**The Type “C” Reorganization**

Code: IRC §§ 368(a)(1)(C), 368(a)(2)(B), 368(a)(2)(G), 368(b)

Regs: Treas. Reg. § 1.368-2(d)

B&E: ¶ 12.24

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Rev. Rul. 73-102, 1973-1 CB 186

Advice has been requested whether, under the circumstances described below, the “solely for voting stock” requirement of section 368(a)(1)(C) of the Internal Revenue Code is satisfied.

For valid business reasons, X corporation entered into a plan of reorganization with unrelated Y corporation. Pursuant to the plan, X transferred all of its assets to Y in exchange for Y voting stock and the assumption by Y of the X liabilities, including liabilities to pay claims of dissenting shareholders.

Under the plan, Y paid 50x dollars to dissenting X shareholders in satisfaction of their claims, based on the fair market value of their X stock surrendered. The dissenting shareholders surrendered all their X stock for cash in the transaction. The fair market value of the gross assets transferred by X to Y was 2,000x dollars. The amount of the liabilities assumed by Y (other than the liability to pay dissenting shareholders) was 150x dollars.

Section 368(a)(1)(C) of the Code defines as a reorganization the acquisition by one corporation, in exchange solely for shares of its voting stock, of substantially all the properties of another corporation. Section 368(a)(1)(C) of the Code further provides that in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other will be disregarded.

Section 368(a)(2)(B) of the Code provides that if, in addition to voting stock, the acquiring corporation exchanges money or other property, and if the acquiring corporation acquires, solely for voting stock, property of the other corporation having a fair market value which is at least 80 percent of the fair market value of all the property of the other corporation, then such acquisition will be treated as qualifying under section 368(a)(1)(C) of the Code. For the purpose of the percentage computation of section 368(a)(2)(B) of the Code, liabilities assumed by the acquiring corporation are treated as money.

In Helvering v. Southwest Consolidated Corp., 315 U.S. 194 (1942), Ct. D. 1544, 1942-1 C.B. 215, the Supreme Court of the United States held that the “solely for voting stock” requirement of the predecessor of section 368(a)(1)(C) of the Code was violated where the acquiring corporation directly or indirectly transferred to the acquired corporation or its shareholders property other than voting stock in exchange for the equity interest being acquired. The Court stated: " 'Solely' leaves no leeway.”

The payment by Y of 50x dollars to dissenting shareholders of X in satisfaction of their claims was, in substance, the same as if Y had exchanged cash plus voting stock for the properties of X. Therefore, this cash payment is not a payment by Y of an assumed liability, but is additional consideration paid by Y in the exchange for the properties acquired by Y. Thus, the acquisition of the X property for the Y voting stock and cash cannot qualify under section 368(a)(1)(C) of the Code unless section 368(a)(2)(B) of the Code applies.

For purposes of section 368(a)(2)(B) of the Code, Y constructively paid a total of 200x dollars in money to X (liabilities assumed in the amount of 150x dollars, plus 50x dollars paid to the dissenting shareholders). Therefore, Y received property of X having a fair market value of 1,800x dollars (gross assets in the amount of 2,000x dollars, less 200x dollars in money constructively paid to X) solely for voting stock of Y, which represents 90 percent of the fair market value of all of the X property.

Accordingly, in the instant case, since at least 80 percent of all the property of X was acquired solely for voting stock of Y, it is held that the transaction qualifies as a reorganization under sections 368(a)(1)(C) and (a)(2)(B) of the Code. Under section 361(b)(1)(A) of the Code, no gain is recognized to X upon the constructive receipt and distribution of 50x dollars to the dissenting shareholders. Under section 361(b)(2) of the Code, no loss is recognized to X. The cash received by the dissenting shareholders will be treated as a constructive distribution to them by X in redemption of their X stock subject to the provisions and limitations of section 302 of the Code.

