

corporation which is a successor corporation to the corporation the interest in which has been terminated.

(d) For the purpose of section 302(c)(2)(A)(i), a person will be considered to be a creditor only if the rights of such person with respect to the corporation are not greater or broader in scope than necessary for the enforcement of his claim. Such claim must not in any sense be proprietary and must not be subordinate to the claims of general creditors. An obligation in the form of a debt may thus constitute a proprietary interest. For example, if under the terms of the instrument the corporation may discharge the principal amount of its obligation to a person by payments, the amount or certainty of which are dependent upon the earnings of the corporation, such a person is not a creditor of the corporation. Furthermore, if under the terms of the instrument the rate of purported interest is dependent upon earnings, the holder of such instrument may not, in some cases, be a creditor.

(e) In the case of a distributee to whom section 302(b)(3) is applicable, who is a creditor after such transaction, the acquisition of the assets of the corporation in the enforcement of the rights of such creditor shall not be considered an acquisition of an interest in the corporation for purposes of section 302(c)(2) unless stock of the corporation, its parent corporation, or, in the case of a redemption of stock of a parent corporation, of a subsidiary of such corporation is acquired.

(f) In determining whether an entire interest in the corporation has been terminated under section 302(b)(3), under all circumstances paragraphs (2), (3), (4), and (5) of section 318(a) (relating to constructive ownership of stock) shall be applicable.

(g) Section 302(c)(2)(B) provides that section 302(c)(2)(A) shall not apply—

(1) If any portion of the stock redeemed was acquired directly or indirectly within the 10-year period ending on the date of the distribution by the distributee from a person, the ownership of whose stock would (at the time of distribution) be attributable to the distributee under section 318(a), or

(2) If any person owns (at the time of the distribution) stock, the ownership

of which is attributable to the distributee under section 318(a), such person acquired any stock in the corporation directly or indirectly from the distributee within the 10-year period ending on the date of the distribution, and such stock so acquired from the distributee is not redeemed in the same transaction, unless the acquisition (described in subparagraph (1) of this paragraph) or the disposition by the distributee (described in subparagraph (2) of this paragraph) did not have as one of its principal purposes the avoidance of Federal income tax. A transfer of stock by the transferor, within the 10-year period ending on the date of the distribution, to a person whose stock would be attributable to the transferor shall not be deemed to have as one of its principal purposes the avoidance of Federal income tax merely because the transferee is in a lower income tax bracket than the transferor.

(Sec. 302(c)(2)(A)(iii) (68A Stat. 87; 26 U.S.C. 302 (c)(2)(A)(iii)))

[T.D. 7535, 43 FR 10686, Mar. 15, 1978]

§ 1.303-1 General.

Section 303 provides that in certain cases a distribution in redemption of stock, the value of which is included in determining the value of the gross estate of a decedent, shall be treated as a distribution in full payment in exchange for the stock so redeemed.

§ 1.303-2 Requirements.

(a) Section 303 applies only where the distribution is with respect to stock of a corporation the value of whose stock in the gross estate of the decedent for Federal estate tax purposes is an amount in excess of (1) 35 percent of the value of the gross estate of such decedent, or (2) 50 percent of the taxable estate of such decedent. For the purposes of such 35 percent and 50 percent requirements, stock of two or more corporations shall be treated as the stock of a single corporation if more than 75 percent in value of the outstanding stock of each such corporation is included in determining the value of the decedent's gross estate. For the purpose of the 75 percent requirement, stock which, at the decedent's death, represents the surviving

spouse's interest in community property shall be considered as having been included in determining the value of the decedent's gross estate.

(b) For the purpose of section 303(b)(2)(A)(i), the term *gross estate* means the gross estate as computed in accordance with section 2031 (or, in the case of the estate of a decedent nonresident not a citizen of the United States, in accordance with section 2103). For the purpose of section 303(b)(2)(A)(ii), the term *taxable estate* means the taxable estate as computed in accordance with section 2051 (or, in the case of the estate of a decedent nonresident not a citizen of the United States, in accordance with section 2106). In case the value of an estate is determined for Federal estate tax purposes under section 2032 (relating to alternate valuation), then, for purposes of section 303(b)(2), the value of the gross estate, the taxable estate, and the stock shall each be determined on the applicable date prescribed in section 2032.

(c)(1) In determining whether the estate of the decedent is comprised of stock of a corporation of sufficient value to satisfy the percentage requirements of section 303(b)(2)(A) and section 303(b)(2)(B), the total value, in the aggregate, of all classes of stock of the corporation includible in determining the value of the gross estate is taken into account. A distribution under section 303(a) may be in redemption of the stock of the corporation includible in determining the value of the gross estate, without regard to the class of such stock.

(2) The above may be illustrated by the following example:

Example. The gross estate of the decedent has a value of \$1,000,000, the taxable estate is \$700,000, and the sum of the death taxes and funeral and administration expenses is \$275,000. Included in the gross estate of the decedent is stock of three corporations which, for Federal estate tax purposes, is valued as follows:

| | |
|-----------------------------------|-----------|
| Corporation A: | |
| Common stock | \$100,000 |
| Preferred stock | 100,000 |
| Corporation B: | |
| Common stock | 50,000 |
| Preferred stock | 350,000 |
| Corporation C: Common stock | |
| | 200,000 |

The stock of Corporation A and Corporation C included in the estate of the decedent con-

stitutes all of the outstanding stock of both corporations. The stock of Corporation A and the stock of Corporation C, treated as the stock of a single corporation under section 303(b)(2)(B), has a value in excess of \$350,000 (35 percent of the gross estate or 50 percent of the taxable estate). Likewise, the stock of Corporation B has a value in excess of \$350,000. The distribution by one or more of the above corporations, within the period prescribed in section 303(b)(1), of amounts not exceeding, in the aggregate, \$275,000, in redemption of preferred stock or common stock of such corporation or corporations, will be treated as in full payment in exchange for the stock so redeemed.

