

Tax Planning for the Redemption of Stock in S Corporations
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There are many reasons why a corporation would choose to redeem some of its outstanding shares of stock. Such reasons include: permitting a majority shareholder of a closely held business to withdraw from the corporation; changing the corporate structure to rely more on debt than equity financing, buying out certain minority or dissatisfied shareholders, reducing the number of outstanding shareholders in preparation of an election to be treated as an S corporation, or providing a funding source to pay the estate taxes of a majority owner.

Whatever the reason, the tax consequences of the redemption should be taken into account. In addition, although the tax consequences of the redemption of stock in an S corporation are similar to the tax consequences of the redemption of stock in a C corporation, there are some key differences that should be considered.

Does the Redemption Qualify as a Sale or Exchange?

In many redemptions, a corporation is acquiring the stock of some but not all of its shareholders. Since the transaction looks like a sale of the shareholder's stock to the issuing corporation, it is easy to assume that the transaction would always be treated as a sale or exchange for federal income tax purposes. This assumption is often incorrect. In cases where the redeemed shareholder is deemed to not have sufficiently reduced his ownership in the corporation redeeming its stock, the transaction could be treated as if that shareholder had received a dividend instead of having sold its stock. Furthermore, where the transaction is treated as the distribution of a dividend and the corporation is an S corporation, a partial redemption may be able to qualify (in whole or in part) as a tax-free return of the redeemed shareholder's tax basis. Therefore, the first tax issue that should be addressed with respect to a proposed redemption is whether the transaction will be treated as a sale or exchange or as a distribution by the redeeming corporation with respect to its stock for federal income tax purposes.

In general, if a shareholder receives cash from a corporation in exchange for some or all of his stock in that corporation, the transaction will generally be treated as a redemption of the stock by the corporation and will be governed by Section 302 of the Internal Revenue Code.² The rules of Code Section 302 apply to both C and S corporations.³ Under Code Section 302, a shareholder who exchanges his shares of stock in a corporation for cash will be treated as having sold his shares if the exchange meets one of the following three tests:

- (i) the exchange results in a “*complete termination*” of his equity interest in the redeeming corporation;
- (ii) the exchange is “*substantially disproportionate*” with respect to the shareholder; or

- (iii) the cash received is “*not essentially equivalent to a dividend*” with respect to the shareholder.⁴

Alternatively, if none of the above three tests are satisfied, then the shareholder’s receipt of cash in redemption of his shares of stock in the redeeming corporation will generally be treated as a distribution by the redeeming corporation to that shareholder with respect to his shares of stock in the redeeming corporation. As explained in greater detail below, this distribution could result in the cash received being treated for as the receipt of a dividend by the redeemed shareholder for federal income tax purposes.

In analyzing whether one of these three tests is satisfied, in addition to the shares the shareholder actually owns, he may be deemed to own additional shares under the constructive ownership rules of Code Section 318.⁵ Generally, the constructive ownership rules under Code Section 318 treat a shareholder as owning:

- (a) shares of stock owned by certain relatives,
- (b) shares of stock owned by related corporations, partnerships, estates or trusts, and
- (c) shares of stock the shareholder has an option to acquire.⁶

The constructive ownership rules are relatively complex and factually intensive. Thus, redeeming corporations and shareholders should consult with their tax advisors with respect to the applicability of these rules to their particular facts and circumstances.

Complete Termination Test

The complete termination test will be satisfied if a shareholder is treated for federal income tax purposes as having completely terminated his interest in the redeeming corporation. A redeemed shareholder will be treated as having completely terminated his interest in the redeeming corporation if, immediately after the redemption, the shareholder does not actually own and is not treated as owning under the constructive ownership rules any shares in the redeeming corporation.⁷ If this test would be satisfied but for the fact that the redeemed shareholder is considered to own stock that is owned by his spouse, children, grandchildren, or parents, the redeemed shareholder may be able to waive the attribution of these family owned shares provided certain conditions are met and certain agreements are made with the Internal Revenue Service.⁸ However, meeting these requirements may not always be possible. For example, one of the requirements to waive family attribution is that the redeemed shareholder may not own any interest in the redeeming corporation (other than an interest as a creditor) for the ten year period immediately following the redemption.⁹ This requirement could make it difficult to qualify a redemption under this test where older family members are turning over a company to their children but want to continue to have a vote in the operations of the business.

