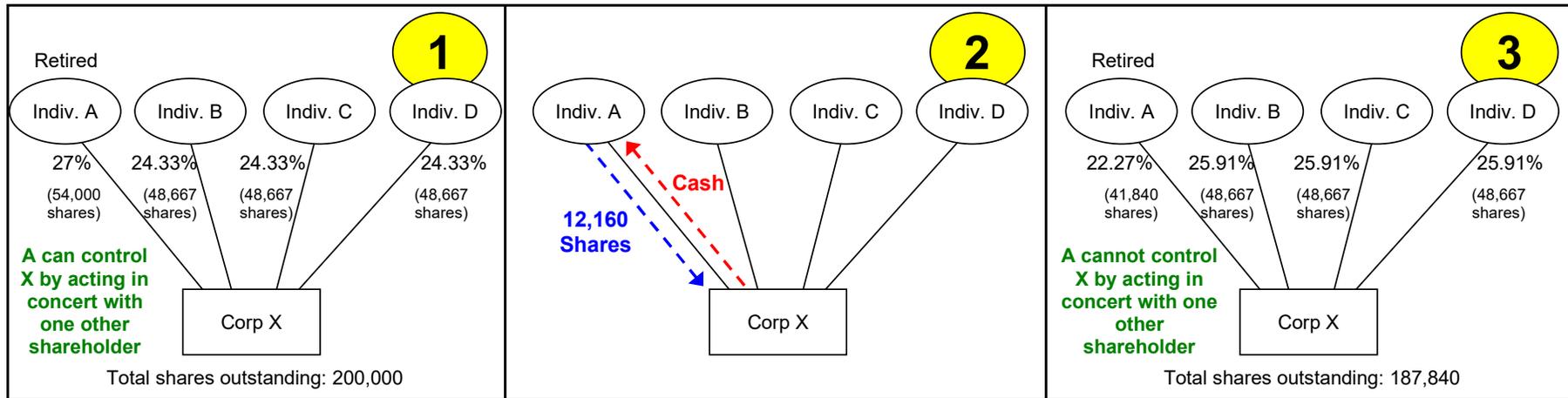


Stock Redemption: Lost Control Where Acting In Concert With One Other Shareholder

Initial Structure

Redemption

Ending Point



Corporation X had outstanding one class of stock consisting of 200,000 shares of common stock each of which was entitled to one vote. A, an individual, owned 54,000 shares of X common stock (27%), each of which was entitled to one vote. Because A was retired from business, A took no active part in the management of X. The remaining 146,000 shares of outstanding X common stock (73%) were held in equal portions by individuals B, C, and D. None of the X shareholders were related within the meaning of section 318(a)(1).

X redeemed for cash 12,160 shares of its stock held by A. After the redemption, A owned 41,840 shares of the outstanding stock of X which represented 22.27% of the 187,840 shares then outstanding. The redemption reduced A's percentage of ownership and voting rights in X from 27% to 22.27%. This reduction in A's percentage ownership in X failed to meet the percentage requirement of section 302(b)(2)(C).

In determining whether the redemption meets the requirements of section 302(b)(1), it is significant that the redemption, in reducing A's interest from 27% to 22.27%, correspondingly reduced A's right to vote, A's right to earnings, and A's right to share in net assets on liquidation. Moreover, the reduction of A's voting rights from 27% to 22.27% is meaningful in itself in that it caused A to go from a position of holding a block of X stock that afforded A control of X if A acted in concert with only one other stockholder, to a position where such action was not possible. Thus, the ruling held that the reduction constituted a meaningful reduction of A's interest in X, and the redemption was not essentially equivalent to a dividend.