(d) If stock includible in determining the value of the gross estate of a decedent is exchanged for new stock, the basis of which is determined by reference to the basis of the old stock, the redemption of the new stock will be treated the same under section 303 as the redemption of the old stock would have been. Thus section 303 shall apply with respect to a distribution in redemption of stock received by the estate of a decedent (1) in connection with a reorganization under section 368, (2) in a distribution or exchange under section 355 (or so much of section 356 as relates to section 355), (3) in an exchange under section 1036 or (4) in a distribution to which section 305(a) applies. Similarly, a distribution in redemption of stock will qualify under section 303, notwithstanding the fact that the stock redeemed is section 306 stock to the extent that the conditions of section 303 are met.

(e) Section 303 applies to distributions made after the death of the decedent and (1) before the expiration of the 3-year period of limitations for the assessment of estate tax provided in section 6501(a) (determined without the application of any provisions of law extending or suspending the running of such period of limitations), or within 90 days after the expiration of such period, or (2) if a petition for redetermination of a deficiency in such estate tax has been filed with the Tax Court within the time prescribed in section 6213, at any time before the expiration of 60 days after the decision of the Tax Court becomes final. The extension of the period of distribution provided in section 303(b)(1)(B) has reference solely to bona fide contests in the Tax Court

and will not apply in the case of a petition for redetermination of a deficiency which is initiated solely for the purpose of extending the period within which section 303 would otherwise be applicable.

(f) While section 303 will most frequently have application in the case where stock is redeemed from the executor or administrator of an estate, the section is also applicable to distributions in redemption of stock included in the decedent's gross estate and held at the time of the redemption by any person who acquired the stock by any of the means comprehended by part III, subchapter A, chapter 11 of the Code, including the heir, legatee, or donee of the decedent, a surviving joint tenant, surviving spouse, appointee, or taker in default of appointment, or a trustee of a trust created by the decedent. Thus section 303 may apply with respect to a distribution in redemption of stock from a donee to whom the decedent has transferred stock in contemplation of death where the value of such stock is included in the decedent's gross estate under section 2035. Similarly, section 303 may apply to the redemption of stock from a beneficiary of the estate to whom an executor has distributed the stock pursuant to the terms of the will of the decedent. However, section 303 is not applicable to the case where stock is redeemed from a stockholder who has acquired the stock by gift or purchase from any person to whom such stock has passed from the decedent. Nor is section 303 applicable to the case where stock is redeemed from a stockholder who has acquired the stock from the executor in satisfaction of a specific monetary bequest.

(g)(1) The total amount of the distributions to which section 303 may apply with respect to redemptions of stock included in the gross estate of a decedent may not exceed the sum of the estate, inheritance, legacy, and succession taxes (including any interest collected as a part of such taxes) imposed because of the decedent's death and the amount of funeral and administration expenses allowable as deductions to the estate. Where there is more than one distribution in redemption of stock described in section

303(b)(2) during the period of time prescribed in section 303(b)(1), the distributions shall be applied against the total amount which qualifies for treatment under section 303 in the order in which the distributions are made. For this purpose, all distributions in redemption of such stock shall be taken into account, including distributions which under another provision of the Code are treated as in part or full payment in exchange for the stock redeemed.

(2) Subparagraph (1) of this paragraph may be illustrated by the following example:

Example. (i) The gross estate of the decedent has a value of \$800,000, the taxable estate is \$500,000, and the sum of the death taxes and funeral and administrative expenses is \$225,000. Included in determining the gross estate of the decedent is the stock of a corporation which for Federal estate tax purposes is valued at \$450,000. During the first year of administration, one-third of such stock is distributed to a legatee and shortly thereafter this stock is redeemed by the corporation for \$150,000. During the second year of administration, another one-third of such stock includible in the estate is redeemed for \$150,000.

(ii) The first distribution of \$150,000 is applied against the \$225,000 amount that qualifies for treatment under section 303, regardless of whether the first distribution was treated as in payment in exchange for stock under section 302(a). Thus, only \$75,000 of the second distribution may be treated as in full payment in exchange for stock under section 303. The tax treatment of the remaining \$75,000 would be determined under other provisions of the Code.

(h) For the purpose of section 303, the estate tax or any other estate, inheritance, legacy, or succession tax shall be ascertained after the allowance of any credit, relief, discount, refund, remission or reduction of tax.

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 6724, 29 FR 5343, Apr. 21, 1964; T.D. 7346, 40 FR 10669, Mar. 7, 1975]

§ 1.303-3 Application of other sections.

(a) The sole effect of section 303 is to exempt from tax as a dividend a distribution to which such section is applicable when made in redemption of stock includible in a decedent's gross estate. Such section does not, however, in any other manner affect the principles set forth in sections 302 and 306.