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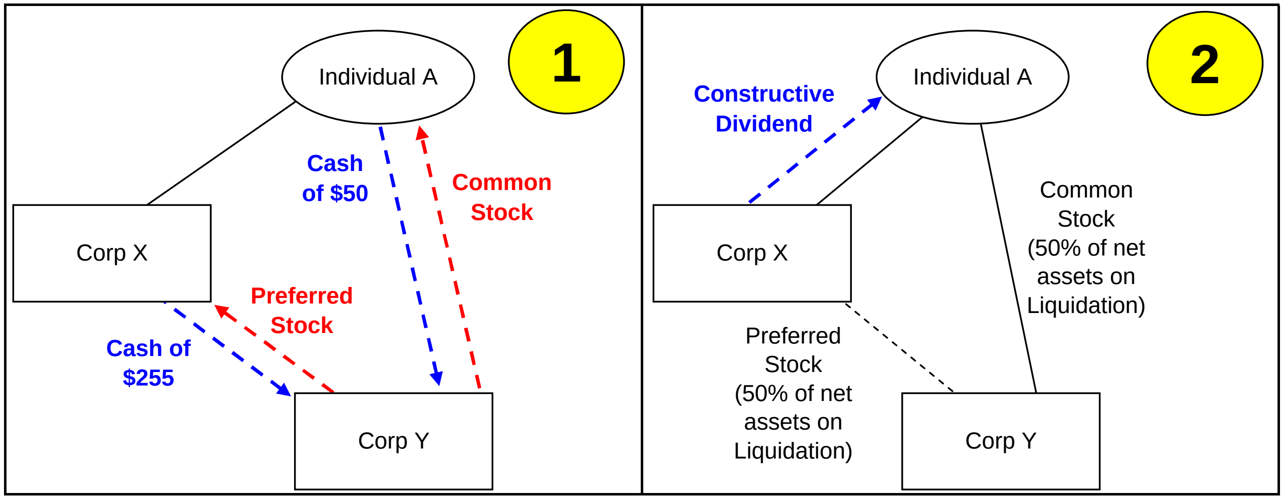
Revenue Ruling 76-454

Constructive Dividend as Part of 351 Exchange

Contributions **Constructive Dividend**



A, an individual, owned all of the stock of X, a domestic corporation. A organized Y, a domestic corporation, paying 50x dollars in cash for all of its common stock, and subsequently as part of the plan of incorporation, caused X to purchase from Y all of Y's 4 percent noncumulative, nonvoting preferred stock for 255x dollars. Upon liquidation, the net assets of Y are distributable 50 percent to the holders of its common stock and 50 percent to the holders of its preferred stock. Because the right to share in the net assets upon liquidation for each class of stock is substantially disproportionate to the amounts paid for each class of stock, the 255x dollars paid by X for the preferred stock exceeds its fair market value.

Reg. 1.351-1(b)(1) provides, in part, as follows:

> Where property is transferred to a corporation by two or more persons in exchange for stock or securities * * * it is not required that the stock and securities received by each be substantially in proportion to his interest in the property immediately prior to the transfer. However, where the stock and securities received are received in disproportion to such interest, the entire transaction will be given tax effect in accordance with its true nature, and in appropriate cases the transaction may be treated as if the stock and securities had first been received in proportion and then some of such stock and securities had been used to make gifts * * *, to pay compensation * * *, or to satisfy obligations of the transferor of any kind.

Accordingly, it is appropriate to treat the transactions in the instant case as transfers by X and A, respectively, of 255x dollars and 50x dollars and the receipt from Y and X and A of stock worth, respectively, 255x dollars and 50x dollars followed by a distribution by X of a sufficient amount of the stock it constructively received to reflect the true values of the stocks in the hands of X and A after the transactions. That is, X is treated as having received all of the Y preferred stock and enough of the Y common stock so that the total value of the stock it received equalled the 255x dollar contribution it made to Y. X is then considered to have distributed the Y common stock it constructively received to A to reflect the fact that after the transaction X owned only Y preferred stock and A owned all of Y's common stock. This distribution is subject to the provisions of section 301.