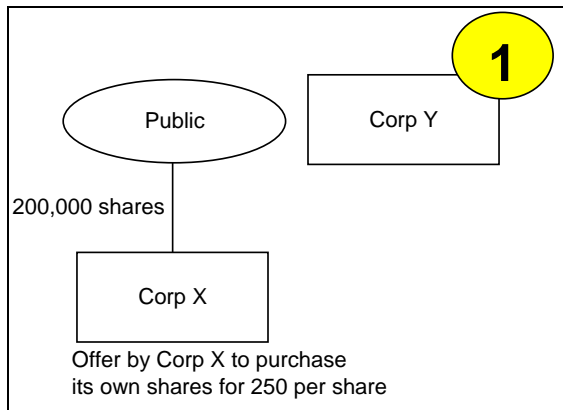
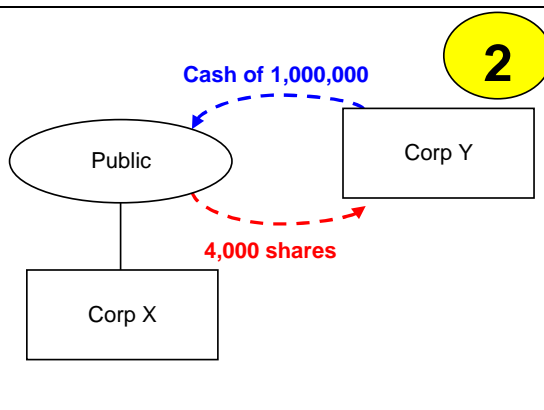


**No DRD for Redemption  
Integrated with Sale**

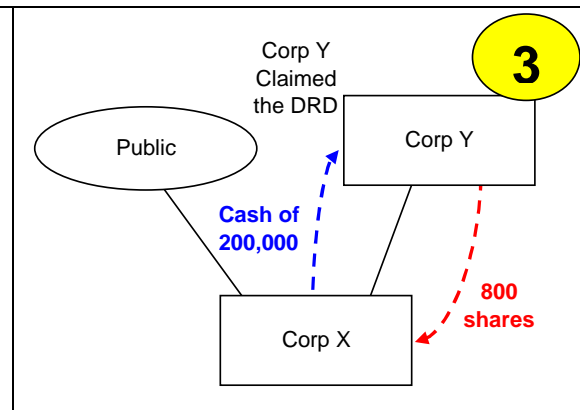
**Initial Structure (April 4, 1976)**



**Share Purchase (April 5, 1976)**

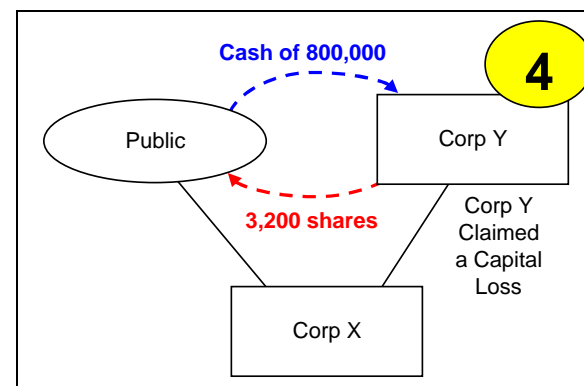


**Tender of Shares (April 5, 1976)**



X corporation has outstanding approximately 200,000x shares of voting common stock, which is widely held and publicly traded. On April 4, 1976, X offered to purchase shares of its common stock at the rate of \$250 per share. On April 5, 1976, Y corporation, which owned no X common stock either actually or constructively under section 318 prior to the tender offer, purchased 4,000 shares of X stock on the market for a total price of \$1,000,000, and immediately tendered 800 shares to X for redemption. On April 21, 1976, Y sold the remaining 3,200 shares of X stock on the market for \$800,000. On its Federal income tax return for its fiscal year ended September 30, 1976, Y reported the \$200,000 redemption proceeds as a dividend, claimed the 85 percent dividends received deduction of section 243 and paid a tax of \$14,400. Y claimed a \$200,000 short term capital loss on the sale of the 3,200 shares of X stock and applied this loss against short-term capital gains of \$200,000 from other sources, realizing a tax saving of \$96,000. The net effect of the entire transaction, as reported by Y, was a tax saving of \$81,600.

**Sales of Shares (April 21, 1976)**



In *Zenz v. Quinlivan*, 213 F.2d 914 (6th Cir. 1954), the sole shareholder of a corporation, desiring to dispose of her entire interest therein, sold part of her stock to a competitor and shortly thereafter sold the remainder of her stock to the corporation. The Government contended the redemption was a dividend because the result was the same as if the steps had been reversed, that is, as if the stock had been redeemed first and the sale of stock to the competitor had followed. The court rejected the Government's contention and held that the redemption of the stock was not a dividend to the shareholder because the redemption, coupled with the earlier sale, extinguished the shareholder's interest in the corporation. In this case, the redemption and the sale were undertaken pursuant to an integrated plan. Therefore, even assuming the redemption distribution, standing by itself, would have been essentially equivalent to a dividend, the redemption and sale combined completely terminated Y's interest in X within the meaning of section 302(b)(3). That the redemption occurred before the sale is irrelevant. Accordingly, the redemption by X of the 800 shares of X stock held by Y should have been treated as an exchange under section 302(a) rather than as the distribution of a dividend. Y was not entitled to a deduction for dividends received.