Rev. Rul. 88-48, 1988-1 CB 117

ISSUE

If a transferor corporation sold 50 percent of its historic assets to unrelated parties for cash and immediately afterwards transferred to an acquiring corporation all of its assets (including the cash from the sale), did the subsequent transfer meet the “substantially all” requirement of section 368(a)(1)(C) of the Internal Revenue Code?

FACTS

X and Y were unrelated corporations that for many years were engaged in the hardware business. X operated two significant lines of business, a retail hardware business and a wholesale plumbing supply business. Y desired to acquire and continue to operate X's hardware business but did not desire to acquire the other business. Accordingly, pursuant to an overall plan, the following steps were taken. First, in a taxable transaction, X sold its entire interest in the plumbing supply business (constituting 50 percent of its total historic business assets) to purchasers unrelated to either X or Y or their shareholders. Second, X transferred all of its assets, including the cash proceeds from the sale, to Y solely for Y voting stock and the assumption of X 's liabilities. Finally, in pursuance of the plan of reorganization, X distributed the Y stock (the sole asset X then held) to <Page 118> the X shareholders in complete liquidation.

Except for the issue relating to the “substantially all” requirement, the transfer of assets from X to Y constituted a corporate reorganization within the meaning of section 368(a)(1)(C) of the Code.

LAW AND ANALYSIS

Section 368(a)(1)(C) of the Code defines a corporate reorganization to include the acquisition by one corporation, in exchange solely for all or part of its voting stock, of substantially all the properties of another corporation.

Section 368(a)(1)(C) of the Code is intended to accommodate transactions that are, in effect, mergers, but which fail to meet the statutory requirements that would bring them within section 368(a)(1)(A). See S. Rep. No. 558, 73d Cong., 2d Sess. 16, 17 (1939), 1939-1 C.B. (Pt. 2) 586, 598.

Congress intended that transactions that are divisive in nature not qualify under section 368(a)(1)(C) of the Code, but, instead, be subject to the tests under section 368(a)(1)(D). See S. Rep. No. 1622, 83d Cong., 2d Sess. 274 (1954). The enactment of section 368(a)(2)(G) indicates the continuing interest in furthering this underlying objective of preventing divisive “C” reorganizations.

Rev. Rul. 57-518, 1957-2 C.B. 253, concerns whether, in a “C” reorganization, assets may be retained to pay liabilities. The ruling states that what constitutes “substantially all” for purposes of section 368(a)(1)(C) of the Code depends on the facts and circumstances in each case. Rev. Rul. 57-518 exemplifies the Service's longstanding position that where some assets are transferred to the acquiring corporation and other assets retained, then the transaction may be divisive and so fail to meet the “substantially all” requirement of section 368(a)(1)(C). See also Rev. Rul. 78-47, 1978-1 C.B. 113.

In the present situation, 50 percent of the X assets acquired by Y consisted of cash from the sale of one of X's significant historic businesses. Although Y acquired substantially all the assets X held at the time of transfer, the prior sale prevented Y from acquiring substantially all of X 's historic business assets. The transaction here at issue, however, was not divisive. The sale proceeds were not retained by the transferor corporation or its shareholders, but were transferred to the acquiring corporation. Moreover, the prior sale of the historic business assets was to unrelated purchasers, and the X shareholders retained no interest, direct or indirect, in these assets. Under these circumstances, the “substantially all” requirement of section 368(a)(1)(C) was met because all of the assets of X were transferred to Y.

HOLDING

The transfer of all of its assets by X to Y met the “substantially all” requirement of section 368(a)(1)(C) of the Code, even though immediately prior to the transfer X sold 50 percent of its historic business assets to unrelated parties for cash and transferred that cash to Y instead of the historic assets.

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**Rev. Rul. 2003-79, 2003-2 CB 80**

Issue

Whether the acquisition by an unrelated corporation of all the assets of a newly formed controlled corporation following the distribution of the stock of the controlled corporation by a distributing corporation will satisfy the requirement of 368(a)(1)(C) of the Internal Revenue Code that substantially all of the properties of the acquired corporation be acquired where the assets of the controlled corporation represent less than substantially all of the assets that the distributing corporation held before it formed the controlled corporation.

