

## Memorandum

**TO:** DRAFTING COMMITTEE ON RECORD OWNERS  
OF BUSINESSES ACT

**FROM:** Harry J. Haynsworth, Chair

**DATE:** March 4, 2008

**RE:** **Overview of Issues Involved in Determining Beneficial Ownership and  
Control of Interests in Business Entities**

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Collection and maintenance of accurate business entity beneficial ownership and control information is a key component of the anti-money laundering business entity proposals that have been made by FATF, the U.S. Senate Homeland Security Committee Permanent Subcommittee on Investigations, the Department of Justice and various units within the Treasury Department dealing with money laundering issues. The purpose of this memorandum is to provide a brief overview of the issues and problems that will arise if business entities are required to collect and maintain complete beneficial ownership information in addition to record owner information, which is and always has been the recordkeeping standard in U.S. business entity laws.

Several samples of beneficial ownership statutes are attached as exhibits. All of them share certain common characteristics. First, all of them have as their objective determining who actually controls the entity. Second, they all contain an indirect as well as a direct ownership requirement.

1. Control

Control is generally defined as having a specified percentage of voting power sufficient to elect or remove the managers of a business entity. The percentage figure used in current statutes varies considerably. European Union Directive 2005/60/EC (Exhibit 1) uses 25% as does the United Kingdom definition (Exhibit 2). The most recent Department of Justice proposal (Exhibit 3) specifies 15%. I have seen some control definitions relating to publicly-traded corporations that use a 10% figure (*see* Exhibit 4). The general statutory rule for election of directors in a corporation is a majority (50%+) of the shares entitled to vote for directors. The general statutory rule in U.S. uniform unincorporated entity statutes is unanimity (100%), but this percentage can be changed by agreement of the partners (partnership) or members (limited

liability company).<sup>1</sup> Many state unincorporated entity statutes, however, use a majority member or percentage of capital vote as the default rule for the election of managers.

Two additional differences between corporate and unincorporated entity statutes complicate the control analysis. The first is that in U.S. unincorporated entities managerial and financial rights are severable. Therefore, it is possible to have 100% of the voting and managerial rights in one or more individuals and 100% of the financial rights in another person. This type of arrangement is fairly common in limited partnerships where there is typically a single general partner who manages the partnership and may have a right to some of the profits and limited partners who have few, if any, voting rights but are entitled to most of the profits and distributions.<sup>2</sup> Also, it is possible in an unincorporated entity for an owner to transfer all of the owner's rights to profits distributions to a third party (called a transferee), but to retain all of the voting and managerial rights.

A second difference is that in many U.S. unincorporated entities both voting rights and distribution rights are based on the relative percentage of each partner's or member's capital account (roughly capital contributions and undistributed profits), which can change on a daily basis, whereas in a corporation voting rights and distribution and equity rights are based on the relative percentage of stock ownership rights and change only where there is a transfer of the underlying stock. Thus in a partnership a partner might have 51% of the total capital accounts on day 1 and because of a disproportionate distribution made at the end of day 1 have only 49% of the capital on day 2 without any transfer of the underlying equity interest having taken place. If a 50% control test was the benchmark, the partner would be in control on day 1 but not on day 2.

The beneficial ownership proposals made by FATF, et al. all exclude publicly held companies<sup>3</sup> and seem to be aimed at determining "control" in companies that are classified as closely held, a term that is generally understood to mean a business entity having a small number of equity owners.<sup>4</sup> This being the case, it would seem that the "control" standard should be

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<sup>1</sup> The default unanimity rule in many unincorporated entity statutes raises an interesting "control" issue. Since each owner has in effect a veto power on all decisions, does that mean that all the owners have a controlling interest or that none of them have a controlling interest?

<sup>2</sup> It is possible to achieve basically the same result in a corporation by use of non-voting stock.

<sup>3</sup> As a general rule, a publicly held company is one whose ownership interests are widely held. A common standard would be a business entity whose ownership interests are listed on a stock exchange and/or are required to file reports with the SEC under the 1934 Securities and Exchange Act (300 or more shareholders). Publicly held companies constitute less than 1% of all U.S. business entities.

<sup>4</sup> There is no agreed-upon standard for the maximum number of owners in a closely held business. The maximum number of shareholders a corporation can have to qualify for taxation under Subchapter S of the Internal Revenue Code is 75 (when Subchapter S was first enacted approximately 50 years ago, the maximum was 10). The Subchapter S maximum would be on the high side of "closely held" definitions used in other statutes and in cases.

“more than 50%”<sup>5</sup> since that is the standard for election of directors/managers in U.S. corporation statutes and many U.S. unincorporated entity statutes. A 25% or less control standard makes more sense with respect to publicly held companies because the holders of large blocks of stock constituting much less than 50% in a publicly held corporation can in many cases be sufficient to control the outcome of director elections, etc.

## 2. Indirect Ownership

A second characteristic shared by all existing beneficial ownership statutes is that an individual is deemed to own not only the equity interest in a business entity that the individual owns directly but also equity interests that the individual owns indirectly. These indirect interests are added to the direct interests to determine the total interest the individual owns. The existing statutes generally contain two categories of indirect or constructive ownership. The first is family members and the second is constructive ownership based on ownership interests in trusts, estates, and various forms of business entities.

Under family member constructive ownership rules, stock (or any other ownership interest) is attributed to and from other family members. First, you have to determine which family members are included. How far up and down the family tree is appropriate, *i.e.*, are grandparents and grandchildren included? What about stepchildren and adopted children and spouses and the spouse's parents, etc.? Are individuals who live in the same home as the record owner but are not related by blood to the record owner considered as family for purposes of the constructive ownership rules?<sup>6</sup>

Several issues involving attribution to and from trusts, estates and various business entities must also be resolved. With respect to trusts, should there be a distinction between revocable and irrevocable trusts? What if an individual is the trustee of the trust but is not a beneficiary of the trust? How should contingent as opposed to vested interests be treated? What percentage of beneficial interest is necessary to trigger the attribution of the interest to an individual in order to determine control? Beneficial ownership interests in estates raise these same questions. With respect to attribution to and from various forms of business entities, you would have to specify in the statute what percentage ownership in the entity is necessary to trigger the attribution. Other issues that have to be determined are how are options and warrants and convertible securities treated? Is non-voting stock included in the calculation? In unincorporated entities, is the attribution based solely on voting rights, as is the case with a corporation, or should it be based on the partner's share of the capital account or both? Should S

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<sup>5</sup> Any statute or regulation defining control would have to state how options to acquire stock or other equity interests should be treated in determining the interest held by an individual. Whether only vested options should be counted would also have to be specified.

<sup>6</sup> A category not included in many of the existing beneficial ownership statutes is a relationship based not on family but on employment or a contractual relationship. For example, what if Osama Bin Laden's chauffeur is the record owner of stock in a corporation. Should that stock nevertheless be attributed to Osama Bin Laden because of the “control” he would have over the chauffeur?

corporations, which are corporations for state law purposes but are treated somewhat like partnerships for federal tax purposes, be treated the same as C corporations or as partnerships?