Substantially Disproportionate Test

A redemption will also be treated as a sale or exchange for federal income tax purposes if the redemption meets the “substantially disproportionate” test. In general, this is a mechanical test aimed at determining whether the redeemed shareholder has had a substantial reduction in

his voting power in the redeeming corporation. A redeemed shareholder is considered to have a substantial reduction in his voting power if such shareholder's percentage ownership in the voting stock of the redeeming corporation, including both actual and constructive ownership, immediately after the redemption is both:

- (i) less than eighty percent (< 80%) of such shareholder's percentage ownership of the voting stock of the redeeming corporation (including both actual and constructive ownership) immediately before the redemption; and
- (ii) less than fifty percent (< 50%) of the total combined voting powers of all classes of stock entitled to vote.¹⁰

Although, the test appears to be fairly straight forward, you still need to be careful in its application. In making the calculations, the test becomes somewhat complicated because the ownership includes both the redeemed shareholder's direct and constructive ownership of the stock of the redeeming corporation.¹¹ The constructive ownership rules will make it impossible for some relatives of majority shareholders from being able to meet this test. In addition, care must be taken when the redeeming corporation has multiple classes of stock because the test focuses on the voting power of the redeemed shareholder. For example, if the redeeming corporation has voting common stock and non-voting preferred stock and the only stock being redeemed is non-voting preferred stock, then the redemption will not be able to meet the substantially disproportionate test because there will be no decrease in the redeemed shareholder's voting stock.

Not Essentially Equivalent to a Dividend Test

In addition to the complete termination and substantially disproportionate tests, a third test permits a shareholder to receive sale or exchange treatment if the redemption is "not essentially equivalent to a dividend."¹² The Supreme Court has defined this test as requiring a "meaningful reduction" in the redeemed shareholder's percentage ownership of the redeeming corporation's stock.¹³ This test requires a redeemed shareholder to compare his share interest in the redeeming corporation, including any actual and constructive ownership, immediately after the redemption to his share interest in such corporation, including any actual and constructive ownership, immediately before the redemption. Whether a redemption will result in a meaningful reduction in the redeemed shareholder's percentage ownership of the redeeming corporation depends on the facts and circumstances of the redeemed shareholder. The Internal Revenue Service has held in a published Revenue Ruling that a minority stockholder in a widely-held public corporation (i.e., a holder whose relative stock interest in the company was minimal in relation to the respective shares outstanding and who exercises no "control" over corporate affairs) had a meaningful reduction in the holder's share interest after a redemption transaction where the holder's actual and constructive percentage ownership in the corporation was reduced from 0.00011118 percent to 0.0001081 percent (an approximate 3.31 percent reduction in relative interest).¹⁴ Since this test is very fact specific, the prudent approach will be to make sure that the proposed redemption falls within prior holdings of the Internal Revenue Service or applicable court decisions prior to relying on this test for sale or exchange treatment.

What are the Tax Consequences of a Sale or Exchange?

If the redeemed shareholder meets any one of the above three tests of Code Section 302, then the redeemed shareholder will be treated as having sold his or her stock in exchange for the cash received.¹⁵ Such redeemed shareholder will generally recognize gain or loss in an amount equal to the difference between the cash received and the redeemed shareholder's tax basis in the redeeming corporation stock exchanged therefor.¹⁶ Such gain will be a capital gain if the redeeming shareholder held his or her shares in the redeeming corporation as a capital asset within the meaning of Code Section 1221 (generally requiring that such stock is held for investment purposes) on the effective date of the redemption.¹⁷ In addition, such capital gain will be a long-term capital gain if the redeemed shareholder held such redeemed shares in the redeeming corporation for a period of more than one year as of the effective date of the redemption.¹⁸ If the shareholder is a non-corporate taxpayer, such net long-term capital gains are currently taxed at a maximum federal income tax rate of 15%.¹⁹

If the redemption triggers a loss, the loss will generally be a capital loss and may be subject to certain limitations. In general, capital losses incurred by taxpayers other than a corporation may only be recognized in a given tax year to the extent of the sum of the individual's capital gains plus \$3,000, with any excess carried over to future tax years subject to these same annual limitations.²⁰ In the case of a corporation, losses from the sale or exchange of capital assets are allowed only to the extent of the corporation's capital gains and any excess capital loss is generally carried back three and forward five taxable years.²¹

What are the Tax Consequences of a Distribution (i.e. Redemptions Not Treated as a Sale or Exchange)?