Facts

D, a domestic corporation, directly conducts Business X and Business Y. Ds assets are equally divided between the two businesses. A, a domestic corporation unrelated to D, conducts Business X and wishes to acquire D's Business X, but not D's Business Y.

To accomplish the acquisition, D and A agree to undertake the following steps in the following order: (i) D will transfer its Business X assets to C, a newly formed domestic corporation, in exchange for 100 percent of the stock of C, (ii) D will distribute the C stock to D's shareholders, (iii) A will acquire all the assets of C in exchange solely for voting stock of A, and (iv) C will liquidate. Apart from the question of whether the acquisition of C's assets by A will satisfy the requirement of 368(a)(1)(C) that the acquiring corporation acquire substantially all of the properties of the acquired corporation, steps (i) and (ii) together meet all the requirements of 368(a)(1)(D), step (ii) meets all the requirements of 355(a), and steps (iii) and (iv) together meet all the requirements of 368(a)(1)(C).

Law

Section 355 provides that if certain requirements are met, a corporation may distribute stock and securities in a controlled corporation to its shareholders and security holders without causing the distributees to recognize gain or loss.

Section 368(a)(1)(C) defines a reorganization to include the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all of the properties of another corporation.

Section 368(a)(1)(D) defines a reorganization to include a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction that qualifies under 354, 355, or 356.

In Helvering v. Elkhorn Coal Co., 95 F.2d 732 [20 AFTR 1301](4 Cir. 1937), cert. denied, 305 U.S. 605, rehg denied, 305 U.S. 670 (1938), Elkhorn Coal, in anticipation of being acquired by Mill Creek, transferred part of its operating assets to a newly formed subsidiary and distributed the subsidiary’s stock to Elkhorn Coal's shareholders. The court concluded that the distribution of subsidiary stock prevented the subsequent acquisition from qualifying under a predecessor of 368(a)(1)(C) because, as a result of the distribution, Mill Creek did not acquire substantially all of Elkhorn Coal's historical assets.

In Commissioner v. Mary Archer W. Morris Trust, 367 F.2d 794 [18 AFTR 2d 5843](4th Cir. 1966), aff'g 42 T.C. 779 (1964), the taxpayer, in anticipation of a merger with a national bank, contributed its insurance business to a new subsidiary and distributed the subsidiary’s stock to its shareholders. The divestiture was necessary to comply with national banking laws. The court held that the distribution satisfied the requirements for nonrecognition under 355(a) and, therefore, that the contribution qualified as a reorganization under 368(a)(1)(D).

In Rev. Rul. 68-603, 1968-2 C.B. 148, the Internal Revenue Service announced that it would follow the decision in Mary Archer W. Morris Trust to the extent it held that (1) the active business requirements of 355(b)(1)(A) were satisfied even though the distributing corporation, immediately after the spin-off, merged into the unrelated acquiring corporation, (2) the control immediately after requirement of 368(a)(1)(D) implies no limitation upon a reorganization of the transferor corporation (the distributing corporation) after the distribution of the stock of the controlled corporation, and (3) there was a business purpose for the spin-off and the merger.

Rev. Rul. 98-27, 1998-1 C.B. 1159, states that the Service will not apply any formulation of the step transaction doctrine to determine whether the distributed corporation was a controlled corporation immediately before a distribution under 355(a) solely because of any post-distribution acquisition or restructuring of the distributed corporation, whether prearranged or not. The holding of Rev. Rul. 98-27 is based on § 1012(a) and §1012(c) of the Taxpayer Relief Act of 1997 (the “1997 Act”), Pub. L. No. 105-34, 111 Stat. 788, 916-17. Section 1012(c) amended the control requirements of 368(a)(1)(D) and 351 to provide that, generally for transactions seeking qualification after August 5, 1997, under either provision and 355, the shareholders of the distributing corporation must own stock possessing more than 50 percent of the voting power and more than 50 percent of the total value of the controlled corporation's stock immediately after the distribution. See §§ 368(a)(2)(H) and 351(c). Section 1012(a) amended 355 by adding subsection (e), which provides rules for the recognition of gain on certain distributions of stock or securities of a controlled corporation in connection with acquisitions of stock representing a 50 percent or greater interest in the distributing corporation or any controlled corporation.

