8), (9), and (15)* of § 1.305-3(e).

(c) *Adjustment in purchase price.* A transfer of stock (or rights to acquire stock) or an increase or decrease in the conversion ratio or redemption price of stock which represents an adjustment of the price to be paid by the distributing corporation in acquiring property (within the meaning of section 317(a)) is not within the purview of section 305 because it is not a distribution with respect to its stock. For example, assume that on January 1, 1970, pursuant to a reorganization, corporation X acquires all the stock of corporation Y solely in exchange for its convertible preferred class B stock. Under the terms of the class B stock, its conversion ratio is to be adjusted in 1976 under a formula based upon the earnings of corporation Y over the 6-year period ending on December 31, 1975. Such an adjustment in 1976 is not covered by section 305.

(d) *Definitions.* (1) For purposes of this section and §§ 1.305-2 through 1.305-7, the term *stock* includes rights or warrants to acquire such stock.

(2) For purposes of §§ 1.305-2 through 1.305-7, the term *shareholder* includes a holder of rights or warrants or a holder of convertible securities.

[T.D. 7281, 38 FR 18532, July 12, 1973; 38 FR 19910, July 25, 1973]

§ 1.305-2 Distributions in lieu of money.

(a) *In general.* Under section 305(b)(1), if any shareholder has the right to an election or option with respect to whether a distribution shall be made either in money or any other property, or in stock or rights to acquire stock of the distributing corporation, then, with respect to all shareholders, the distribution of stock or rights to acquire stock is treated as a distribution of property to which section 301 applies regardless of—

(1) Whether the distribution is actually made in whole or in part in stock or in stock rights;

(2) Whether the election or option is exercised or exercisable before or after the declaration of the distribution;

(3) Whether the declaration of the distribution provides that the distribution will be made in one medium unless the shareholder specifically requests payment in the other;

(4) Whether the election governing the nature of the distribution is provided in the declaration of the distribution or in the corporate charter or arises from the circumstances of the distribution; or

(5) Whether all or part of the shareholders have the election.

(b) *Examples.* The application of section 305(b)(1) may be illustrated by the following examples:

Example (1). (i) Corporation X declared a dividend payable in additional shares of its common stock to the holders of its outstanding common stock on the basis of two additional shares for each share held on the record date but with the provision that, at the election of any shareholder made within a specified period prior to the distribution date, he may receive one additional share for each share held on the record date plus \$12 principal amount of securities of corporation Y owned by corporation X. The fair market value of the stock of corporation X on the distribution date was \$10 per share. The fair market value of \$12 principal amount of securities of corporation Y on the distribution date was \$11 but such securities had a cost basis to corporation X of \$9.

(ii) The distribution to all shareholders of one additional share of stock of corporation X (with respect to which no election applies) for each share outstanding is not a distribution to which section 301 applies.

(iii) The distribution of the second share of stock of corporation X to those shareholders who do not elect to receive securities of corporation Y is a distribution of property to which section 301 applies, whether such shareholders are individuals or corporations. The amount of the distribution to which section 301 applies is \$10 per share of stock of corporation X held on the record date (the fair market value of the stock of corporation X on the distribution date).

(iv) The distribution of securities of corporation Y in lieu of the second share of stock of corporation X to the shareholders of corporation X whether individuals or corporations, who elect to receive such securities, is also a distribution of property to which section 301 applies.