

60 TREASURY DEPARTMENT REPORT ON PRIVATE FOUNDATIONS

applies and since, beyond the situations governed by that rule, there would appear to be little room for abuse through gifts of stock, evidences of indebtedness, or cash, these areas should be excepted from the proposed measure.

For estate tax purposes, this recommendation would not require unproductive property which has been the subject of a completed inter vivos transfer to a private foundation to be included in the donor's gross estate; but it would permit the testamentary transfer of such property to a foundation to qualify for an estate tax deduction only under rules similar to those suggested in the controlled property section of the Report. Gift tax treatment would complement that prescribed by the estate tax statute: a completed lifetime conveyance of unproductive property would constitute a taxable gift, accorded a charitable deduction only upon the occurrence of one of the three qualifying events within a specified period after the transfer.

In its discussion of the problems presented by contributions of family controlled property, Part II-D of the report has indicated that valid arguments exist both for and against restricting the measure directed at those problems to the context of donor-influenced foundations. The problems of the present section are, in many ways, analogous to those of controlled property. Consequently, if the Congress concludes that it is desirable to limit the scope of the controlled property remedy to contributions made to donor-influenced foundations, it may also wish to consider such a restriction of the rules recommended in the present section.

B. CONTRIBUTIONS OF SECTION 306 STOCK AND OTHER ORDINARY INCOME ASSETS

(1) *Section 306 stock*

In 1954 Congress addressed itself directly and specifically to the problem of the so-called preferred stock bailout. Concerned with the obvious tax avoidance inherent in situations in which the shareholders of a corporation distributed preferred or other special stock to themselves as a tax-free dividend, realized capital gains upon selling this stock to a third party, and then had the corporation redeem the stock with earnings and profits—thereby accomplishing the distribution of corporate profits at the tax rate prescribed for capital gains—Congress determined to withdraw the favorable treatment accorded the earnings bailout. To that end, it adopted legislation providing, generally, that the amount which a shareholder realizes upon the sale, redemption, or other disposition of certain types of stock—designated “section 306 stock”—will be taxed to him as ordinary income. The typical situation covered by the legislation involves distribution of a preferred stock dividend to the holders of a corporation's common stock.

Since 1954 it has become apparent that, while this provision seals off avoidance possibilities for those who wish to sell or redeem section 306 stock, it does not foreclose the bailout device for taxpayers who contribute such stock to charity. Judicial authority has held that a person does not “realize” anything, within the technical meaning of the tax statute, when he makes a deductible charitable contribution. Hence, because the terms of section 306 become operative only where a disposition of stock occasions a “realization” for its former owner, they do not apply where the owner donates the stock to charity. As a