If a redemption does not satisfy any of the three tests described above, then the amounts distributed by a redeeming corporation to a redeemed shareholder in exchange for his shares will be treated as a distribution by such corporation to the shareholder with respect to that shareholder's stock in the corporation. In this context, the rules for a C corporation and an S corporation differ.

In the case of a C corporation, the distribution will be treated as a dividend to the extent of the C corporation's undistributed earnings and profits.²² If the amount of the distribution exceeds the corporation's undistributed earnings and profits, then such excess amount will be treated as a non-taxable return to the extent of the shareholder's tax basis in the stock and then as capital gain.²³ This gain would be treated as long-term capital gain if the shareholder held the stock for more than one year as of the effective date of the redemption.²⁴

The rules for S corporations are a bit more complex and will depend on several factors including whether:

- (i) the S corporation was formerly a C corporation and has undistributed C corporation earnings and profits;
- (ii) the tax basis of the shareholder's stock being redeemed; and
- (iii) where applicable, the amount of the S corporation's accumulated adjustments account (hereinafter, "AAA").

If the redeeming corporation is an S corporation that was originally a C corporation and has undistributed C corporation earnings and profits, the shareholder's tax consequences will depend upon the shareholder's tax basis in his S corporation stock immediately before the distribution, the balance of the S corporation's AAA and the amount of the S corporation's undistributed C corporation earnings and profits. In general, an S corporation's AAA account represents the earnings of the S corporation that have been previously taxed to the S corporation shareholders for all years that the corporation has been an S corporation reduced by the amount of any prior distributions treated as distributions of AAA and certain other reductions. Thus, in essence, the balance of AAA represents previously taxed S corporation net income that has not been distributed to that S corporation's shareholders and can, under the correct circumstances, be distributed to the S corporation shareholders without incurring another level of tax. If an S corporation makes a distribution to its shareholders during a tax year, other than a distribution treated as a dividend of the S corporation's undistributed C corporation earnings and profits, then the S corporation reduces its AAA by the amount of the distribution. If the S corporation makes multiple distributions in a tax year that exceed the amount of the S corporation's AAA, determined as of the end of the S corporation's tax year, then the AAA is allocated proportionately between such distributions. Therefore, unless the S corporation has excess AAA above the amount of the S corporation's distributions for a tax year, the exact amount of AAA allocated to a distribution will not be known until the end of that tax year. The amount of AAA allocable to a distribution is important because, as described below, where the AAA allocable to the distribution exceeds a redeemed shareholder's tax basis in his stock the result is a capital gain distribution which simultaneously reduces the S corporation's AAA.

In general, assuming the redemption does not qualify for sale or exchange treatment but the AAA allocable to such distribution *does not exceed the shareholder's tax basis in his stock*, the distribution will be treated as follows:

- (i) first, as a non-taxable distribution of the S corporation's AAA to the extent the distribution does not exceed the redeemed shareholder's tax basis in his stock and the S corporation's AAA that is allocated to the distribution;
- (ii) then, the excess is treated as a taxable dividend to the extent of the S corporation's undistributed C corporation earnings and profits;
- (iii) then, any remaining amount is treated as a nontaxable reduction in the remaining tax basis in the shareholder's stock; and
- (iv) finally, amounts in excess of tax basis result in a capital gain distribution.²⁵

Alternatively, if the exact same distribution occurs but the allocable share of the S corporation's AAA to such redemption *exceeds the shareholder's tax basis in his stock*, the distribution would be treated as follows:

- (i) first, as a non-taxable distribution of the S corporation's AAA to the extent the distribution does not exceed the redeemed shareholder's tax basis in his stock;
- (ii) then, as a taxable capital gain to the extent of the excess allocable AAA (i.e. AAA allocable to the distribution that is excess of the shareholder's tax basis in his stock);

- (iii) then, the excess is treated as a taxable dividend to the extent of the S corporation's undistributed C corporation earnings and profits; and
- (iv) finally, amounts in excess of the S corporation's undistributed C corporation earnings and profits results in a capital gain distribution.²⁶

In both of the above cases, distributions that are not treated as dividends will reduce both the S corporation's AAA and the shareholder's tax basis in their S corporation stock (but not below zero).