The Conference Report accompanying the 1997 Act states, in part, that:

The . . . bill does not change the present-law requirement under section 355 that the distributing corporation must distribute 80 percent of the voting power and 80 percent of each other class of stock of the controlled corporation. It is expected that this requirement will be applied by the Internal Revenue Service taking account of the provisions of the proposal regarding plans that permit certain types of planned restructuring of the distributing corporation following the distribution, and to treat similar restructurings of the controlled corporation in a similar manner. Thus, the 80-percent control requirement is expected to be administered in a manner that would prevent the tax-free spin-off of a less-than-80-percent controlled subsidiary, but would not generally impose additional restrictions on post-distribution restructurings of the controlled corporation if such restrictions would not apply to the distributing corporation.

H.R. Rep. No. 105-220, at 529-30 (1997); 1997-4 C.B. 1457, at 1999-2000.

Section 6010(c)(2) of the Internal Revenue Service Restructuring and Reform Act of 1998 (the 1998 Act), P.L. 105-206, 1998-3 C.B. 145, amended 1012(c) of the 1997 Act to provide that, in the case of a 368(a)(1)(D) or 351 transaction that is followed by a 355 transaction, solely for purposes of determining the tax treatment of any transfer of property by the distributing corporation to the controlled corporation, the fact that the shareholders of the distributing corporation dispose of part or all of the controlled corporation's stock after the 355 distribution shall not be taken into account in determining whether the control requirement of either 368(a)(1)(D) or 351 has been satisfied.

The Senate Report accompanying the 1998 Act contains three examples in which distributing corporation D transfers appreciated business X to newly created subsidiary C in exchange for at least 85 percent of the C stock and then distributes its C stock to the D shareholders. As part of the same plan, C then merges into unrelated acquiring corporation A. Each example concludes that if the distribution satisfies the requirements of 355, the control immediately after requirement will be satisfied solely for purposes of determining the tax treatment of the transfer of business X by D to C. See S. Rep. No. 105-174, at 173-176 (1998); 1998-3 C.B. 537, at 709-712.

Analysis

Section 1012 of the 1997 Act, as amended by 6010(c) of the 1998 Act, evidences the intention of Congress that a corporation formed in connection with a distribution that qualifies for nonrecognition under 355 will be respected as a separate corporation for purposes of determining (i) whether the corporation was a controlled corporation immediately before the distribution and (ii) whether a pre-distribution transfer of property to the controlled corporation satisfies the requirements of 368(a)(1)(D) or 351, even if a post-distribution restructuring causes the controlled corporation to cease to exist. See Rev. Rul. 98-44, 1998-2 C.B. 315; Rev. Rul. 98-27, supra; S. Rep. No. 105-174, supra. Therefore, the controlled corporation should also be considered independently from the distributing corporation in determining whether an acquisition of the controlled corporation will qualify as a reorganization under 368. Accordingly, in determining under 368(a)(1)(C) whether an acquiring corporation has acquired substantially all of the properties of a newly formed controlled corporation, reference should be made solely to the properties held by the controlled corporation immediately following the distributing corporation's transfer of properties to the controlled corporation, rather than to the properties held by the distributing corporation immediately before its formation of the controlled corporation.

Hence, the acquisition by A of all the properties held by C immediately after the distribution will satisfy the requirement of 368(a)(1)(C) that A acquire substantially all the properties of C. This result obtains even though an acquisition by A of the same properties from D would have failed this requirement if D had retained Business X, contributed Business Y to C, and distributed the stock of C. See Helvering v. Elkhorn Coal Co., supra.

