



OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
June 19, 2000

Number: **200042004**
Release Date: 10/20/2000
CC:DOM:FS:CORP
TL-N-1604-00

UILC: 351.00 -00

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL

FROM: Deborah A. Butler
Assistant Chief Counsel CC:DOM:FS

SUBJECT: Section 351 Transaction

This Field Service Advice responds to your memorandum dated March 15, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

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LEGEND:

P =
Date 1 =
Date 2 =
Date 3 = _____
Date 4 =
b% =
c% =
d=
f =
\$e =
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\$k =
Corporation A =

Corporation B =
Corporations E and F =

Corporation D =

Corporation X =

ISSUE 1

Whether the transactions among Corporation B, Corporation D, and Corporation A constituted nontaxable I.R.C. § § 368(a)(1)(A) and 351 transactions, or a sale of assets by Corporation B to Corporation A.

ISSUE 2

Whether, immediately after the exchange, Corporation B and Corporation D retained the necessary control (within the meaning of section 368(c)) of Corporation A to qualify their transfers of property, in exchange for stock in Corporation A, as a section 351 transaction.

CONCLUSION #1

We believe the series of transactions among Corporation B, Corporation D, and Corporation A constituted nontaxable I.R.C. § § 368(a)(1)(A) and 351 transactions, rather than a sale of assets by Corporation B to Corporation A.

CONCLUSION #2

We believe that, immediately after the exchange, Corporation B and Corporation D retained the necessary control (within the meaning of section 368(c)) of Corporation A to qualify their transfers of property to Corporation A, in exchange for stock in Corporation A, as a section 351 transaction.

FACTS

Overview

The following transactions occurred pursuant to a plan. Corporation B initially formed Corporation A. Corporation B contributed certain assets to Corporation A in exchange for stock in Corporation A. Immediately after Corporation B contributed the assets to Corporation A, Corporation D (a corporation unrelated to Corporation A or Corporation B) merged into Corporation A and Corporation A changed its name to Corporation X. (For simplicity, we will refer to Corporation X as Corporation A, the name prior to the name change.)

Detailed Facts

On Date 1, Corporation B incorporated Corporation A, issuing one share of common stock to Corporation B. Corporation B agreed that, until Corporation B contributed assets to Corporation A, Corporation A would remain a "shell company," which would not acquire any assets, incur any liabilities, engage in any business operations, hire any individual, or issue any stock.

On Date 2, Corporation B and Corporations E and F, wholly-owned subsidiaries of P, transferred certain assets to Corporation A. In exchange, Corporation A: 1.) issued d shares of common stock, and f shares of preferred stock, to Corporation B; 2.) assumed Corporation B indebtedness in the amount of \$h, and 3.) executed a

promissory note, in the amount of \$e, in favor of Corporation B and Corporations E and F. Corporation A paid off the assumed liability on Date 3; Corporation A paid off the promissory note on Date 4.

Immediately after Corporation B transferred the assets to Corporation A, Corporation D merged into Corporation A. Each previously issued Corporation A share was converted into a share of Corporation A, and each Corporation D share was automatically converted into one share of Corporation A. Our understanding is that the merger constituted a reorganization within the meaning of I.R.C. § 368(a)(1)(A). Corporation D represented on its tax return that the transaction constituted a reverse acquisition (within the meaning of Treas. Reg. §1.1502-75(d)(3)).

After the merger, Corporation B held approximately b%, and the former shareholders of D held the remaining c%, of the stock of Corporation A. Additionally, Corporation A held the assets that Corporation D and Corporation B transferred to it, as well as the assets that Corporations E and F sold to it.

Corporation B viewed its transfer of property to Corporation A, in exchange for stock in Corporation A, as a section 351 transaction. Corporation D viewed Corporation B and Corporation D as transferors in a section 351 transaction in which each transferred property to Corporation A in exchange for stock in Corporation A. You indicate the taxpayer will be asserting nontax business purposes for the transaction.

Corporation A reported the payment of \$g as boot. Corporation B reported its share of the \$g payment, i.e, \$i, as boot. Corporations E and F reported their shares of the \$g payment as income from the sale of assets.

LAW AND ANALYSIS

Section 351(a) provides that no gain or loss is recognized if property is transferred to a corporation by one or more persons solely in exchange for stock in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation.