Once the constructive ownership rules have been established, then you have to apply them to a specific set of facts. The examples in Treas. Reg. 1-318-2 through -4, (*see* Exhibit 6), applying the constructive ownership rules in Section 318 of the Internal Revenue Code illustrate the complexities of making this determination.<sup>7</sup> For the most part, the determination of beneficial ownership must be made by accountants and lawyers for the entity and the owners of the entity for a particular purpose (*e.g.*, taxes, SEC reporting requirements) at a particular point in time. The calculation is not made on a day-to-day basis because so many events can occur (*e.g.*, death, bankruptcy, voluntary transfers) that can affect the beneficial ownership calculation.

Requiring a business entity to collect and maintain on an ongoing basis all the information necessary to make the beneficial ownership determination would be an enormous burden and a radical departure from existing recordkeeping requirements. Moreover, because of the complexities involved, there would undoubtedly be massive amounts of noncompliance, most of which would be unintentional. An entity would have to know all of an individual's family, as defined in the statute and the names of all the shareholders, partners and members of any entity that is an equity owner in the entity responsible for keeping the information. It would also need to know the name of the owners of any entity that was an owner of that second entity, and so on, as well as the beneficiaries of estates and trusts that have an ownership interest in any of the entities in the chain. It is quite common in the U.S. to have three or more tiers of entity ownership, which complicates the analysis. An even more difficult task would be the necessity to obtain knowledge of any changes in the various ownership interests in the chain, many of which it would have no notice of unless the transferor notifies the entity of the change because the transfer does not cause a change in the record owners of the entity. A change in beneficiaries of an estate or trust is an example. Another example would be a transfer by an owner of an entity that is an equity holder of the entity that is required to keep the beneficial ownership information current where the transfer does not result in a change in the name of that entity.<sup>8</sup>

Having individuals maintain beneficial owner records and file any changes in any company they own with the Secretary of State, which is Part B of the Department of Justice Proposal (Exhibit 3) does not solve any of the complex problems involved with having these records kept by business entities. The statute would still have to define what control and indirect ownership rules apply and inadvertent noncompliance would undoubtedly be even greater than if companies were required to keep the information. Moreover, requiring this information to be filed in the Secretary of State raises another level of additional complexity. The issues that

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<sup>7</sup> The examples show that in many cases more than one individual could be deemed to own a "controlling" interest because of the constructive ownership rules. *See* Treas. Reg. §1.318-2(b) where four family members each own directly 25% of the stock but constructively three of the four own 100% of the stock and the fourth owns 75% of the stock.

<sup>8</sup> Control can also be achieved by private contractual arrangements such as voting agreements, which the business entity might not know about because this type of arrangement does not involve a change of record ownership in the entity.

would have to be determined include the following: Would the individual have to file this information in the state of his or her residence or in the state where the business entity was formed (or in which it has become domesticated). Would these beneficial owner records be public or non-public? Who would have access to this information? Are the secretaries of state capable of keeping dual sets of easily retrievable records on companies, one set dealing with public information and a second dealing with non-public information? Who would have to bear the cost of this new recordkeeping requirement?<sup>9</sup>

Amending the record owner provisions in existing U.S. entity laws to enable law enforcement officials to trace ownership in an entity back to the individuals who ultimately control the entity (using whatever definition of control is deemed appropriate under applicable criminal statutes) will provide a workable system that will accomplish the legitimate needs of law enforcement officials to obtain beneficial ownership information without the imposition or the enormous costs and complexities of amending business entity laws to require companies to maintain accurate, current beneficial ownership records.

HJH/nr  
Attach.

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<sup>9</sup> If only individuals rather than entities are required to keep and/or file beneficial ownership records, this would require statutory law other than amendments to the state business entity statutes, which only deal with compliance issues applicable to an entity, the relationship between the owners and managers and the entity and the rights and liabilities of the entity to third parties.

(6) 'beneficial owner' means the natural person(s) who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted. The beneficial owner shall at least include:

(a) in the case of corporate entities:

(i) the natural person(s) who ultimately owns or controls a legal entity through direct or indirect ownership or control over a sufficient percentage of the shares or voting rights in that legal entity, including through bearer share holdings, other than a company listed on a regulated market that is subject to disclosure requirements consistent with Community legislation or subject to equivalent international standards; a percentage of 25 % plus one share shall be deemed sufficient to meet this criterion;

(ii) the natural person(s) who otherwise exercises control over the management of a legal entity;

(b) in the case of legal entities, such as foundations, and legal arrangements, such as trusts, which administer and distribute funds:

(i) where the future beneficiaries have already been determined, the natural person(s) who is the beneficiary of 25 % or more of the property of a legal arrangement or entity;

(ii) where the individuals that benefit from the legal arrangement or entity have yet to be determined, the class of persons in whose main interest the legal arrangement or entity is set up or operates;

(iii) the natural person(s) who exercises control over 25 % or more of the property of a legal arrangement or entity;

(7) 'trust and company service providers' means any natural or legal person which by way of business provides any of the following services to third parties:

(a) forming companies or other legal persons;

(b) acting as or arranging for another person to act as a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons;

(c) providing a registered office, business address, correspondence or administrative address and other

related services for a company, a partnership or any other legal person or arrangement;

(d) acting as or arranging for another person to act as a trustee of an express trust or a similar legal arrangement;

(e) acting as or arranging for another person to act as a nominee shareholder for another person other than a company listed on a regulated market that is subject to disclosure requirements in conformity with Community legislation or subject to equivalent international standards;

(8) 'politically exposed persons' means natural persons who are or have been entrusted with prominent public functions and immediate family members, or persons known to be close associates, of such persons;

(9) 'business relationship' means a business, professional or commercial relationship which is connected with the professional activities of the institutions and persons covered by this Directive and which is expected, at the time when the contact is established, to have an element of duration;

(10) 'shell bank' means a credit institution, or an institution engaged in equivalent activities, incorporated in a jurisdiction in which it has no physical presence, involving meaningful mind and management, and which is unaffiliated with a regulated financial group.

Article 4

1. Member States shall ensure that the provisions of this Directive are extended in whole or in part to professions and to categories of undertakings, other than the institutions and persons referred to in Article 2(1), which engage in activities which are particularly likely to be used for money laundering or terrorist financing purposes.

2. Where a Member State decides to extend the provisions of this Directive to professions and to categories of undertakings other than those referred to in Article 2(1), it shall inform the Commission thereof.

Article 5

The Member States may adopt or retain in force stricter provisions in the field covered by this Directive to prevent money laundering and terrorist financing.

