

“(i) nonconvertible preferred stock.

“(ii) additional stock of that class of stock which meets the requirements of subparagraph (A)(iii), or

“(iii) preferred stock which is convertible into stock which meets the requirements of subparagraph (A)(iii) at a fixed conversion ratio which takes account of all stock dividends and stock splits with respect to the stock into which such convertible stock is convertible.

“(D) For purposes of this paragraph, the term ‘stock’ includes rights to acquire such stock.

“(3) In cases to which Treasury Decision 6990 (promulgated January 10, 1969) would not have applied, in applying paragraphs (1) and (2) April 22, 1969, shall be substituted for January 10, 1969.

“(4) Section 305(b)(4) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall not apply to any distribution (or deemed distribution) with respect to preferred stock (including any increase in the conversion ratio of convertible stock) made before January 1, 1991, pursuant to the terms relating to the issuance of such stock which were in effect on January 10, 1969.

“(5) With respect to distributions made or considered as made after January 10, 1969, in taxable years ending after such date, to the extent that the amendment made by subsection (a) [amending this section] does not apply by reason of paragraph (2), (3), or (4) of this subsection, section 305 of the Internal Revenue Code of 1986 (as in effect before the amendment made by subsection (a)) shall continue to apply.”

SAVINGS PROVISION

For provisions that nothing in amendment by section 11801(a)(17), (c)(7) of Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

§ 306. Dispositions of certain stock

(a) General rule

If a shareholder sells or otherwise disposes of section 306 stock (as defined in subsection (c))—

(1) Dispositions other than redemptions

If such disposition is not a redemption (within the meaning of section 317(b))—

(A) The amount realized shall be treated as ordinary income. This subparagraph shall not apply to the extent that—

- (i) the amount realized, exceeds
- (ii) such stock's ratable share of the amount which would have been a dividend at the time of distribution if (in lieu of section 306 stock) the corporation had distributed money in an amount equal to the fair market value of the stock at the time of distribution.

(B) Any excess of the amount realized over the sum of—

- (i) the amount treated under subparagraph (A) as ordinary income, plus
- (ii) the adjusted basis of the stock,

shall be treated as gain from the sale of such stock.

(C) No loss shall be recognized.

(D) TREATMENT AS DIVIDEND.—For purposes of section 1(h)(11) and such other provisions as the Secretary may specify, any amount treated as ordinary income under this paragraph shall be treated as a dividend received from the corporation.

(2) Redemption

If the disposition is a redemption, the amount realized shall be treated as a distribution of property to which section 301 applies.

(b) Exceptions

Subsection (a) shall not apply—

(1) Termination of shareholder's interest, etc.

(A) Not in redemption

If the disposition—

- (i) is not a redemption;
- (ii) is not, directly or indirectly, to a person the ownership of whose stock would (under section 318(a)) be attributable to the shareholder; and
- (iii) terminates the entire stock interest of the shareholder in the corporation (and for purposes of this clause, section 318(a) shall apply).

(B) In redemption

If the disposition is a redemption and paragraph (3) or (4) of section 302(b) applies.

(2) Liquidations

If the section 306 stock is redeemed in a distribution in complete liquidation to which part II (sec. 331 and following) applies.

(3) Where gain or loss is not recognized

To the extent that, under any provision of this subtitle, gain or loss to the shareholder is not recognized with respect to the disposition of the section 306 stock.

(4) Transactions not in avoidance

If it is established to the satisfaction of the Secretary—

(A) that the distribution, and the disposition or redemption, or

(B) in the case of a prior or simultaneous disposition (or redemption) of the stock with respect to which the section 306 stock disposed of (or redeemed) was issued, that the disposition (or redemption) of the section 306 stock,

was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax.

(c) Section 306 stock defined

(1) In general

For purposes of this subchapter, the term “section 306 stock” means stock which meets the requirements of subparagraph (A), (B), or (C) of this paragraph.

