Substantially Disproportionate Redemptions

10/19/2022

	Pre-Redemption	Post-Redemption
Shares Actually Owned:	80	19
Shares Constructively Owned:	0	0
Total Shares Outstanding:	100	39

Total Shares Owned Pre-Redemption:	80
Total Shares Owned Post-Redemption:	19
Pre-Redemption Ratio:	80.00%
Post-Redemption Ratio:	48.72%
80% of Pre-Redemption Ratio:	64.00%

Post-Redemption Ratio Must be Less than 80% of Pre-Redemption Ratio.
Shareholder Must Own Less than 50% of Total Combined Voting Power.

Number of Shares Corporation Must Redeem

Number of Shares Owned Prior to Redemption:	80
Number of Shares Outstanding Prior to Redemption:	100
Percent Owned by Shareholder Prior to Redemption:	80.00%
Shares to Redeem if Shareholder Owns 62.5% or more of Outstanding Shares:	61
Shares to Redeem if Shareholder Owns less than 62.5% of Outstanding Shares:	0
Shares to Redeem:	61

Substantially Disproportionate Redemptions

This calculation determines the number of shares that a corporation must redeem (buy back) in order for a redemption from a shareholder to qualify as a "substantially disproportionate" redemption. Substantially disproportionate redemptions are entitled to "sale or exchange" treatment. The calculation performs the "proper number to redeem" calculation by comparing the post-redemption ration with the pre-redemption ratio.

All distributions from a corporation to a shareholder with respect to its stock are considered dividends to the extent of earnings and profits. Dividends are taxed at ordinary income rates. This policy applies even if the recipient shareholder gives up stock in the transaction.

Some distributions, however, are deemed "amounts received in exchange" for the stock, rather than dividends. In this case, the seller pays tax only on the difference between the "amount realized" and the "adjusted basis."

To qualify as an exchange, the transaction must satisfy the requirements of one of several tests. One of these is the "substantially disproportionate" test. Under this test, the transaction is considered an exchange if the distribution from the corporation is substantially disproportionate with respect to the selling shareholder. In short, this means there has been a significant relative change in the shareholder's control, share of profits, and share of assets in case of a sale or liquidation.

A redemption is substantially disproportionate if it meets the following three criteria:

- After the redemption, the shareholder owns less than half of the total combined voting power of all classes of outstanding stock entitled to vote.
- After the redemption, the shareholder's percentage of total outstanding voting stock is less than 80% of pre-redemption ratio.
- The shareholder's post-redemption percentage ownership of outstanding common stock (voting or non-voting) is less than 80% of pre-redemption ownership.

If one of the other stockholders is someone whose stock is attributed to the stockholder (such as a child, wife, etc.) under constructive ownership (attribution) rules, the redemption of the seller's shares will not qualify as substantially disproportionate. The disqualification occurs because the stockholder is deemed to own his own 20 shares, plus the 10 shares attributed to him. His after-redemption percentage would be 30/90 (33.3%), which is more than 80 percent of his pre-redemption percentage (40/100, 40%).