Section 351(b) provides, in part, that if section 351(a) would apply to an exchange but for the fact that there is received, in addition to the stock permitted to be received under section 351(a), other property or money, gain (if any) to such recipient shall be recognized, but not in excess of the amount of money received, plus the fair market value of such other property received.

Section 368(c) provides that the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Section 351(c) provides that, in determining control for purposes of section 351, the fact that any corporate transferor distributes part or all of the stock that it receives in the exchange to its shareholders shall not be taken into account.

Rev. Rul. 68-349, 1968-2 C.B. 143, held that the transfer of property by an individual to a newly formed corporation does not qualify under section 351 where another corporation simultaneously transfers all its property to the new corporation for purposes of qualifying the individual's transfer under section 351. The organization of the new corporation is considered, under the circumstances, to be merely a continuation of the transferor corporation.

In Rev. Rul. 68-349, individual A owned appreciated property that Y corporation desired to acquire for use in its business. Pursuant to a plan, X was organized, and Y transferred all of its assets, subject to all of its liabilities, to X in exchange for X voting stock. At the same time, A transferred the appreciated property Y desired to acquire to X in exchange for X voting stock. Y then distributed the X stock received to its shareholders in exchange for their Y stock. Thereafter, X continued the operation of the business formerly conducted by Y.

The ruling indicated that the transfers of property by A and Y were part of one plan in which, immediately after the exchange, A and the Y shareholders were in control (within the meaning of sections 368(c) and 351(c)) of X. However, it was apparent X was organized to enable A to transfer the appreciated assets without the recognition of gain. The ruling concluded that X is considered, under the circumstances, to be merely a continuation of Y. Immediately after the exchange, A was not in control (within the meaning of section 368(c)) of the continuing entity, and the transfer by A to the entity did not fall under section 351.

Rev. Rul. 76-123, however, distinguished Rev. Rul. 68-349. Rev. Rul. 76-123, 1976-1 C.B. 94, held that the transaction in that ruling constituted a reorganization under section 368(a)(1)(C), as well as a section 351 transaction.

In Rev. Rul. 76-123, A, an individual, owned all the stock of X, a corporation incorporated in State O. B, an individual unrelated to A, owned all the stock of Y, a corporation incorporated in State P. A and B determined that the businesses operated by X and Y could be improved if their interests in X and Y were combined, but the separate corporate existence of X and Y were preserved. A and B decided that the laws of State P were more favorable to the operation of the combined enterprise. A and B transferred all their stock in X and Y to Z, a newly-organized corporation incorporated in State P, in exchange for 60 percent and 40 percent of the Z stock (as well as \$10x cash), respectively. X then distributed to Z all its assets in complete liquidation, and Y remained a wholly owned subsidiary of Z.

The ruling concluded that A's transfer of its X stock to Z and Z's liquidation of X were interdependent steps in an overall reorganization plan. The transaction is treated, for Federal income tax purposes, as a section 368(a)(1)(C) reorganization in which Z acquired all the assets of X solely in exchange for Z voting stock (see

Rev. Rul. 67-274, 1967-2 C.B. 141), followed by X's distribution of the Z stock to A in exchange for A's X stock.

The ruling further concluded that X's liquidating distribution to Z and B's transfer of the Y stock to Z was a section 351 transaction in which, immediately after the exchange, X and B were in control (within the meaning of section 368(c)) of Z. X's distribution of the Z stock to A did not violate the control requirement of section 368(c). See I.R.C. § 351(c).

Rev. Rul. 76-123 distinguished Rev. Rul. 68-349. Rev. Rul. 76-123 concluded that, under the facts of Rev. Rul. 76-123, Z was not employed solely for the purpose of enabling B's transfer of Y stock without the recognition of gain. Additionally, Z was not merely a continuation of X. Z was organized to enable X to be reincorporated in State P. Further, B's transfer of his Y stock to Z effected the combination of the former business interests of A and B in the form of affiliated corporations.

We believe the instant case is similar to Rev. Rul. 76-123. The facts presented to us indicate that, as part of an overall plan, Corporation B and Corporation D transferred property to Corporation A in exchange for stock in Corporation A, and, immediately after the exchange, Corporation B and Corporation D were in control (within the meaning of section 368(c)) of Corporation A. The facts indicate the transactions among Corporation B, Corporation D, and Corporation A constituted nontaxable I.R.C. § 368(a)(1)(A) and 351 transactions, rather than a sale of assets by Corporation B to Corporation A.

