

Redemption of stock from private foundation. The redemption of stock from a private foundation to the extent necessary for the foundation to avoid the excess business holdings tax under section 4943 of the Code is a sale or exchange not equivalent to a dividend under section 302(b)(1) and the proceeds will be taxed neither as investment income nor as undistributed income.

F is a private foundation, as defined in section 509(a) of the Internal Revenue Code of 1954. Since 1950, F has held shares of voting common stock of X, a closely held corporation, as its principal asset. X redeemed some of its stock held by F to the extent necessary for F to avoid liability for the tax on excess business holdings imposed by section 4943. At the time of the redemption X was not a 'disqualified person' as that term is defined in section 4946(a).

Held, in view of the transitional rules of sections 101(1)(3)(D) and 101(1)(8) of the Tax Reform Act of 1969, Pub. L. 91-172, 1969-3 C.B. 10, 36, the distribution by X in redemption of part of F's stock will be treated as not essentially equivalent to a dividend under section 302(b)(1) of the Code for purposes of determining gross investment income under section 4940 (taxes imposed on a private foundation's investment income) and adjusted net income under section 4942 (taxes imposed on a private foundation's undistributed income). Therefore, the amount distributed will be treated under sections 4940 and 4942 as a distribution in full payment in exchange for the stock surrendered as provided in section 302(a). Thus, the redemption proceeds will not constitute dividend income under section 4940 nor will they constitute adjusted net income under section 4942 since the redemption will produce only long-term capital gain. See S. Rep. 91-552, 91st Cong. 1st Sess. 43 (1969), 1969-3 C.B. 440, 452, and H.R. Rep. No. 91-782, 91st Cong., 1st Sess. 282 (1969), 1969-3 C.B. 644, 647 (Conference Report).