12/4/2007

Meaning of beneficial owner

- (1) In the case of a body corporate, "beneficial owner" means any individual who—
  - (a) as respects any body other than a company whose securities are listed on a regulated market, ultimately owns or controls (whether through direct or indirect ownership or control, including through bearer share holdings) more than 25% of the shares or voting rights in the body; or
  - (b) as respects any body corporate, otherwise exercises control over the management of the body.
- (2) In the case of a partnership (other than a limited liability partnership), "beneficial owner" means any individual who—
  - (a) ultimately is entitled to or controls (whether the entitlement or control is direct or indirect) more than a 25% share of the capital or profits of the partnership or more than 25% of the voting rights in the partnership; or
  - (b) otherwise exercises control over the management of the partnership.
- (3) In the case of a trust, "beneficial owner" means—
  - (a) any individual who is entitled to a specified interest in at least 25% of the capital of the trust property;
  - (b) as respects any trust other than one which is set up or operates entirely for the benefit of individuals falling within sub-paragraph (a), the class of persons in whose main interest the trust is set up or operates;
  - (c) any individual who has control over the trust.
- (4) In paragraph (3)—
  - "specified interest" means a vested interest which is—
    - (a) in possession or in remainder or reversion (or, in Scotland, in fee); and
    - (b) defeasible or indefeasible;
  - "control" means a power (whether exercisable alone, jointly with another person or with the consent of another person) under the trust instrument or by law to—
    - (a) dispose of, advance, lend, invest, pay or apply trust property;
    - (b) vary the trust;
    - (c) add or remove a person as a beneficiary or to or from a class of beneficiaries;
    - (d) appoint or remove trustees;
    - (e) direct, withhold consent to or veto the exercise of a power such as is mentioned in sub-paragraph (a), (b), (c) or (d).
- (5) For the purposes of paragraph (3)—
  - (a) where an individual is the beneficial owner of a body corporate which is entitled to a specified interest in the capital of the trust property or which has control over the trust, the individual is to be regarded as entitled to the interest or having control over the trust; and
  - (b) an individual does not have control solely as a result of—
    - (i) his consent being required in accordance with section 32(1)(c) of the Trustee Act 1925 (power of advancement);
    - (ii) any discretion delegated to him under section 34 of the Pensions Act 1995 (power of investment and delegation);
    - (iii) the power to give a direction conferred on him by section 19(2) of the Trusts of Land and Appointment of Trustees Act 1996 (appointment and retirement of trustee at instance of beneficiaries); or
    - (iv) the power exercisable collectively at common law to vary or extinguish a trust where the beneficiaries under the trust are of full age and capacity and (taken together) absolutely entitled to the property subject to the trust (or, in Scotland, have a full and unqualified right to the fee).
- (6) In the case of a legal entity or legal arrangement which does not fall within paragraph (1), (2) or (3), "beneficial owner" means—

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The following is a draft summary of the basic requirements that the Department of Justice deems necessary to include in any legislation establishing minimum requirements for the collection of beneficial owner information by the States. The objective of any legislative change is to establish the collection and maintenance of accurate records which identify the true beneficial owner(s) of a business. The proposed legislation must include the following:

A. Establish a definition of "beneficial owner". There are a number of definitions worldwide for "beneficial owner", which may assist in drafting this important definition, including but not limited to the definitions contained in: 31 CFR 103.175; 17 CFR 240.13d-3; the United Kingdom Money Laundering Regulations, effective December 15, 2007;<sup>1</sup> and the European Union (Third Anti-Money Laundering Directive).<sup>2</sup> For purposes of this concept paper, the following definition of beneficial owner has been elected:

"beneficial owner" means (a) a natural individual who has a level of control over, or entitlement to, the funds or assets of the corporation or limited liability company or partnership that, as a practical matter, enables such individual, directly or indirectly, to control, manage or direct such entity; or (b) a natural individual who owns more than 15% of the corporation or limited liability company or partnership. If a natural individual exercises such control or ownership over such corporation or limited liability company or partnership through another legal entity, such as a corporation, limited liability company or a partnership, the beneficial owners shall also identify each such legal entity being used by such individual to exercise control over the corporation or limited liability company or partnership and the majority beneficial owner of such entity.

B. Require the beneficial owner of a business:

1. to provide a State with adequate information regarding the identity and location of the beneficial owners, prior to the initial incorporation of the entity. The objective of this requirement is that the beneficial owners provide, and that the States collect the names, current addresses and photos of the natural individuals (rather than legal entities) who will be the true owners of the business that the States are being asked to form. For United States Citizens, the beneficial owner must provide either a copy of his or her driver's license or passport. All other beneficial owners must provide a copy of his or her passport.

<sup>1</sup> Used by the United Kingdom in conjunction with the Financial Action Task Force (FATF), a leading international organization combating money laundering and terrorist financing.

<sup>2</sup> Used by the European Union in conjunction with the FATF.

**DRAFT**

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2. to verify through signature, subject to criminal penalty, that the information provided to the States has been reviewed, and is true and accurate. This provision is to ensure that there are sufficient criminal penalties to allow either State or Federal authorities to prosecute individuals who provide false information to the State regarding beneficial owners.

3. to be subject to criminal and civil liability until the new beneficial owners' documents are provided to the incorporating State, when an existing business is sold or transferred to a new beneficial owner. This provision is to ensure that businesses maintain and update accurate records with the incorporating State. It is anticipated that there will be criminal penalties for the knowing failure to document the attempted transfer of beneficial ownership. Additionally, it is anticipated that—when the identity documents for a new beneficial owner has not been filed with the proper State authorities—any attempted transfer of ownership will be void, and civil liability for damages caused by the corporation after the date of the putative transfer will attach to the existing beneficial owners. This civil liability will include a rebuttable presumption that the corporate veil is pierced as to the beneficial owners.

C. Require the States to maintain the information regarding the beneficial owner. This provision is to ensure that law enforcement has access to the beneficial owner documents (including payment information for State taxes and fees) for a reasonable period of time (e.g. five to seven years) after the business has ceased to exist.

D. Allow State and Federal law enforcement access to the beneficial owners' information within a reasonable amount of time, after a written request has been made by a law enforcement agency. This provision is to ensure that State and Federal law enforcement have timely access to the beneficial owners' information so the agents may expeditiously use and benefit from the information when investigating criminal activity. State and Federal law enforcement must also have the ability to share beneficial owner records with their foreign law enforcement counterparts when requested within the context of their official duties. To address concerns of those States that do not wish to make the beneficial owners' information available to the general public, this provision will be limited so that only law enforcement will have access to the information in conjunction with a criminal investigation or request from a foreign counterpart.

E. Establish an exception to the above requirements for publicly traded companies, such as those traded on the New York Stock Exchange (e.g. Ford Motor Company); and for larger legitimate privately owned companies (e.g. Mars Incorporated). This provision is intended to avoid burdening both the States and the larger legitimate public and private corporations with the requirement to produce and maintain a large number of documents. These larger corporations have no history of facilitating criminal activity through the use of shell companies; and are already required, as are the corporations' subsidiary companies, to provide Federal and State regulators with significant amounts of information regarding the corporation's ownership and management.

Notes on Terms Used in Comments

Official Comments to subchapter F sections, the director who has a conflicting interest is for convenience referred to as "the director" and the corporation of which he or she is a director is referred to as "the corporation" or "X Co." A subsidiary of the corporation is referred to as "Y Co." Another corporation dealing with X Co. is referred to as "Z Co."

