§ 1.305-4 Distributions of common and preferred stock.

(a) In general. Under section 305(b)(3), a distribution (or a series of distributions) by a corporation which results in the receipt of preferred stock whether or not convertible into common stock) by some common shareholders and the receipt of common stock by other common shareholders is treated as a distribution of property to which section 301 applies. For the meaning of the term a series of distribution, see subparagraphs (1) through (6) of § 1.305-3(b).

(b) Examples. The application of section 305(b)(3) may be illustrated by the following examples:

Example 1. Corporation X is organized with one class of stock, class A common. During the year the corporation declares a dividend on the class A stock payable in newly authorized class C shares which is nonconvertible and limited and preferred as to dividends. Both the distribution of class A shares and the distribution of new class C shares are distributions to which section 301 applies.

Example 2. Corporation Y is organized with two classes of common stock, class A and class B. Dividends may be paid in stock or in cash on either class of stock without regard to the medium of payment of dividends on the other class. A dividend is declared on the class A stock payable in additional shares of class A stock and a dividend is declared on class B stock payable in newly authorized class C stock which is nonconvertible and limited and preferred as to dividends. Both the distribution of class A shares and the distribution of new class C shares are distributions to which section 301 applies.

Example 3. Corporation Z is organized with two classes of preferred stock, class A and class B, with the class B preferred stock redeemable in 10 years at a fixed ratio that is subject to full adjustment in the event stock dividends or rights are distributed to the class A shareholders. The class B stock pays no dividends but it is mandatorily redeemable in 10 years for $200. Under sections 305(c) and 305(b)(4), the entire redemption premium (i.e., the excess of the redemption price over the issue price) is deemed to be a distribution of preferred stock on preferred stock which is taxable as a distribution of property under section 301. This amount is considered to be distributed over the 10-year period under principles similar to the principles of section 1272(a).

Example 4. Corporation W is organized with two classes of preferred stock, class A and class B. Dividends are paid in stock on either class of stock without regard to the medium of payment of dividends on the other class. A dividend is declared on the class A stock payable in additional shares of class A stock and a dividend is declared on class B stock payable in newly authorized class C stock which is nonconvertible and limited and preferred as to dividends. Both the distribution of class A shares and the distribution of new class C shares are distributions to which section 301 applies.

Example 5. Corporation V is organized with two classes of stock, class A common and class B convertible preferred. The class B stock is issued for $100 per share and is convertible at the holder's option into class A stock at a fixed ratio that is subject to full adjustment in the event stock dividends or rights are distributed to the class A shareholders. The class B stock pays no dividends but it is mandatorily redeemable in 10 years for $200. Under sections 305(c) and 305(b)(4), the entire redemption premium (i.e., the excess of the redemption price over the issue price) is deemed to be a distribution of preferred stock on preferred stock which is taxable as a distribution of property under section 301. This amount is considered to be distributed over the 10-year period under principles similar to the principles of section 1272(a). During the year, the corporation declares a dividend on the class A stock payable in additional shares of class A stock.

(i) Facts. Corporation V is organized with two classes of stock, class A common and class B convertible preferred. The class B stock is issued for $100 per share and is convertible at the holder's option into class A stock at a fixed ratio that is subject to full adjustment in the event stock dividends or rights are distributed to the class A shareholders. The class B stock pays no dividends but it is mandatorily redeemable in 10 years for $200. Under sections 305(c) and 305(b)(4), the entire redemption premium (i.e., the excess of the redemption price over the issue price) is deemed to be a distribution of preferred stock on preferred stock which is taxable as a distribution of property under section 301. This amount is considered to be distributed over the 10-year period under principles similar to the principles of section 1272(a). During the year, the corporation declares a dividend on the class A stock payable in additional shares of class A stock.

(ii) Analysis. The distribution on the class A stock is a distribution to which sections 305(b)(2) and 301 apply since it increases the proportionate interests of the class A shareholders in the assets and earnings and profits of the corporation and the class B shareholders have received property (i.e., the constructive distribution described above). If, however, the conversion ratio of the class B stock were subject to full adjustment to reflect the distribution of stock to class A shareholders, the distribution of stock dividends on the class A stock would not increase the proportionate interest of the class A shareholders in the assets and earnings and profits of the corporation and such distribution would not be a distribution to which section 301 applies.

(iii) Effective date. This Example 15 applies to stock issued on or after December 20, 1995. For previously issued stock, see § 1.305-3(c).

Example 15 (as contained in the 26 CFR part 1 edition revised April 1, 1995).

Example 15:

1. Facts. Corporation V is organized with two classes of stock, class A common and class B convertible preferred. The class B stock is issued for $100 per share and is convertible at the holder's option into class A stock at a fixed ratio that is subject to full adjustment in the event stock dividends or rights are distributed to the class A shareholders. The class B stock pays no dividends but it is mandatorily redeemable in 10 years for $200. Under sections 305(c) and 305(b)(4), the entire redemption premium (i.e., the excess of the redemption price over the issue price) is deemed to be a distribution of preferred stock on preferred stock which is taxable as a distribution of property under section 301. This amount is considered to be distributed over the 10-year period under principles similar to the principles of section 1272(a). During the year, the corporation declares a dividend on the class A stock payable in additional shares of class A stock.

2. Analysis. The distribution on the class A stock is a distribution to which sections 305(b)(2) and 301 apply since it increases the proportionate interests of the class A shareholders in the assets and earnings and profits of the corporation and the class B shareholders have received property (i.e., the constructive distribution described above). If, however, the conversion ratio of the class B stock were subject to full adjustment to reflect the distribution of stock to class A shareholders, the distribution of stock dividends on the class A stock would not increase the proportionate interest of the class A shareholders in the assets and earnings and profits of the corporation and such distribution would not be a distribution to which section 301 applies.

3. Effective date. This Example 15 applies to stock issued on or after December 20, 1995. For previously issued stock, see § 1.305-3(c).

Example 15 (as contained in the 26 CFR part 1 edition revised April 1, 1995).