(A) Distributed to seller

Stock (other than common stock issued with respect to common stock) which was distributed to the shareholder selling or otherwise disposing of such stock if, by reason of section 305(a), any part of such distribution was not includible in the gross income of the shareholder.

(B) Received in a corporate reorganization or separation

Stock which is not common stock and—

- (i) which was received, by the shareholder selling or otherwise disposing of such stock, in pursuance of a plan of reor-

ganization (within the meaning of section 368(a)), or in a distribution or exchange to which section 355 (or so much of section 356 as relates to section 355) applied, and

(ii) with respect to the receipt of which gain or loss to the shareholder was to any extent not recognized by reason of part III, but only to the extent that either the effect of the transaction was substantially the same as the receipt of a stock dividend, or the stock was received in exchange for section 306 stock.

For purposes of this section, a receipt of stock to which the foregoing provisions of this subparagraph apply shall be treated as a distribution of stock.

(C) Stock having transferred or substituted basis

Except as otherwise provided in subparagraph (B), stock the basis of which (in the hands of the shareholder selling or otherwise disposing of such stock) is determined by reference to the basis (in the hands of such shareholder or any other person) of section 306 stock.

(2) Exception where no earnings and profits

For purposes of this section, the term “section 306 stock” does not include any stock no part of the distribution of which would have been a dividend at the time of the distribution if money had been distributed in lieu of the stock.

(3) Certain stock acquired in section 351 exchange

The term “section 306 stock” also includes any stock which is not common stock acquired in an exchange to which section 351 applied if receipt of money (in lieu of the stock) would have been treated as a dividend to any extent. Rules similar to the rules of section 304(b)(2) shall apply—

(A) for purposes of the preceding sentence, and

(B) for purposes of determining the application of this section to any subsequent disposition of stock which is section 306 stock by reason of an exchange described in the preceding sentence.

(4) Application of attribution rules for certain purposes

For purposes of paragraphs (1)(B)(ii) and (3), section 318(a) shall apply. For purposes of applying the preceding sentence to paragraph (3), the rules of section 304(c)(3)(B) shall apply.

(d) Stock rights

For purposes of this section—

(1) stock rights shall be treated as stock, and

(2) stock acquired through the exercise of stock rights shall be treated as stock distributed at the time of the distribution of the stock rights, to the extent of the fair market value of such rights at the time of the distribution.

(e) Convertible stock

For purposes of subsection (c)—

(1) if section 306 stock was issued with respect to common stock and later such section

306 stock is exchanged for common stock in the same corporation (whether or not such exchange is pursuant to a conversion privilege contained in the section 306 stock), then (except as provided in paragraph (2)) the common stock so received shall not be treated as section 306 stock; and

(2) common stock with respect to which there is a privilege of converting into stock other than common stock (or into property), whether or not the conversion privilege is contained in such stock, shall not be treated as common stock.

(f) Source of gain

The amount treated under subsection (a)(1)(A) as ordinary income shall, for purposes of part I of subchapter N (sec. 861 and following, relating to determination of sources of income), be treated as derived from the same source as would have been the source if money had been received from the corporation as a dividend at the time of the distribution of such stock. If under the preceding sentence such amount is determined to be derived from sources within the United States, such amount shall be considered to be fixed or determinable annual or periodical gains, profits, and income within the meaning of section 871(a) or section 881(a), as the case may be.

(g) Change in terms and conditions of stock

If a substantial change is made in the terms and conditions of any stock, then, for purposes of this section—

(1) the fair market value of such stock shall be the fair market value at the time of the distribution or at the time of such change, whichever such value is higher;

(2) such stock's ratable share of the amount which would have been a dividend if money had been distributed in lieu of stock shall be determined as of the time of distribution or as of the time of such change, whichever such ratable share is higher; and

(3) subsection (c)(2) shall not apply unless the stock meets the requirements of such subsection both at the time of such distribution and at the time of such change.