Subchapter Definitions

- (1) "Director's conflicting interest transaction" means a transaction effected or proposed to be effected by the corporation (or by an entity controlled by the corporation)
  - (i) to which, at the relevant time, the director is a party; or
  - (ii) respecting which, at the relevant time, the director had knowledge and a material financial interest known to the director; or
  - (iii) respecting which, at the relevant time, the director knew that a related person was a party or had a material financial interest.
- (2) "Control" (including the term "controlled by") means (i) having the power, directly or indirectly, to elect or remove a majority of the members of the board of directors or other governing body of an entity, whether through the ownership of voting shares or interests, by contract, or otherwise, or (ii) being subject to a majority of the risk of loss from the entity's activities or entitled to receive a majority of the entity's residual returns.
- (3) "Relevant time" means (i) the time at which directors' action respecting the transaction is taken in compliance with section 8.62, or (ii) if the transaction is not brought before the board of directors of the corporation (or its committee) for action under section 8.62, at the time the corporation (or an entity controlled by the corporation) becomes legally obligated to consummate the transaction.
- (4) "Material financial interest" means a financial interest in a transaction that would reasonably be expected to impair the objectivity of the director's judgment when participating in action on the authorization of the transaction.
- (5) "Related person" means:
  - (i) the director's spouse;
  - (ii) a child, stepchild, grandchild, parent, step-parent, grandparent, sibling, step sibling, half sibling, aunt, uncle, niece or nephew (or spouse of any thereof) of the director or of the director's spouse;
  - (iii) an individual living in the same home as the director;

2. to verify through signature, subject to criminal penalty, that the information provided to the States has been reviewed, and is true and accurate. This provision is to ensure that there are sufficient criminal penalties to allow either State or Federal authorities to prosecute individuals who provide false information to the State regarding beneficial owners.

3. to be subject to criminal and civil liability until the new beneficial owners' documents are provided to the incorporating State, when an existing business is sold or transferred to a new beneficial owner. This provision is to ensure that businesses maintain and update accurate records with the incorporating State. It is anticipated that there will be criminal penalties for the knowing failure to document the attempted transfer of beneficial ownership. Additionally, it is anticipated that—when the identity documents for a new beneficial owner has not been filed with the proper State authorities—any attempted transfer of ownership will be void, and civil liability for damages caused by the corporation after the date of the putative transfer will attach to the existing beneficial owners. This civil liability will include a rebuttable presumption that the corporate veil is pierced as to the beneficial owners.

C. Require the States to maintain the information regarding the beneficial owner. This provision is to ensure that law enforcement has access to the beneficial owner documents (including payment information for State taxes and fees) for a reasonable period of time (e.g. five to seven years) after the business has ceased to exist.

D. Allow State and Federal law enforcement access to the beneficial owners' information within a reasonable amount of time, after a written request has been made by a law enforcement agency. This provision is to ensure that State and Federal law enforcement have timely access to the beneficial owners' information so the agents may expeditiously use and benefit from the information when investigating criminal activity. State and Federal law enforcement must also have the ability to share beneficial owner records with their foreign law enforcement counterparts when requested within the context of their official duties. To address concerns of those States that do not wish to make the beneficial owners' information available to the general public, this provision will be limited so that only law enforcement will have access to the information in conjunction with a criminal investigation or request from a foreign counterpart.

E. Establish an exception to the above requirements for publicly traded companies, such as those traded on the New York Stock Exchange (e.g. Ford Motor Company); and for larger legitimate privately owned companies (e.g. Mars Incorporated). This provision is intended to avoid burdening both the States and the larger legitimate public and private corporations with the requirement to produce and maintain a large number of documents. These larger corporations have no history of facilitating criminal activity through the use of shell companies; and are already required, as are the corporations' subsidiary companies, to provide Federal and State regulators with significant amounts of information regarding the corporation's ownership and management.

Minnesota anti-takeover Statute

Exhibit 5

§ 80B.01

CORPORATE TAKEOVERS

... securities exchange, whether or not registered pursuant to the Securities Exchange Act of 1934, or the over-the-counter market.

10. Beneficial owner. "Beneficial owner" includes, but is not limited to, any person who directly or indirectly through any contract, arrangement, understanding, relationship, or otherwise has or shares the power to vote or the voting of a security and/or the power to dispose of, or direct the disposition of, the security. "Beneficial ownership" includes, but is not limited to, the right, exercisable within 60 days, to acquire securities through the exercise of options, warrants, or rights or the conversion of convertible securities or otherwise. The securities subject to these options, warrants, rights, or conversion privileges held by a person shall be deemed to be outstanding for the purpose of computing the percentage of outstanding securities of the class owned by this person, but shall not be deemed to be outstanding for the purpose of computing the percentage of the class owned by any other person. A person shall be deemed the beneficial owner of securities beneficially owned by any relative or spouse or relative of the spouse residing in the home of this person, any trust or estate in which this person owns ten percent or more of the total beneficial interest or serves as trustee or executor, any corporation or entity in which this person owns ten percent or more of the equity, and any affiliate or associate of this person.

Laws 1973, c. 331, § 1. Amended by Laws 1974, c. 406, §§ 94, 95; Laws 1980, c. 516, § 2; Laws 1984, c. 488, § 2; Laws 1985, 1st Sp., c. 5, §§ 1 to 3; Laws 1986, c. 444, Laws 1987, 1st Sp., c. 1, §§ 1, 2, eff. June 1, 1987.  
§ 45 U.S.C.A. §§ 77b to 77e, 77j, 77k, 77m, 77o, 77s, 78a to 78c, 78e-3, 78f to 78hh.

Historical and Statutory Notes

Laws 1984, c. 488, § 1, provides:

3. Subdivision 1. Findings. The legislature finds that take-overs, particularly hostile take-overs:

(1) exaggerate the tendency of many businesses to focus on short-term performance to the detriment of such long-term societal interests as increased research and development, improved productivity, and the modernization of physical plant and employee capabilities;

(2) are often inconsistent with the economic interests of shareholders;

(3) in many instances threaten the jobs and careers of Minnesota citizens and undermine the ethical foundations of companies, as when jobs are eliminated and career commitments to employees are breached or ignored;

(4) often result in plant closings or consolidations that damage communities dependent on the jobs and taxes provided by these plants;

(5) not infrequently wipe out long-standing customer/supplier relationships and the stability and continuity which these relationships provide throughout society.

(6) frequently tie up billions of dollars of scarce capital that could be more effectively applied;

(7) all too often stifle, and ultimately destroy, the entrepreneurial, innovative spirit of creative individuals in independent firms; and

(8) are usually conducted in an atmosphere and pursuant to laws that do not provide a reasonable opportunity for affected parties to make informed decisions.