Although these two distributions look fairly similar, they have different impacts on the S corporation and the redeemed shareholder. In the first distribution, the redeemed shareholder is treated as receiving all of his tax basis in his stock to the extent of the S corporation has sufficient AAA prior to being treated as having received a taxable dividend or a capital gain distribution. In the second distribution, the redeemed shareholder recognizes capital gain to the extent that the AAA allocated to the distribution exceeds the shareholder's tax basis in his stock. The second distribution is not very tax efficient because the S corporation's AAA, which is a corporate level asset, is being reduced simultaneously with the redeemed shareholder recognizing capital gain on such distribution. Therefore, a redeeming corporation should make sure it will have sufficient AAA to help prevent the loss of AAA with a simultaneous recognition of capital gain by the redeemed shareholder.

In a redemptions treated as a distribution, amounts treated as distributions of undistributed C corporation earnings and profits by the S corporation are treated similar to dividends by a C corporation. These distributions should generally be treated as qualified dividend income under Code Section 1(h) if the redeemed shareholder held stock in the redeeming S corporation for at least 60 days during the 121 day period beginning 60 days prior to the effective date of the redemption.²⁷ Qualified dividend income is currently taxed at a maximum federal income tax rate of 15%.²⁸ Amounts treated as capital gain will be treated as long-term capital gain if the redeemed shareholder held his redeemed stock for more than one year as of the effective date of the redemption. As stated above, net long-term capital gains for non-corporate taxpayers are currently taxed at a maximum federal income tax rate of 15%.²⁹

The rules for S corporations that have always been an S corporations and S corporations that were prior C corporations but do not have undistributed C corporation earnings and profits are a bit simpler. In such a case, distributions in redemption of a shareholders S corporation shares are treated first as a nontaxable return of the shareholder's tax basis in their S corporation stock, then as a capital gain distribution.³⁰ If the stock is held by the shareholder for more than one year as of the effective date of the redemption, the gain should be treated as long-term capital gain, and for non-corporate taxpayers, currently taxed at a maximum federal income tax rate of 15%.³¹

Shareholder's Other Considerations

When the shareholder of an S corporation has his stock redeemed, there are a few things that should be taken into account with respect to the shareholder's tax basis in his stock. In general, a shareholder's tax basis in his S corporation's stock is adjusted at the close of the S

corporation's taxable year.³² However, if a shareholder disposes of his stock during the S corporation's taxable year, then the stock basis adjustments with respect to the stock are effective immediately prior to the disposition.³³ Therefore, in calculating the tax consequences of a redemption to an S corporation shareholder, the tax basis of the stock being redeemed should be adjusted to reflect the income, loss, distributions and other items that have taken place prior to the effective date of the redemption.

Getting a reasonable estimate of the expected basis adjustment prior to the redemption may not always be an easy process. An S corporation generally allocates its income and loss pro rata to its shareholders on a per share per day basis.³⁴ However, if any shareholder completely terminates his interest in the S corporation or if the S corporation redeems at least 20% of the S corporation's outstanding stock, then the S corporation may elect to "close its books" as of the end of the day of the disposition.³⁵ This closing of the books creates two tax years, with the first ending at the close of the day on which there is a qualifying disposition of S corporation stock and the second running from the following day through the S corporation's normal year-end.³⁶ In the case of a shareholder completely terminating his interest in the S corporation, all shareholders of the S corporation must agree to the election.³⁷ In some cases, this may make it difficult or unfeasible for an S corporation to elect to "close its books" when the shareholder redeemed owns less than 20% of the S corporation's outstanding stock. Since a "closing of the books" election may not always be available, the ability to accurately estimate the amount of the partial year adjustment should be considered in determining the timing of redemptions.

Another shareholder consideration when planning for a redemption of his stock is to determine whether it is beneficial for him to designate which shares are to be redeemed. In general, the stock basis of each S corporation share is determined on a share-by-share basis.³⁸ Therefore, if some but not all of a shareholder's shares of S corporation stock are being redeemed and that shareholder has different tax basis in his shares he may want to specifically identify the higher tax basis shares as the shares being redeemed.³⁹ These rules permit a redeemed shareholder to specify the shares with a higher tax basis, and thus, reduce the amount of current gain recognized.

Still another aspect to be considered in redemptions is the possibility of "disappearing tax basis." In general, when a redemption transaction is treated as a distribution rather than as a sale or exchange, if there is any tax basis in the redeemed stock that is not reduced to zero as a result of the rules described above, that excess basis is transferred to the redeemed shareholder's remaining shares.⁴⁰ Thus, if the redeemed shareholder's interest in the S corporation completely terminates, but due to the shareholder's constructive ownership under Code Section 318 of other persons or entity's shares, such shareholder may not be entitled to sale or exchange treatment and could have tax basis remaining in shares in which he does not own. If that occurs, it is unclear what happens to the remaining tax basis.

