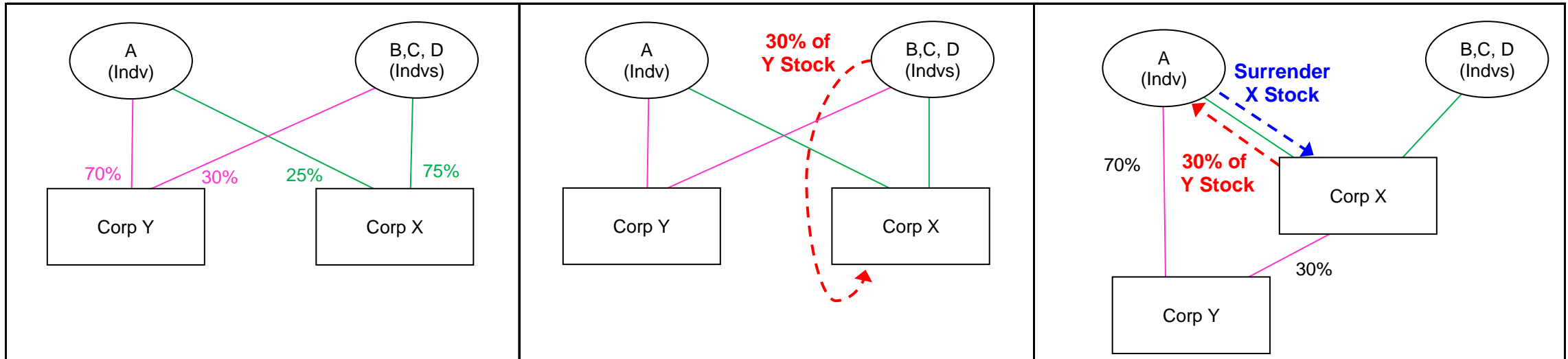


Corporation as Conduit for Exchange of Stock a Taxable Transaction

Initial Structure

Contribution of Y Stock

Distribution / Redemption of Y Stock



Four unrelated individuals, A, B, C, and D each owned 25 percent of the stock of Corp X. B, C and D each owned ten percent of the stock of Corp Y and A owned seventy percent of the stock of Corp Y. For a number of years, A had unsuccessfully urged B, C and D to have Corp X discontinue one of its businesses.

According to a prearranged plan, B, C, and D contributed their Corp Y stock to Corp X, and shortly thereafter Corp X redeemed all the Corp X stock held by A in exchange for the contributed Corp Y stock in a transaction intended to qualify as a redemption under section 302. After the transaction, B, C, and D owned all the outstanding stock of Corp X and A owned all the outstanding stock of Corp Y.

In *Commissioner v. Court Holding Co.*, 324 U.S. 331, the Supreme Court of the United States stated that “A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title. To permit the true nature of a transaction to be disguised by mere formalities, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.”

In the instant case, the contribution and redemption was to enable B, C, and D to exchange their Corp Y stock for the Corp X stock of A. Corp X was merely a conduit through which the Corp Y stock passed pursuant to the prearranged plan. Accordingly, the transaction is a taxable exchange under section 1001 between B, C, and D on the one hand and A on the other of Corp Y stock for Corp X stock. Thus, gain or loss will be recognized to A, B, C, and D on the exchange.

Ending Point