Subd. 2. Purposes. (The purposes of Laws 1984, chapter 488, sections 1 to 18 [amending §§ 80B.01, 80B.03, 80B.05, 80B.06 to 80B.08, 80B.10, 80B.12, 302A.011, 302A.449, 302A.671 and repealing § 80B.02] are to:

(1) assure that the impacts of take-overs on all affected constituencies are identified and disclosed prior to the consummation of these transactions;

(2) provide to shareholders both necessary information and the opportunity to thus cast fully informed votes on any take-over transactions;

(3) encourage reasoned decision-making by assuring equal financial treatment of all share-

- (iv) an entity (other than the corporation or an entity controlled by the corporation) controlled by the director or any person specified above in this subdivision (5);
- (v) a domestic or foreign (A) business or nonprofit corporation (other than the corporation or an entity controlled by the corporation) of which the director is a director, (B) unincorporated entity of which the director is a general partner or a member of the governing body, or (C) individual, trust or estate for whom or of which the director is a trustee, guardian, personal representative or like fiduciary; or
- (vi) a person that is, or an entity that is controlled by, an employer of the director.

(6) "Fair to the corporation" means, for purposes of section 8.61(b)(3), that the transaction as a whole was beneficial to the corporation, taking into appropriate account whether it was (i) fair in terms of the director's dealings with the corporation, and (ii) comparable to what might have been obtainable in an arm's length transaction, given the consideration paid or received by the corporation.

(7) "Required disclosure" means disclosure of (i) the existence and nature of the director's conflicting interest, and (ii) all facts known to the director respecting the subject matter of the transaction that a director free of such conflicting interest would reasonably believe to be material in deciding whether to proceed with the transaction.

**Official Comment**

The definitions set forth in section 8.60 apply only to subchapter F's provisions and, except to the extent relevant to subchapter G, have no application elsewhere in the Model Act. (For the meaning and use of certain terms used below, such as "D," "X Co." and "Y Co." see the Note at the end of the Introductory Comment of subchapter F.)

**1. Director's Conflicting Interest Transaction**

The definition of "director's conflicting interest transaction" in subdivision (1) is the core concept underlying subchapter F, demarcating the transactional area that lies within—and without—the scope of the subchapter's provisions. The definition operates preclusively in that, as used in section 8.61, it denies the power of a court to invalidate transactions or otherwise to remedy conduct that falls outside the statutory definition of "director's conflicting interest transaction" solely on the ground that the director has a conflict of interest in the transaction. (Nevertheless, as stated in the Introductory Comment, the transaction might be open to attack under rules of law concerning director misbehavior other than rules based solely on the existence of a conflict of interest transaction, as to which subchapter F is preclusive).

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EXHIBIT 6

the term "dividend" also means any distribution of property (whether or not a dividend as defined in subsection (a)) made by the corporation to its shareholders, to the extent of its undistributed personal holding company income (determined under section 545 without regard to distributions under this paragraph) for such year.

(B) For purposes of subparagraph (A), the term "distribution of property" includes a distribution in complete liquidation occurring within 24 months after the adoption of a plan of liquidation, but—

- (i) only to the extent of the amounts distributed to distributees other than corporate shareholders, and
- (ii) only to the extent that the corporation designates such amounts as a dividend distribution and duly notifies such distributees of such designation, under regulations prescribed by the Secretary; but
- (iii) not in excess of the sum of such distributees' allocable share of the undistributed personal holding company income for such year, computed without regard to this subparagraph or section 562(b).

(3) DEFICIENCY DIVIDEND DISTRIBUTIONS BY A REGULATED INVESTMENT COMPANY OR REAL ESTATE INVESTMENT TRUST.—The term "dividend" also means any distribution of property (whether or not a dividend as defined in subsection (a)) which constitutes a "deficiency dividend" as defined in section 860(f).

Amendments

• 1978, Revenue Act of 1978 (P.L. 95-600)

P.L. 95-600, §362(d)(1)(A), (B), (c):

Amended Code Sec. 316(b)(3). Effective for determinations (as defined in Code Sec. 860(d)) after 11-6-78. Prior to amendment, paragraph (3) read:

"(3) DEFICIENCY DIVIDEND DISTRIBUTIONS BY A REAL ESTATE INVESTMENT TRUST.—The term "dividend" also means any distribution of property (whether or not a dividend as defined in subsection (a)) which constitutes a "deficiency dividend" as defined in section 859(d)."

• 1976, Tax Reform Act of 1976 (P.L. 94-455)

P.L. 94-455, §1601(d):

Added Code Sec. 316(b)(3). Effective for determinations (as defined in Code Sec. 859(c)) occurring after 10-4-76.

P.L. 94-455, §1906(b)(13)(A):

Amended 1954 Code by substituting "Secretary" for "Secretary or his delegate" each place it appeared. Effective 2-1-77.

• 1964, Revenue Act of 1964 (P.L. 88-272)

P.L. 88-272, §225(f)(1):

Amended Code Sec. 316(b)(2). Effective for distributions made in any tax year of the distributing corporation beginning after 12-31-63. Prior to amendment, Code Sec. 316(b)(2) read as follows:

"(2) Distributions by personal holding companies.—In the case of a corporation which—

"(A) under the law applicable to the taxable year in which the distribution is made, is a personal holding company (as defined in section 542), or

"(B) for the taxable year in respect of which the distribution is made under section 563(b) (relating to dividends paid after the close of the taxable year), or section 547 (relating to deficiency dividends), or the corresponding provisions of prior law, is a personal holding company under the law applicable to such taxable year, the term 'dividend' also means any distribution of property (whether or not a dividend as defined in subsection (a)) made by the corporation to its shareholders, to the extent of its undistributed personal holding company income (determined under section 545 without regard to distributions under this paragraph) for such year."

• 1956, Life Insurance Company Tax Act for 1955 (P.L. 429, 84th Cong.)

P.L. 429, 84th Cong., §5(1):

Amended Sec. 316(b)(1). Effective 1-1-55. Prior to amendment Sec. 316(b)(1) read as follows:

"(1) Certain insurance company dividends.—The definition in subsection (a) shall not apply to the term 'dividend' as used in sections 803(e), 821(a)(2), 823(2), and 832(c)(1) (where the reference is to dividends of insurance companies paid to policyholders)."

[Sec. 317]

SEC. 317. OTHER DEFINITIONS.

[Sec. 317(a)]

(a) PROPERTY.—For purposes of this part, the term "property" means money, securities, and any other property; except that such term does not include stock in the corporation making the distribution (or rights to acquire such stock).

[Sec. 317(b)]

(b) REDEMPTION OF STOCK.—For purposes of this part, stock shall be treated as redeemed by a corporation if the corporation acquires its stock from a shareholder in exchange for property, whether or not the stock so acquired is cancelled, retired, or held as treasury stock.

[Sec. 318]

SEC. 318. CONSTRUCTIVE OWNERSHIP OF STOCK.

[Sec. 318(a)]

(a) GENERAL RULE.—For purposes of those provisions of this subchapter which are contained in this section are expressly made applicable—

Sec. 316(b)(2)(B)

**(1) MEMBERS OF FAMILY.**

(A) **IN GENERAL.**—An individual shall be considered as owning the stock owned, directly or indirectly, by or for—

- (i) his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and
- (ii) his children, grandchildren, and parents.

