Office of Chief Counsel
Internal Revenue Service

memorandum

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EWJohnson

date: August 3, 2000

to: Case Manager, Group 1354
Large and Mid-Size Business (LMSB)
Attn: Caryl Sharp, Lynette Wiegel

from: District Counsel, North Central District, St. Paul

subject: **Transferee Liability -** [redacted]

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This memorandum is in response to the request for advice submitted June 16, 2000.

ISSUES

1. Who is liable for the proposed I.R.C. § 1374 tax?

2. What are the applicable statute of limitation dates?

3. Who may extend the statute of limitation dates and what language should be used?

CONCLUSION

1. [redacted] is directly liable for the proposed I.R.C. § 1374 tax. On the given facts, there are no transferees

liable for the proposed I.R.C. § 1374 tax.

2. The statute of limitations date for assessing the proposed I.R.C. § 1374 tax against [redacted] is [redacted]. If a notice of deficiency is issued, we suggest the following language be used to identify the taxpayer: [redacted] **(E.I.N. —), successor to** [redacted] **(E.I.N. —), successor to** [redacted] **(E.I.N. —).** The notice of deficiency should otherwise contain the same information and content that it would contain if it were addressed directly to [redacted].

3. The statute of limitations for the proposed I.R.C. § 1374 tax may be extended by [redacted]. We suggest that the following language be used to identify the taxpayer on the Form 872: [redacted] **(E.I.N. —), successor to** [redacted] **(E.I.N. —), successor to** [redacted] **(E.I.N. —)*.** At the bottom of the page, we suggest including the following language: ***With respect to the tax liability of** [redacted] **for tax year** [redacted].

DISCUSSION

[redacted], a [redacted] corporation, was formed in [redacted]. [redacted] elected to file as an S-corporation starting for tax year [redacted]. For tax years prior to tax year [redacted], [redacted] was a C-corporation.

[redacted] through [redacted] was owned by [redacted] and [redacted] (husband and wife) and their children and trusts controlled by the [redacted] family (generally 'the [redacted] family').

[redacted], a [redacted] corporation, was formed on [redacted]. On [redacted], [redacted] was merged into [redacted] in a tax-free reorganization under I.R.C. § 368(a)(1)(A). Through the merger, the [redacted] family became the shareholders of [redacted]. [redacted] filed its return for tax year [redacted] on [redacted]. [redacted] for tax year [redacted] filed as an S-corporation.

On [redacted], [redacted], a [redacted] limited liability company, was formed. On [redacted], [redacted] was merged into [redacted]. Through the merger, the [redacted] family became the shareholders of [redacted]. [redacted] for all tax years filed federal income tax returns as a partnership.

On [redacted], the [redacted] family contributed existing indebtedness to [redacted] in return for additional [redacted] shares.

. On [redacted], [redacted] was merged into [redacted], a [redacted] corporation. As part of the merger, the [redacted] family sold their [redacted] shares; after the merger they did not own shares in [redacted].

A merger does not qualify as an I.R.C. § 368(a)(1)(A) tax-free reorganization unless the entities merged are corporations for federal income tax purposes under I.R.C. § 7701 and Treas. Reg. § 301.7701. I.R.C. § 368 refers only to 'corporations'.

If an S-corporation distributes appreciated property, the S-corporation recognizes gain. I.R.C. §§ 336(a); 1371(a). The gain thus recognized is passed through and is taxable to the S-corporation shareholders. I.R.C. § 1366.

An additional corporate tax is imposed on recognized S-corporation gains if the S-corporation was previously a C-corporation and the gains were built-in at the time of the conversion from the C-corporation to the S-corporation. I.R.C. § 1374. The I.R.C. § 1374 tax is imposed directly on the S-corporation, not on its shareholders. Bufferd v. Commissioner, 506 U.S. 523, 530 fn. 9 (1993); compare, Reg. § 1.6037-1(c). Because the I.R.C. § 1374 tax is imposed directly on the S-corporation, the statute of limitations for assessing the tax against the S-corporation runs from the filing of the S-corporation return, whether or not the S-corporation is subject to TEFRA procedures. Bufferd, 506 U.S. at 530 fn. 9.

If an entity merges into another entity, the surviving entity is generally directly liable for any tax of the non-surviving entity incurred prior to the merger. See, Southern Pacific Transportation Co. v. Commissioner, 84 T.C. 367(1985).

I.R.C. § 6901 authorizes the Internal Revenue Service to collect tax owed by a property transferor from the transferee. Transferee liability exists to the extent that the transferee receives property for consideration less than the fair market value of the property transferred. See, Alonso v. Commissioner, 78 T.C. 577 (1982).

Because [redacted] was not a corporation for federal income tax purposes, the merger of [redacted] and [redacted] does not qualify for tax-free treatment under I.R.C. § 368. Thus, any built-in gain on the [redacted] assets must be recognized and to the extent such built-in gain

was present when [redacted] changed to an S-corporation, [redacted] is liable for I.R.C. § 1374 tax on such gain.

[redacted], successor to [redacted], successor to [redacted], is directly liable for the I.R.C. § 1374 tax. The three-year statute of limitations date for assessing the proposed I.R.C. § 1374 tax against [redacted] is [redacted].

It does not appear that there is any transferee liability for the I.R.C. § 1374 tax. The facts do not reveal any transfers from [redacted], [redacted], or [redacted], for less than fair market value.

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