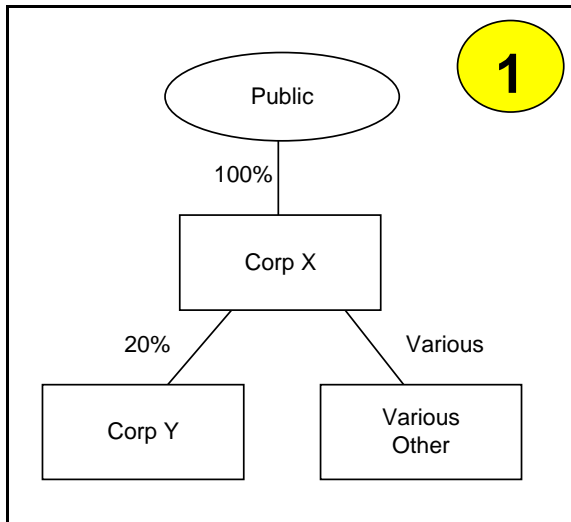
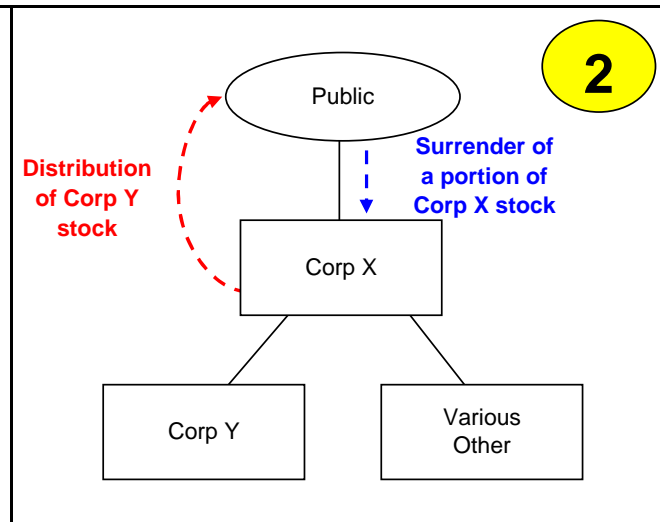


**In-Kind Redemption to Shareholders
in Their Capacity as Shareholders**

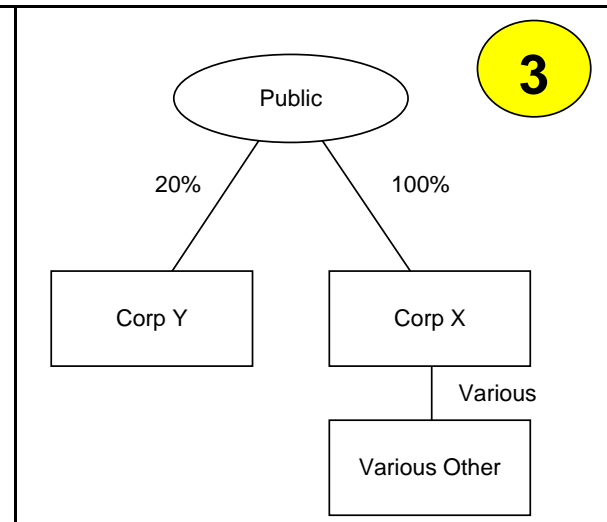
Initial Structure



In-Kind Redemption



Ending Point



X corporation is engaged in the business of making and holding substantial long-term investments in stock of other corporations, and it does not normally sell these assets. Its own capital stock is publicly held. X corporation owned 20 percent of Y corporation's outstanding stock which represented approximately 30 percent of X corporation's investment assets. X corporation had effective control of Y corporation, the stock of which was also publicly held. The Y corporation stock had almost trebled in market price since X corporation acquired it. X corporation decided to terminate its investment in Y corporation. The Y corporation stock was offered on a pro rata basis to all of X corporation's shareholders, and shareholders owning 35 percent of the stock of X corporation availed themselves of the offer. Prior to the redemption offer none of X corporation's shareholders agreed to purchase Y corporation stock from X corporation, nor were there any negotiations with specific buyers for the sale of the Y corporation stock.

Former section 311(a) provided that no gain or loss will be recognized to a corporation on the distribution, with respect to its stock, of property. Reg. 1.311-1(a) provides that the term "distributions with respect to its stock" includes distributions made in redemption of stock. Reg. 1.311-1(e)(1) creates an exception to the foregoing by stating that section 311 is limited to distributions made by reason of the corporation-shareholder relationship, and it will not apply to transactions between a corporation and a shareholder in his capacity as debtor, creditor, employee, or vendee where the fact that such debtor, creditor, employee, or vendee is a shareholder is incidental to the transaction. In this case the corporation-shareholder relationship was essential. The fact that one of X corporation's primary purposes in undertaking the redemption was to dispose of the Y corporation stock did not in itself, create a vendor-vendee relationship between X corporation and its shareholders. Accordingly, since the distribution of Y corporation stock was made by reason of the corporation-stockholder relationship, under section 311(a) no gain or loss was recognized to X corporation on the distribution.