(Aug. 16, 1954, ch. 736, 68A Stat. 90; Pub. L. 94-455, title XIX, §§1901(b)(3)(J), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1793, 1834; Pub. L. 95-600, title VII, §702(a)(1), (2), Nov. 6, 1978, 92 Stat. 2925; Pub. L. 96-223, title IV, §401(a), Apr. 2, 1980, 94 Stat. 299; Pub. L. 97-248, title II, §§222(e)(1)(A), (2), 226(b), 227(a), Sept. 3, 1982, 96 Stat. 480, 492; Pub. L. 98-369, div. A, title VII, §712(i)(2), (l)(5)(B), (6), July 18, 1984, 98 Stat. 948, 954; Pub. L. 101-508, title XI, §11801(a)(18), Nov. 5, 1990, 104 Stat. 1388-521; Pub. L. 108-27, title III, §302(e)(3), May 28, 2003, 117 Stat. 763.)

AMENDMENTS

2003—Subsec. (a)(1)(D). Pub. L. 108-27 added subpar. (D).

1990—Subsec. (h). Pub. L. 101-508 struck out subsec. (h) which related to stock received in distributions and reorganizations to which 1939 Code applied.

1984—Subsec. (b)(1). Pub. L. 98-369, §712(i)(2), substituted “interest, etc.” for “interest” in heading.

Subsec. (c)(3). Pub. L. 98-369, §712(l)(6), incorporated existing second sentence in provision designated subpar. (A) and added subpar. (B).

Subsec. (c)(4). Pub. L. 98-369, § 712(j)(5)(B), substituted “the rules of section 304(c)(3)(B) shall apply” for “sections 318(a)(2)(C) and 318(a)(3)(C) shall be applied without regard to the 50 percent limitation contained therein”.

1982—Subsec. (b)(1)(B). Pub. L. 97-248, § 222(e)(2), substituted “paragraph (3) or (4) of section 302(b)” for “section 302(b)(3)”.

Subsec. (b)(2). Pub. L. 97-248, § 222(e)(1)(A), struck out “partial or” before “complete liquidation”.

Subsec. (c)(3). Pub. L. 97-248, § 226(b), added par. (3).

Subsec. (c)(4). Pub. L. 97-248, § 227(a), added par. (4).

1980—Subsecs. (a)(3), (b)(5). Pub. L. 96-223 repealed the amendments made by Pub. L. 95-600, § 702(a)(1), (2). See 1978 Amendment notes below.

1978—Subsec. (a)(3). Pub. L. 95-600, § 702(a)(1), added par. (3) which related to ordinary income from the sale or redemption of section 306 stock which was carryover basis property adjusted for 1976 value. See Repeals note below.

Subsec. (b)(5). Pub. L. 95-600, § 702(a)(2), added par. (5) which provided that subsec. (a) of this section shall not apply to the extent that section 303 applies to a distribution in redemption of section 306 stock. See Repeals note below.

1976—Subsec. (a)(1)(A), (B)(i). Pub. L. 94-455, § 1901(b)(3)(J), substituted “ordinary income” for “gain from the sale of property which is not a capital asset”.

Subsec. (b)(4). Pub. L. 94-455, § 1906(b)(13)(A), struck out “or his delegate” after “Secretary”.

Subsec. (f). Pub. L. 94-455, § 1901(b)(3)(J), substituted “ordinary income” for “gain from the sale of property which is not a capital asset”.

EFFECTIVE DATE OF 2003 AMENDMENT

Amendment by Pub. L. 108-27 applicable, except as otherwise provided, to taxable years beginning after Dec. 31, 2002, see section 302(f) of Pub. L. 108-27, set out as an Effective and Termination Dates of 2003 Amendment note under section 1 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Amendment by Pub. L. 98-369 effective as if included in the provision of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. 97-248, to which such amendment relates, see section 715 of Pub. L. 98-369, set out as a note under section 31 of this title.