(B) **EFFECT OF ADOPTION.**—For purposes of subparagraph (A)(ii), a legally adopted child of an individual shall be treated as a child of such individual by blood.

**(2) ATTRIBUTION FROM PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.**

(A) **FROM PARTNERSHIPS AND ESTATES.**—Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as owned proportionately by its partners or beneficiaries.

**(B) FROM TRUSTS.**

(i) Stock owned, directly or indirectly, by or for a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust.

(ii) Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by such person.

(C) **FROM CORPORATIONS.**—If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation.

**(3) ATTRIBUTION TO PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.**

(A) **TO PARTNERSHIPS AND ESTATES.**—Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as owned by the partnership or estate.

**(B) TO TRUSTS.**

(i) Stock owned, directly or indirectly, by or for a beneficiary of a trust (other than an employees' trust described in section 401(a) which is exempt from tax under section 501(a)) shall be considered as owned by the trust, unless such beneficiary's interest in the trust is a remote, contingent interest. For purposes of this clause, a contingent interest of a beneficiary in a trust shall be considered remote if, under the maximum exercise of discretion by the trustee in favor of such beneficiary, the value of such interest, computed actuarially, is 5 percent or less of the value of the trust property.

(ii) Stock owned, directly or indirectly, by or for a person who is considered the owner of any portion of a trust under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as owned by the trust.

(C) **TO CORPORATIONS.**—If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, such corporation shall be considered as owning the stock owned, directly or indirectly, by or for such person.

(4) **OPTIONS.**—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

**(5) OPERATING RULES.**

(A) **IN GENERAL.**—Except as provided in subparagraphs (B) and (C), stock constructively owned by a person by reason of the application of paragraph (1), (2), (3), or (4), shall, for purposes of applying paragraphs (1), (2), (3), and (4), be considered as actually owned by such person.

(B) **MEMBERS OF FAMILY.**—Stock constructively owned by an individual by reason of the application of paragraph (1) shall not be considered as owned by him for purposes of again applying paragraph (1) in order to make another the constructive owner of such stock.

(C) **PARTNERSHIPS, ESTATES, TRUSTS, AND CORPORATIONS.**—Stock constructively owned by a partnership, estate, trust, or corporation by reason of the application of paragraph (3) shall not be considered as owned by it for purposes of applying paragraph (2) in order to make another the constructive owner of such stock.

(D) **OPTION RULE IN LIEU OF FAMILY RULE.**—For purposes of this paragraph, if stock may be considered as owned by an individual under paragraph (1) or (4), it shall be considered as owned by him under paragraph (4).

(E) **S CORPORATION TREATED AS PARTNERSHIP.**—For purposes of this subsection—

(i) an S corporation shall be treated as a partnership, and

(ii) any shareholder of the S corporation shall be treated as a partner of such partnership.

The preceding sentence shall not apply for purposes of determining whether stock in the S corporation is constructively owned by any person.

#### Amendments

• 1984, Deficit Reduction Act of 1984 (P.L. 98-369)

P.L. 98-369, § 721(j):

Added Code Sec. 318(a)(5)(E). Effective as if included in the provision of P.L. 97-354 to which it relates.

• 1964 (P.L. 88-554).

P.L. 88-554, § 5(a):

Amended Code Sec. 318(a)(2), (3), and (4), and added Code Sec. 318(a)(5). Effective 8-31-64. Prior to amendment, subsections (a)(2), (3), and (4) read as follows:

(2) **Partnerships, estates, trusts, and corporations.**

(A) **Partnerships and estates.**—Stock owned, directly or indirectly, by or for a partnership or estate shall be considered as being owned proportionately by its partners or beneficiaries. Stock owned, directly or indirectly, by or for a partner or a beneficiary of an estate shall be considered as being owned by the partnership or estate.

(B) **Trusts.**—Stock owned, directly or indirectly, by or for a trust shall be considered as being owned by its beneficiaries in proportion to the actuarial interest of such beneficiaries in such trust. Stock owned, directly or indirectly, by or for a beneficiary of a trust shall be considered as being owned by the trust, unless such beneficiary's interest in the trust is a remote contingent interest. For purposes of the preceding sentence, a contingent interest of a beneficiary in a trust shall be considered remote, if, under the maximum exercise of discretion by the trustee in favor of such beneficiary, the value of such interest, computed actuarially, is 5 percent or less of the value of the trust property. Stock owned, directly or indirectly, by or for any portion of a trust of which a person is considered the owner under subpart B of part J of subchapter J (relating to grantors and others treated as substantial owners) shall be considered as being owned by such person, and such trust shall be treated as

owning the stock owned, directly or indirectly, by or for that person. This subparagraph shall not apply with respect to any employee's trust described in section 401(a) which is exempt from tax under section 501(c).

(C) **Corporations.**—If 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, then—

(i) such person shall be considered as owning the stock owned, directly or indirectly, by or for that corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation; and

(ii) such corporation shall be considered as owning the stock owned, directly or indirectly, by or for that person.

(3) **Options.**—If any person has an option to acquire stock, such stock shall be considered as owned by such person. For purposes of this paragraph, an option to acquire such an option, and each one of a series of such options, shall be considered as an option to acquire such stock.

(4) **Constructive ownership.** as actual ownership.—

(A) **In general.**—Except as provided in subparagraph (B), stock constructively owned by a person by reason of the application of paragraph (1), (2), or (3) shall, for purposes of applying paragraph (1), (2), or (3), be treated as actually owned by such person.

(B) **Members of family.**—Stock constructively owned by an individual by reason of the application of paragraph (1) shall not be treated as owned by him for purposes of again applying paragraph (1) in order to make another the constructive owner of such stock.

(C) **Option rule in lieu of family rule.**—For purposes of this paragraph, if stock may be considered as owned by an individual under paragraph (1) or (3), it shall be considered as owned by him under paragraph (3).

[Sec. 318(b)]

(b) **CROSS REFERENCES.**—

For provisions to which the rules contained in subsection (a) apply, see—

- (1) section 302 (relating to redemption of stock);
- (2) section 304 (relating to redemption by related corporations);
- (3) section 306(b)(1)(A) (relating to disposition of section 306 stock);
- (4) section 338(h)(3) (defining purchase);
- (5) section 382(l)(3) (relating to special limitations on net operating loss carryovers);
- (6) section 856(d) (relating to definition of rents from real property in the case of real estate investment trusts);
- (7) section 958(b) (relating to constructive ownership rules with respect to controlled foreign corporations); and
- (8) section 6038(e)(2) (relating to information with respect to controlled foreign corporations).

#### Amendments

• 2005, Gift Opportunity Zone Act of 2005 (P.L. 109-135)

P.L. 109-135, § 412(a):

Amended Code Sec. 318(b)(8) by striking "section 6038(d)(2)" and inserting "section 6038(e)(2)". Effective 12-21-2005.

• 1997, Taxpayer Relief Act of 1997 (P.L. 105-34)

P.L. 105-34, § 1142(e)(3):

Amended Code Sec. 318(b)(8) by striking "section 6038(d)(2)" and inserting "6038(d)(2)". Effective for actual odc's beginning after 8-5-97.