Current Treasury Regulations seem to indicate that this "remaining" tax basis would not disappear but would be transferred to the stock of the related person that the redeemed shareholder is treated as constructively owning.⁴¹ However, these rules have been used by some abusive tax shelters and the Internal Revenue Service has announced that it will disallow the basis shift in tax avoidance transactions.⁴² In addition, the Internal Revenue Service has issued

Proposed Treasury Regulations that would not transfer the redeemed shareholder's remaining tax basis to the stock of the related person but instead would treat that basis as a capital loss of the redeemed shareholder.⁴³ Under these Proposed Treasury Regulations, a redeemed shareholder that is not a corporation would generally be permitted to include the loss as of the date that he no longer actually or constructively owned stock in the redeeming corporation.⁴⁴ Although these rules are generally less important in S corporation redemptions, due to the S corporation rules reducing tax basis in transactions treated as distributions, they still must be a consideration in transactions where the redeemed shareholder has tax basis in excess of the amount paid for his stock.

The amount of a redeeming S corporation's AAA is important because it tracks the ability of the S corporation to make tax-free distributions to the S corporation shareholders. In addition, as stated above, AAA is a corporate level asset. Therefore, if only some shareholders are redeemed, the AAA may be allocated disproportionately to those shareholders. In certain cases, this can increase the chances that a redemption will be treated as a tax free return of the redeemed shareholder's tax basis. For example, suppose an S corporation is redeeming a 30% shareholder that is the father of the 70% shareholder. Unless the redeemed shareholder waives family attribution, a redemption of some of the father's stock will be treated as a tax-free distribution to the shareholder provided the shareholder has tax basis and allocable AAA in the amount paid to the father in the redemption.

In addition, the impact on AAA may also be a consideration in determining whether a transaction should be structured to qualify as a sale or exchange or as a transaction treated as a distribution with respect to the redeemed shareholder's stock.⁴⁵ If the redemption is treated as a sale or exchange, then the AAA is reduced by the pro rata number of S corporation shares redeemed⁴⁶. For example, if an S corporation has \$1,000,000 of AAA and it redeems 20% of its outstanding shares, if the redemption is treated as a sale or exchange, then AAA would be reduced by \$200,000. Alternatively, if the redemption is treated as a distribution, then the AAA will be reduced based on the distribution rules described above. This can produce widely different results in the amount of the reduction of AAA and, with the importance of AAA, should be considered in determining the best structure for a proposed redemption.

Conclusion:

Although a redemption by a corporation of its outstanding stock from some of its shareholders seems like a fairly straight forward stock sale, as described above, the redemption rules will often cause the transaction to be treated as a distribution by the corporation to the shareholder and not a sale or exchange. This change in treatment can create significantly different tax results both in the amount of taxable gain recognized and, in the case of S corporations, in the impact to the redeeming corporation's AAA. Furthermore, the likelihood of these rules applying to cause a redemption to be treated as a distribution is generally greater in closely held corporations, making these rules very important considerations to redeeming S corporations. Moreover, although the differences in tax consequences are presently reduced by the fact that currently the maximum tax rate on net long-term capital gains and qualified dividend income are both 15%, this will probably not be the case for tax years beginning after December 31, 2010. If earlier tax rate reductions are not made permanent, then federal income

tax rates for tax years beginning after December 31, 2010 will go back to the rates that existed back in 2003. This would cause the maximum federal income tax rate on net long-term capital gains to increase to 20% and for the maximum tax rate on C corporation dividends to increase to 39.6%. This would mean a possible difference in tax rates of 19.6%. Therefore, both now and in the near future, when structuring a redemption of S corporation stock it is important to remember the six P principle ---- i.e. Proper Prior Planning Prevents Poor Performance.

