

Section 641.—Imposition of Tax

final regulations also provide that section 1059(e)(1) applies to certain exchanges described in section 356.

Section 807.—Rules for Certain Reserves

DATES: This regulation is effective July 16, 1997.

For date of applicability, see §1.1059(e)-1(c).

Section 846.—Discounted Unpaid Losses Defined

FOR FURTHER INFORMATION CONTACT: Richard K. Passales, (202) 622-7530 (not a toll-free number).

Section 1059.—Corporate Shareholder's Basis in Stock Reduced by Nontaxed Portion of Extraordinary Dividends

SUPPLEMENTARY INFORMATION:

Background

On June 18, 1996, the IRS published in the **Federal Register** a notice of proposed rulemaking (CO-9-96), 61 F.R. 30845, concerning certain distributions under section 1059(e)(1) of the Internal Revenue Code. The proposed rules were based on the conclusion that applying the exceptions to extraordinary dividend treatment found in sections 1059(d)(6) and (e)(2) to amounts treated as extraordinary dividends under section 1059(e)(1) is inconsistent with the purposes of section 1059 and may create inappropriate consequences, such as basis shifting that eliminates gain or creates artificial loss.

26 CFR 1.1059(e)-1: Non-pro rata redemptions.

T.D. 8724

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Section 1059 Extraordinary Dividends

The IRS received a few comments on the proposed regulations. No one requested to speak at the public hearing. After consideration of all the comments, the regulations are adopted as revised by this Treasury decision. The revisions and significant comments are discussed below.

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

Explanation of Revisions

SUMMARY: This document contains final regulations under section 1059(e) of the Internal Revenue Code. The final regulations clarify that certain distributions in redemption of stock held by a corporate shareholder are treated as extraordinary dividends notwithstanding provisions that otherwise might exempt the distributions from extraordinary dividend treatment. Corporations that receive a distribution in redemption of stock may be affected if the redemption is either part of a partial liquidation of the redeeming corporation or is not pro rata as to all shareholders. The

Section 1.1059(e)-1(b) of the proposed regulations provides that for purposes of section 1059(e)(1), an exchange under section 356(a)(1) is treated as a redemption and, to the extent any amount is treated as a dividend under section 356(a)(2), it is treated as a dividend under section 301. One practitioner questioned whether §1.1059(e)-1(b) applies to exchanges for section 306 stock that are treated as section 301 distributions under section 356(e). The final regulations clarify that for purposes of section 1059(e)(1), all exchanges under section

356 are treated as redemptions and all amounts treated as a dividend under section 356(a)(2) are treated as dividends under section 301. Accordingly, the final regulations delete the reference to subsection (a)(1) of section 356.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Richard K. Passales, Office of Assistant Chief Counsel (Corporate), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1059(e)–1 also issued under 26 U.S.C. 1059(e)(1) and (e)(2). * * *

Par. 2. In §1.302–2, paragraph (c) introductory text is amended by adding a sentence immediately following the first sentence to read as follows:

§1.302–2 Redemptions not taxable as dividends.

* * * * *

(c) * * * (For adjustments to basis required for certain redemptions of corporate shareholders that are treated as extraordinary dividends, see section 1059 and the regulations thereunder.) * * *

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Par. 3. Section 1.1059(e)–1 is added to read as follows:

§1.1059(e)–1 Non-pro rata redemptions.

(a) *In general.* Section 1059(d)(6) (exception where stock held during entire existence of corporation) and section 1059(e)(2) (qualifying dividends) do not apply to any distribution treated as an extraordinary dividend under section 1059(e)(1). For example, if a redemption of stock is not pro rata as to all shareholders, any amount treated as a dividend under section 301 is treated as an extraordinary dividend regardless of whether the dividend is a qualifying dividend.

(b) *Reorganizations.* For purposes of section 1059(e)(1), any exchange under section 356 is treated as a redemption and, to the extent any amount is treated as a dividend under section 356(a)(2), it is treated as a dividend under section 301.

(c) *Effective date.* This section applies to distributions announced (within the meaning of section 1059(d)(5)) on or after June 17, 1996.

Michael P. Dolan,
*Acting Commissioner of
Internal Revenue.*

Approved June 27, 1997.

Donald C. Lubick,
*Acting Assistant Secretary of
the Treasury.*

(Filed by the Office of the Federal Register on July 15, 1997, 8:45 a.m., and published in the issue of the Federal Register for July 16, 1997, 62 F.R. 38027)

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

Rev. Rul. 97–36