Sec. 318(a)(5)(D)

See p. 20,601 for regulations not amended to reflect law changes

gain from the sale or other disposition of property as provided in section 301(c)(3)(A). A distribution from a depletion reserve based upon discovery value to the extent that such reserve represents the excess of the discovery value over the cost or other basis for determining gain or loss, is, when received by the shareholders, taxable as an ordinary dividend. The amount by which a corporation's percentage depletion allowance for any year exceeds depletion sustained on cost or other basis, that is, determined without regard to discovery or percentage depletion allowances for the year of distribution or prior years, constitutes a part of the corporation's "earnings and profits accumulated after February 28, 1913," within the meaning of section 316, and, upon distribution to shareholders, is taxable to them as a dividend. A distribution made from that portion of a depletion reserve based upon a valuation as of March 1, 1913, which is in excess of the depletion reserve based upon cost, will not be considered as having been paid out of earnings and profits, but the amount of the distribution shall be applied against and reduce the cost or other basis of the stock upon which declared. See section 301. No distribution, however, can be made from such a reserve until all the earnings and profits of the corporation have first been distributed. [Reg. § 1.316-2.]

□ [T.D. 6152, 12-2-55.]

[Reg. § 1.317-1]

**§ 1.317-1. Property defined.**—The term "property" for purposes of Part 1, subchapter C, chapter 1 of the Code, means any property (including money, securities, and indebtedness to the corporation) other than stock or rights to acquire stock in the corporation making the distribution. [Reg. § 1.317-1.]

□ [T.D. 6152, 12-2-55.]

[Reg. § 1.318-1]

**§ 1.318-1. Constructive ownership of stock; introduction.**—(a) For the purposes of certain provisions of chapter 1 of the Code, section 318(a) provides that stock owned by a taxpayer includes stock constructively owned by such taxpayer under the rules set forth in such section. An individual is considered to own the stock owned, directly or indirectly, by or for his spouse (other than a spouse who is legally separated from the individual under a decree of divorce or separate maintenance), and by or for his children, grandchildren, and parents. Under section 318(a)(2) and (3), constructive ownership rules are established for partnerships and partners, estates and beneficiaries, trusts and beneficiaries, and corporations and stockholders. If any person has an option to acquire stock, such stock is considered as owned by such person. The term "option" includes an option to acquire such an option and each of a series of such options.

(b) In applying section 318(a) to determine the stock ownership of any person for any one purpose—

(1) A corporation shall not be considered to own its own stock by reason of section 318(a)(3)(C);

(2) In any case in which an amount of stock owned by any person may be included in the computation more than one time, such stock shall be included only once, in the manner in which it will impute to the person concerned the largest total stock ownership; and

(3) In determining the 50-percent requirement of section 318(a)(2)(C) and (3)(C) all of the stock owned actually and constructively by the person concerned shall be aggregated. [Reg. § 1.318-1.]

□ [T.D. 6152, 12-2-55; Amended by T.D. 6598, 4-25-62; T.D. 6621, 11-30-62 and T.D. 6969, 8-22-68.]

[Reg. § 1.318-2]

**§ 1.318-2. Application of general rules.**—

(a) The application of paragraph (b) of § 1.318-1 may be illustrated by the following examples:

*Example (1).* H, an individual owns all of the stock of Corporation A. Corporation A is not considered to own the stock owned by H in Corporation A.

*Example (2).* H, an individual, his wife, W, and his son, S, each own one-third of the stock of the Green Corporation. For purposes of determining the amount of stock owned by H, W, or S for the purpose of section 318(a)(2)(C) and (3)(C), the amount of stock held by the other members of the family shall be added pursuant to paragraph (b)(3) of § 1.318-1 in applying the 50-percent requirement of such section. H, W, or S, as the case may be, is for this purpose deemed to own 100 percent of the stock of the Green Corporation.

(b) The application of section 318(a)(1), relating to members of a family, may be illustrated by the following example:

*Example.* An individual, H, his wife, W, his son, S, and his grandson (S's son), G, own the 100 outstanding shares of stock of a corporation, each owning 25 shares. H, W, and S are each considered as owning 100 shares. G is considered as owning only 50 shares, that is, his own and his father's.

(c) The application of section 318(a)(2) and (3), relating to partnerships, trusts and corporations, may be illustrated by the following examples:

*Example (1).* A, an individual, has a 50 percent interest in a partnership. The partnership owns 50 of the 100 outstanding shares of stock of a corporation, the remaining 50 shares being owned by A. The partnership is considered as owning 100 shares. A is considered as owning 75 shares.

*Example (2).* A testamentary trust owns 25 of the outstanding 100 shares of stock of a corporation. A, an individual, who holds a vested re-

Reg. § 1.318-2(c)

remainder in the trust having a value, computed actuarially equal to 4 percent of the value of the trust property, owns the remaining 75 shares. Since the interest of A in the trust is a vested interest rather than a contingent interest (whether or not remote), the trust is considered as owning 100 shares. A is considered as owning 76 shares.

*Example (3).* The facts are the same as in (2), above, except that A's interest in the trust is a contingent remainder. A is considered as owning 76 shares. However, since A's interest in the trust is a remote contingent interest, the trust is not considered as owning any of the shares owned by A.

*Example (4).* A and B, unrelated individuals, own 70 percent and 30 percent, respectively, in value of the stock of Corporation M. Corporation M owns 50 of the 100 outstanding shares of stock of Corporation O, the remaining 50 shares being owned by A. Corporation M is considered as owning 100 shares of Corporation O, and A is considered as owning 85 shares.

*Example (5).* A and B, unrelated individuals, own 70 percent and 30 percent, respectively, of the stock of corporation M. A, B, and corporation M all own stock of corporation O. Since B owns less than 50 percent in value of the stock of corporation M, neither B nor corporation M constructively owns the stock of corporation O owned by the other. However, for purposes of certain sections of the Code, such as sections 304 and 856(d), the 50 percent limitation of section 318(a)(2)(C) and (3)(C) is disregarded or is reduced to less than 50 percent. For such purposes, B constructively owns his proportionate share of the stock of corporation O owned directly by corporation M, and corporation M constructively owns the stock of corporation O owned by B. [Reg. §1.318-2.]

□ [T.D. 6152, 12-2-55. Amended by T.D. 6969, 8-22-68.]

