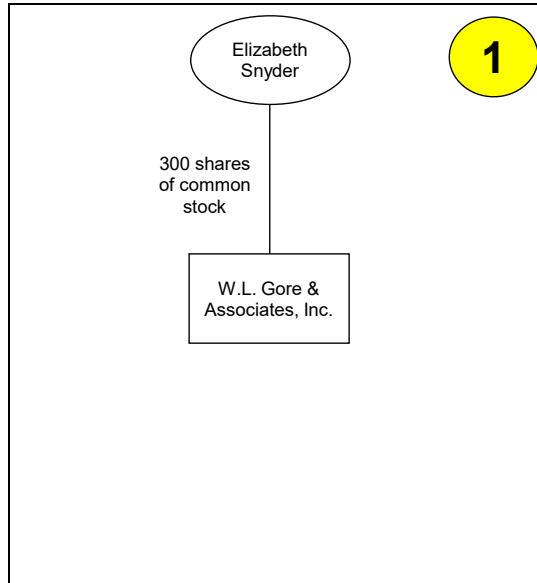
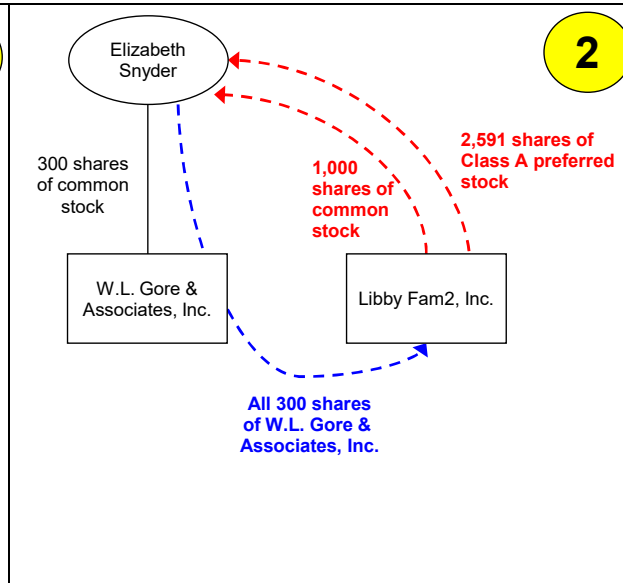


**Deemed Gifts for Failing to Convert From  
Non-Cumulative Preferred to Cumulative Preferred**

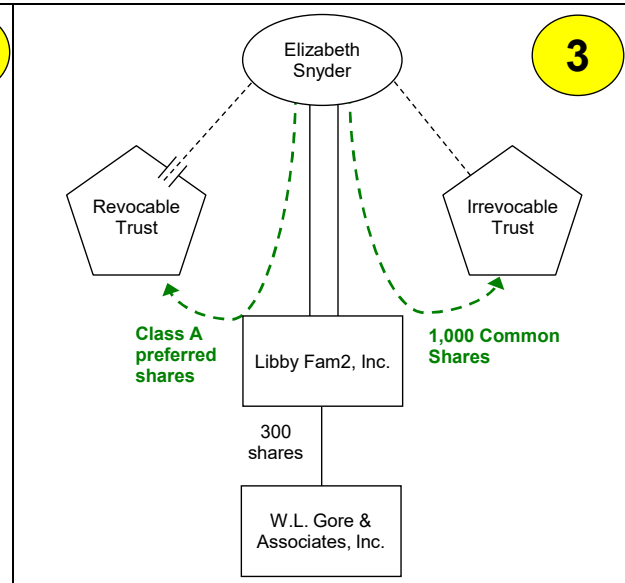
**Initial Structure**



**Holding Company Formation**



**Transfers to Trusts**



The taxpayer incorporated Libbyfam and transferred 300 shares of common stock in Gore to Libbyfam in a tax-free exchange for 1,000 shares of common stock and 2,591 shares of Class A preferred stock.

The Class A preferred stock was entitled to a noncumulative annual dividend of 7% of par value, and was convertible, at the option of the holder, into equal numbers of shares of Class B preferred. The Class B preferred stock was entitled to a cumulative annual dividend of 7% of par value. Class B preferred shareholders could require the corporation to redeem Class B shares at par value plus accumulated, unpaid dividends.

The taxpayer created an irrevocable trust for the benefit of her great-grandchildren that was funded with her 1,000 shares of common stock in Libbyfam. The taxpayer transferred the Class A preferred stock to a revocable trust.

If the taxpayer had converted her Class A preferred into Class B preferred stock, she would have been entitled to cumulative dividends of \$181,370 annually. The value of dividends that would have accumulated was effectively transferred by the taxpayer to her great-grandchildren (the common shareholders). Because she could have demanded that value by converting to Class B preferred, the value was transferred on each date a dividend would have accumulated.

**Deemed Annual Gifts**

