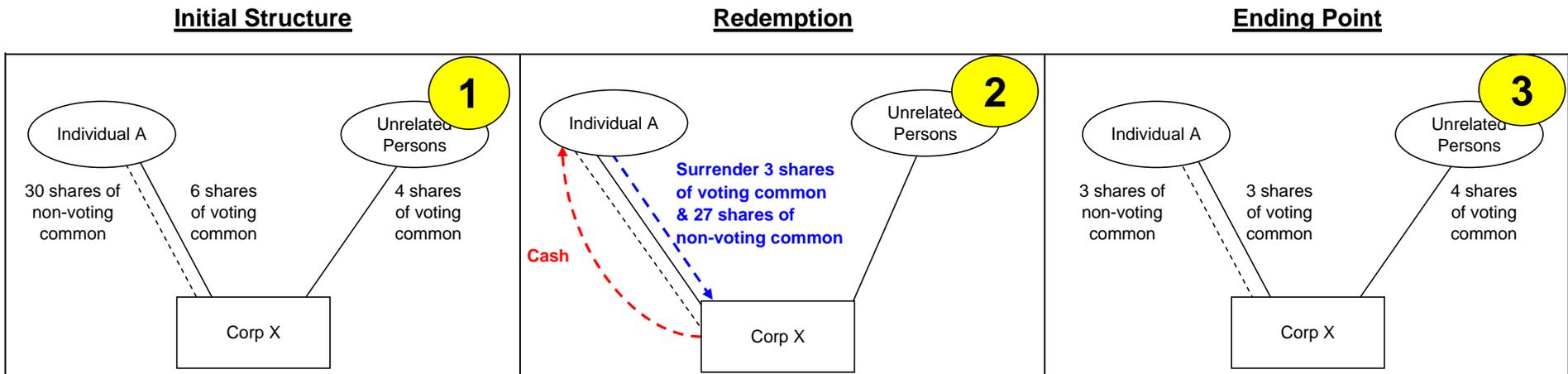


**Substantially Disproportionate Redemption  
Multiple Classes of Common**



X corporation had outstanding 10 shares of voting common stock and 30 shares of nonvoting common stock. The fair market values of a share of voting common stock and a share of nonvoting common stock are approximately equal. A owned 6 shares of X voting common stock and all the nonvoting common stock. The remaining 4 shares of the X voting common stock were held by persons unrelated to A within the meaning of section 318(a). X redeemed 3 shares of voting common stock and 27 shares of nonvoting common stock from A in a single transaction. Thereafter, A owned 3 shares of X voting common stock and 3 shares of nonvoting common stock. The ownership of the remaining 4 shares of X voting common stock was unchanged.

If a distribution in redemption of stock qualifies under section 302(b)(2) as substantially disproportionate, the distribution is treated under section 302(a) as a payment in exchange for the stock redeemed. Under section 302(b)(2)(B) and (C), a distribution is substantially disproportionate if (i) the shareholder owns less than 50 percent of the total combined voting power of the corporation immediately after the redemption, (ii) immediately after the redemption the ratio of voting stock owned by the shareholder to all the voting stock of the corporation is less than 80 percent of the same ratio immediately before the redemption, and (iii) immediately after the redemption the ratio of common stock owned by the shareholder to all of the common stock of the corporation (whether voting or nonvoting) is less than 80 percent of the same ratio immediately before the redemption. Under section 302(b)(2)(C), if more than one class of common stock is outstanding, the determination in (iii) above is made by reference to fair market value. Section 302(b)(2) applies to a redemption of both voting stock and other stock (although not to the redemption solely of nonvoting stock). Reg. 1.302-3(a).

With regard to requirements (i) and (ii) described above, after the redemption, A owned less than 50 percent of the voting power of X (43 percent), and A's voting power was reduced to less than 80 percent of the percentage of voting power in X that A owned before the redemption (from 60 percent to 43 percent for a reduction to 72 percent of the preredemption level). With regard to requirement (iii) above, section 302(b)(2)(C) provides that, if there is more than one class of common stock outstanding, the fair market value of all of the common stock (voting and nonvoting) will govern the determination of whether there has been the requisite reduction in common stock ownership. The requirement concerning reduction in common stock ownership is to be applied on an aggregate basis rather than on a class-by-class basis. Thus, the fact that A has no reduction in interest with regard to the nonvoting common stock and continues to own 100 percent of this stock does not prevent the redemption of this class of stock from qualifying under section 302(b)(2) when the whole transaction meets section 302(b)(2) requirements. Prior to the redemption, A owned 90 percent of the total fair market value of all the outstanding X common stock (36 out of the 40 shares of voting and nonvoting common stock). After the redemption, A owned 60 percent of the total fair market value of all the X common stock (6 out of 10 shares). The reduction in ownership (from 90 percent to 60 percent) was a reduction to less than 80 percent of the fraction that A previously owned of the total fair market value of all the X common stock.