EFFECTIVE DATE OF 1982 AMENDMENT

Amendment by section 222(e)(1)(A), (2) of Pub. L. 97-248 applicable to distributions after Aug. 31, 1982, with exceptions for certain partial liquidations, see section 222(f) of Pub. L. 97-248, set out as a note under section 302 of this title.

Amendment by section 226(b) of Pub. L. 97-248 applicable to transfers occurring after Aug. 31, 1982, except for certain transfers pursuant to an application to form a BHC filed with the Federal Reserve Board before Aug. 16, 1982, see section 226(c) of Pub. L. 97-248, set out as a note under section 304 of this title.

Pub. L. 97-248, title II, § 227(c)(1), Sept. 3, 1982, 96 Stat. 492, provided that: “The amendment made by subsection (a) [amending this section] shall apply to stock received after August 31, 1982, in taxable years ending after such date.”

EFFECTIVE DATE OF 1980 AMENDMENT AND REVIVAL OF PRIOR LAW

Amendment by Pub. L. 96-223 (repealing section 702(a)(1), (2) of Pub. L. 95-600 and the amendments made thereby, which had amended this section) applicable in respect of decedents dying after Dec. 31, 1976, and, except for certain elections, this title to be applied and administered as if those repealed provisions had not been enacted, see section 401(b), (e) of Pub. L. 96-223, set out as a note under section 1023 of this title.

EFFECTIVE DATE OF 1978 AMENDMENT

Pub. L. 95-600, title VII, § 702(a)(3), Nov. 6, 1978, 92 Stat. 2925, provided that the amendments made by sec-

tion 702(a) of Pub. L. 95-600 would apply to the estates of decedents dying after Dec. 31, 1979, prior to repeal by Pub. L. 96-223, title IV, § 401(a), Apr. 2, 1980, 94 Stat. 299.

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by section 1901(b)(3)(J) of Pub. L. 94-455 effective for taxable years beginning after Dec. 31, 1976, see section 1901(d) of Pub. L. 94-455, set out as a note under section 2 of this title.

REPEALS

Pub. L. 95-600, § 702(a)(1), (2), cited as a credit to this section, and the amendments made thereby, were repealed by Pub. L. 96-223, title IV, § 401(a), Apr. 2, 1980, 94 Stat. 299, resulting in the text of this section reading as it read prior to enactment of section 702(a)(1), (2). See Effective Date of 1980 Amendment and Revival of Prior Law note above.

SAVINGS PROVISION

For provisions that nothing in amendment by Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 45K of this title.

§ 307. Basis of stock and stock rights acquired in distributions

(a) General rule

If a shareholder in a corporation receives its stock or rights to acquire its stock (referred to in this subsection as “new stock”) in a distribution to which section 305(a) applies, then the basis of such new stock and of the stock with respect to which it is distributed (referred to in this section as “old stock”), respectively, shall, in the shareholder’s hands, be determined by allocating between the old stock and the new stock the adjusted basis of the old stock. Such allocation shall be made under regulations prescribed by the Secretary.

(b) Exception for certain stock rights

(1) In general

If—

(A) a corporation distributes rights to acquire its stock to a shareholder in a distribution to which section 305(a) applies, and

(B) the fair market value of such rights at the time of the distribution is less than 15 percent of the fair market value of the old stock at such time,

then subsection (a) shall not apply and the basis of such rights shall be zero, unless the taxpayer elects under paragraph (2) of this subsection to determine the basis of the old stock and of the stock rights under the method of allocation provided in subsection (a).

(2) Election

The election referred to in paragraph (1) shall be made in the return filed within the time prescribed by law (including extensions thereof) for the taxable year in which such rights were received. Such election shall be made in such manner as the Secretary may by regulations prescribe, and shall be irrevocable when made.

(c) Cross reference

For basis of stock and stock rights distributed before June 22, 1954, see section 1052.