#### [Reg. §1.318-3]

#### §1.318-3. Estates, trusts, and options.—

(a) For the purpose of applying section 318(a), relating to estates, property of a decedent shall be considered as owned by his estate if such property is subject to administration by the executor or administrator for the purpose of paying claims against the estate and expenses of administration notwithstanding that, under local law, legal title to such property vests in the decedent's heirs, legatees or devisees immediately upon death. The term "beneficiary" includes any person entitled to receive property of a decedent pursuant to a will or pursuant to laws of descent and distribution. A person shall no longer be considered a beneficiary of an estate when all the property to which he is entitled has been received by him, when he no longer has a claim against the estate arising out of having been a beneficiary, and when there is only a remote

possibility that it will be necessary for the estate to seek the return of property or to seek payment from him by contribution or otherwise to satisfy claims against the estate or expenses of administration. When, pursuant to the preceding sentence, a person ceases to be a beneficiary, stock owned by him shall not thereafter be considered owned by the estate, and stock owned by the estate shall not thereafter be considered owned by him. The application of section 318(a) relating to estates may be illustrated by the following examples:

*Example (1).* (a) A decedent's estate owns 50 of the 100 outstanding shares of stock of corporation X. The remaining shares are owned by three unrelated individuals, A, B, and C, who together own the entire interest in the estate. A owns 12 shares of stock of corporation X directly and is entitled to 50 percent of the estate. B owns 18 shares directly and has a life estate in the remaining 50 percent of the estate. C owns 20 shares directly and also owns the remainder interest after B's life estate.

(b) If section 318(a)(5)(C) applies (see paragraph (c)(3) of §1.318-4), the stock of corporation X is considered to be owned as follows: the estate is considered as owning 80 shares, 50 shares directly, 12 shares constructively through A, and 18 shares constructively through B; A is considered as owning 37 shares, 12 shares directly, and 25 shares constructively (50 percent of the 50 shares owned directly by the estate); B is considered as owning 43 shares, 18 shares directly and 25 shares constructively (50 percent of the 50 shares owned directly by the estate); C is considered as owning 20 shares directly and no shares constructively. C is not considered a beneficiary of the estate under section 318(a) since he has no direct present interest in the property held by the estate nor in the income produced by such property.

(c) If section 318(a)(5)(C) does not apply, A is considered as owning nine additional shares (50 percent of the 18 shares owned constructively by the estate through B), and B is considered as owning six additional shares (50 percent of the 12 shares owned constructively by the estate through A).

*Example (2).* Under the will of A, Blackacre is left to B for life, remainder to C, an unrelated individual. The residue of the estate consisting of stock of a corporation is left to D. B and D are beneficiaries of the estate under section 318(a). C is not considered a beneficiary since he has no direct present interest in Blackacre nor in the income produced by such property. The stock owned by the estate is considered as owned proportionately by B and D.

(b) For the purpose of section 318(a)(2)(B), stock owned by a trust will be considered as being owned by its beneficiaries only to the extent of the interest of such beneficiaries in the trust. Accordingly, the interest of income beneficiaries, remainder beneficiaries, and other benefi-

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## Corporate Liquidations

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aries will be computed on an actuarial basis. If a trust owns 100 percent of the stock of Corporation A, and if, on an actuarial basis, W's interest in the trust is 15 percent, Y's life interest is 25 percent, and Z's remainder interest is 60 percent, under this provision W will be considered to be the owner of 15 percent of the stock of Corporation A, Y will be considered to be the owner of 25 percent of such stock, and Z will be considered to be the owner of 60 percent of such stock. The factors and methods prescribed in § 20.2031-7 of this chapter (Estate Tax Regulations) for use in ascertaining the value of an interest in property for estate tax purposes shall be used in determining a beneficiary's actuarial interest in a trust for purposes of this section. See § 20.2031-7 of this chapter (Estate Tax Regulations) for examples illustrating the use of these factors and methods.

(c) The application of section 318(a) relating to options may be illustrated by the following example:

*Example.* A and B, unrelated individuals, own all of the 100 outstanding shares of stock of a corporation, each owning 50 shares. A has an option to acquire 25 of B's shares and has an option to acquire a further option to acquire the remaining 25 of B's shares. A is considered as owning the entire 100 shares of stock of the corporation. [Reg. § 1.318-3.]

□ [T.D. 6152, 12-2-55. Amended by T.D. 6462, 5-5-60 and T.D. 6969, 8-22-68.]

## [Reg. § 1.318-4]

§ 1.318-4. Constructive ownership as actual ownership; exceptions.—(a) *In general.*—Section 318(a)(5)(A) provides that, except as provided in section 318(a)(5)(B) and (C), stock constructively owned by a person by reason of the application of section 318(a)(1), (2), (3), or (4) shall be considered as actually owned by such person for purposes of applying section 318(a)(1), (2), (3), and (4). For example, if a trust owns 50 percent of the stock of corporation X, stock of corporation Y owned by corporation X which is attributed to the trust may be further attributed to the beneficiaries of the trust.

(b) *Constructive family ownership.*—Section 318(a)(5)(B) provides that stock constructively

owned by an individual by reason of ownership by a member of his family shall not be considered as owned by him for purposes of making another family member the constructive owner of such stock under section 318(a)(1). For example, if F and his two sons, A and B, each own one-third of the stock of a corporation, under section 318(a)(1), A is treated as owning constructively the stock owned by his father but is not treated as owning the stock owned by B. Section 318(a)(5)(B) prevents the attribution of the stock of one brother through the father to the other brother, an attribution beyond the scope of section 318(a)(1) directly.

(c) *Reattribution.*—(1) Section 318(a)(5)(C) provides that stock constructively owned by a partnership, estate, trust, or corporation by reason of the application of section 318(a)(3) shall not be considered as owned by it for purposes of applying section 318(a)(2) in order to make another the constructive owner of such stock. For example, if two unrelated individuals are beneficiaries of the same trust, stock held by one which is attributed to the trust under section 318(a)(3) is not reattributed from the trust to the other beneficiary. However, stock constructively owned by reason of section 318(a)(2) may be reattributed under section 318(a)(3). Thus, for example, if all the stock of corporations X and Y is owned by A, stock of corporation Z held by X is attributed to Y through A.

(2) Section 318(a)(5)(C) does not prevent reattribution under section 318(a)(2) of stock constructively owned by an entity under section 318(a)(3) if the stock is also constructively owned by the entity under section 318(a)(4). For example, if individuals A and B are beneficiaries of a trust and the trust has an option to buy stock from A, B is considered under section 318(a)(2)(B) as owning a proportionate part of such stock.

(3) Section 318(a)(5)(C) is effective on and after August 31, 1964, except that for purposes of sections 302 and 304 it does not apply with respect to distributions in payment for stock acquisitions or redemptions if such acquisitions or redemptions occurred before August 31, 1964. [Reg. § 1.318-4.]

□ [T.D. 6152, 12-2-55. Amended by T.D. 6969, 8-22-68.]

## Corporate Liquidations

## [Reg. § 1.331-1]

§ 1.331-1. Corporate liquidations.—(a) *In general.*—Section 331 contains rules governing the extent to which gain or loss is recognized to a shareholder receiving a distribution in complete or partial liquidation of a corporation. Under section 331(a)(1), it is provided that amounts distributed in complete liquidation of a corporation shall be treated as in full payment in ex-

change for the stock. Under section 331(a)(2), it is provided that amounts distributed in partial liquidation of a corporation shall be treated as in full or part payment in exchange for the stock. For this purpose, the term "partial liquidation" shall have the meaning ascribed in section 346. If section 331 is applicable to the distribution of property by a corporation, section 301 (relating to the effects on a shareholder of distributions of property) has no application other than to a dis-

Reg. § 1.331-1(a)