The facts do not indicate that Corporation A was employed solely for the purpose of enabling Corporation B's transfer of property without the recognition of gain. Nor do the facts indicate that Corporation A was a mere continuation of Corporation D.

We believe that, immediately after the exchange, Corporation B and Corporation D retained the necessary control (within the meaning of sections 368(c) and 351(c)) of Corporation A to qualify their transfers of property to Corporation A, in exchange for stock in Corporation A, as a section 351 transaction. This is the case even though Corporation D merged into Corporation A, and Corporation D distributed the A stock received in the exchange to the shareholders of Corporation D in exchange for their stock in Corporation D. Similar to Rev. Rul. 76-123 (where X's distribution of the Z stock to A in exchange for A's X stock was not taken into account and, immediately after the exchange, X and B were considered in control of Z), Corporation D's distribution of the A stock to the shareholders of Corporation D in exchange for stock in Corporation D should not be taken into account and, immediately after the exchange, Corporation B and Corporation D should be considered in control of Corporation A.

The instant case is also similar to Rev. Rul. 68-357, 1968-2 C.B. 144, involving reorganization transactions treated as part of a larger section 351 transaction. In Rev. Rul. 68-357, A and B owned Corporation M. A also owned eighty percent, sixty percent and fifty percent, respectively, of the outstanding stock of Corporations X, Y and Z. To consolidate five businesses, A transferred to Corporation M all of the assets, subject to the liabilities, of his sole proprietorship. Simultaneously, pursuant to an agreement among the parties, Corporations X, Y, and Z transferred to Corporation M all their assets, subject to liabilities, in transactions that qualified as reorganizations under section 368(a)(1)(C). After transferring their assets to Corporation M in exchange for stock in Corporation M, Corporations X, Y, and Z distributed the M stock received in the exchanges to their respective shareholders and dissolved. Immediately after the transfer, A owned sixty percent of the Corporation M stock, and X, Y, and Z owned twenty-five percent of the Corporation M stock. B owned the remaining fifteen percent of the Corporation M stock.

The ruling concluded that the exchanges of property by the transferor corporations and by A solely for voting stock of Corporation M, taken as a whole, represented a section 351(a) transaction. Immediately after the exchanges, the transferors were in control of Corporation M (within the meaning of section 368(c)). Pursuant to section 351(c), the distributions by X, Y, and Z to their shareholders were not taken into account in determining control for section 351 purposes.

Overall, in the instant case, we believe the series of transactions among Corporation B, Corporation D, and Corporation A constituted nontaxable I.R.C. § § 368(a)(1)(A) and 351 transactions, rather than a sale of assets by Corporation B to Corporation A. We believe that, immediately after the exchange, Corporation B and Corporation D retained the necessary control (within the meaning of section 368(c)) of Corporation A to qualify their transfers of property, in exchange for Corporation A stock, as a section 351 transaction. This is the case even though Corporation D merged into Corporation A.

CASE DEVELOPMENT, LITIGATION HAZARDS, AND OTHER CONCERNS

Our analysis assumes the taxpayer has valid nontax business purposes for the transaction. Given the minimal standard the Service applies in determining whether a transaction meets the business purpose requirement of section 351 (see e.g., Rev. Rul. 76-123), we believe the taxpayer will most likely be able to successfully assert that valid business purposes existed for the transaction.

Lastly, we note that the facts in the incoming indicate that the total amount Corporation B received from Corporation A (the Corporation A stock, the promissory

note, and the assumption of indebtedness) exceeded the value of the assets Corporation B transferred to Corporation A. That is, the incoming indicates that the total amount Corporation B received from Corporation A approximated \$j, but the value of the assets Corporation A transferred to Corporation B approximated only \$k. However, in an e-mail to our office, you clarified that it appears the fair market value of the Corporation B assets actually approximated \$j, rather than \$k. Consequently, the total amount Corporation B received from Corporation A does not appear to have exceeded the value of the assets Corporation B transferred to Corporation A.

If you have any further questions, please call 622-7930.

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By: _____
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