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2 All Section references are to the Internal Revenue Code of 1986, as amended (the "Code") unless otherwise indicated.
3 See § 1371(a) (indicating that except as otherwise provided and except to the extent inconsistent with subchapter S, subchapter C shall apply to an S corporation and its shareholders).
4 § 302(b)(1)-(3). If the redeeming corporation liquidates a portion of its business and makes a distribution of the proceeds of that business to its shareholders in partial liquidation of the redeeming corporation, the partial redemption transaction may also qualify for sale or exchange treatment to the partially redeemed shareholders. Partial liquidations and the rules thereunder are covered under § 302(b)(4) and beyond the scope of this article. For recent articles on partial liquidations *see* Braithwaite, "S Corporations and Partial Liquidations -- Two Favorable Tax Regimes; When Two Rights Make a Wrong," 6 Bus. Entities 4 (May/June 2004); Haas, "Favorable Treatment for Distributions after Corporate Dispositions: Use of Partial Liquidations," 98 J. Tax'n 142 (Mar. 2003).
5 § 302(c)(1).
6 See § 318(a).
7 § 302(b)(3).
8 See § 302(c)(2). These conditions include: (i) immediately after the redemption, the redeemed shareholder must have no interest in the redeemed corporation, including an interest as an officer, director, or employee, other than an interest as a creditor; (ii) the redeemed shareholder must not acquire any interest in the corporation (other than stock acquired by bequest or inheritance) within 10 years from the date of the redemption; and (iii) the redeemed shareholder must agree to notify the Internal Revenue Service of any acquisition of such interest and to retain records of the transaction. § 302(c)(2)(A)(i)-(iii).
9 § 302(c)(2)(ii).
10 § 302(b)(2).
11 § 302(c).
12 § 302(b)(3).
13 *U.S. v. Davis*, 397 U.S. 301 (1970), *reh'g denied*, 397 U.S. 1071 (1970).
14 See Rev. Rul. 76-385, 1976-2 C.B. 92.
15 § 302(a).
16 § 1001(a).
17 § 1221(a).
18 § 1222(3).
19 § 1(h). Net long-term capital gains for a taxpayer is defined as the excess of long-term capital gains for the taxable year for that taxpayer over the long-term capital losses for that taxable year for that taxpayer. § 1222(7). For tax years beginning after December 31, 2010, the maximum federal income tax rate on net long-term capital gains will increase back to 20% for most long-term capital gains.
20 §§ 1211(b), 1212(b).
21 §§ 1211(a), 1212(a)(1).
22 §§ 301(c), 302(a), and 316.
23 § 301(c)(2)-(3).
24 §§ 1222(3).
25 § 1368(b)(2), (c)(1).
26 *Id.*
27 § 1(h)(11)(B).
28 § 1(h)(1)(C). For tax years beginning after December 31, 2010, the maximum federal income tax rate on dividends of undistributed earnings and profits from a former C corporation will be 39.6%.

29 § 1(h). Net long-term capital gains for a taxpayer is defined as the excess of long-term capital gains for the
taxable year for that taxpayer over the long-term capital losses for that taxable year for that taxpayer. §
1222(7). For tax years beginning after December 31, 2010, the maximum federal income tax rate on net
30 long-term capital gains will increase back to 20% for most long-term capital gains.

31 § 1368(b).

32 § 1(h). Net long-term capital gains for a taxpayer is defined as the excess of long-term capital gains for the
taxable year for that taxpayer over the long-term capital losses for that taxable year for that taxpayer. §
1222(7). For tax years beginning after December 31, 2010, the maximum federal income tax rate on net
33 long-term capital gains will increase to 20% for most long-term capital gains.

34 Treas. Reg. § 1.1367-1(d)(1).

35 *Id.*

36 § 1377(a)(1).

37 *See* § 1377(a)(2); Treas. Reg. §§ 1.1368-1(g), 1.1367-1(d)(3).

38 § 1377(a)(2); Treas. Reg. § 1.1377-1(b).

39 § 1377(a)(2).

40 § 1367(a).

41 *See* Treas. Reg. § 1.1012-1(c) for rules dealing with the requirements for specifically identifying which
shares of stock are sold or transferred by a taxpayer.

42 Treas. Reg. § 1.302-2(c), example 1.

43 Treas. Reg. § 1.302-2(c), example 2. Proposed Treasury Regulations that were initially issued with respect
to this issue were recently withdrawn and other Proposed Treasury Regulations were more recently issued.

44 *See* Ann. 2006-30, 2006-19 IRB 879; Prop. Treas. Reg. § 1.302-5(f).

45 Notice 2001-45, 2001-33 IRB 129.

46 Prop. Treas. Reg. § 1.302-5(f)(a)(3).

Prop. Treas. Reg. § 1.302-5(f)(b)(4).

§ 1368(e)(1)(B).

§ 1368(e)(1)(B).