Holding

The acquisition by an unrelated corporation of all the assets of a newly formed controlled corporation following the distribution of the stock of the controlled corporation by a distributing corporation will satisfy the requirement of 368(a)(1)(C) that substantially all of the properties of the acquired corporation be acquired where the assets of the controlled corporation represent less than substantially all of the assets that the distributing corporation held before it formed the controlled corporation.

Drafting Information

The principal author of this revenue ruling is Gene Raineri of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, please contact Mr. Raineri at (202) 622-7530 (not a toll-free call).

**Rev. Proc. 77-37, 1977-2 CB 568**

Headnote:

Rev. Proc. 77-37, 1977-2 CB 568 [CAUTION: This Rev Proc has been amplified by Rev Proc 77-41, 1977-2 CB 574, Rev Proc 82-23, 1982-1 CB 474, Rev Proc 83-81, 1983-2 CB 598, Rev Proc 84-42, 1984-1 CB 521, Rev Proc 86-42, 1986-2 CB 722, and Rev Proc 89-50, 1989-2 CB 631, superseded in part by Rev Proc 79-14, 1979-1 CB 496, revoked by Rev Proc 89-30, 1989-1 CB 895, and modified by TD 8760, 1998-1 CB 803 and TD 8761, 1998-1 CB 812.]

Reference(s): Code Sec. 354; Code Sec. 368; Code Sec. 306; Reg § 601.201

Full Text:

1. Purpose

.01. The purpose of this Revenue Procedure is to update Rev. Proc. 74-26, 1974-2 C.B. 478, which sets forth certain operating rules of the Internal Revenue Service pertaining to issuing ruling letters and in determining whether it should decline to issue ruling letters.

.02. This Revenue Procedure incorporates the amplifications and clarifications made to Rev. Proc. 74-26 by Rev. Proc. 75-24, 1975-1 C.B. 719, Rev. Proc. 76-22, 1976-1 C.B. 562, Rev. Proc. 76-26, 1976-2 C.B. 643, and Rev. Proc. 77-27, 1977-2 C.B. 537. Rev. Proc. 75-24 clarified the “substantially all” requirement of section 355(b)(2)(A) of the Code contained in Sec. 3.04; Rev. Proc. 76-22 amplified Sec. 3 by adding subsection.07 to quantify the “relatively small” test of section 1.351-1(a)(1)(ii) of the regulations; Rev. Proc. 76-26 superseded Rev. Proc. 75-11, 1975-1 C.B. 652, by expanding new subsection .06 of Sec. 3 to cover stock escrows and turn back arrangements; and Rev. Proc. 77-27, 1977-2 C.B. 537, added rules relating to certain ruling requests under section 341(b), which have been incorporated herein as Sec. 6.

.03. In addition, this Revenue Procedure changes the first sentence of Sec. 4 to make it clear that less than one percent common stock ownership referred to therein means the aggregate common stock ownership of all shareholders receiving convertible preferred stock in the reorganization.

2. Background

.01. When requested by taxpayers or their authorized representatives, the Reorganization Branch of the Corporation Tax Division issues ruling letters as to the tax consequences of corporate reorganizations, liquidations, stock dividends and redemptions; transfers to and distributions of stock or securities of controlled corporations; exchanges or distributions by corporations in obedience to orders of the Securities and Exchange Commission; and distributions by corporations pursuant to the Bank Holding Company Act. The Reorganization Branch also determines whether distributions, redemptions, exchanges or transfers referred to in sections 306(b)(4), 355(a)(1)(D)(ii), 367, 1492, and 1494 of the Internal Revenue Code of 1954 are in pursuance of a <Page 569> plan having as one of its principal purposes the avoidance of Federal income taxes and answers questions under section 1244 relating to small business stock. In addition, the Reorganization Branch issues ruling letters concerning transactions involving collapsible corporations under section 341 and special limitations on net operating loss carryovers under section 382.

.02. The Reorganization Branch has developed certain operating rules for determining whether a ruling will be issued in certain types of cases and the conclusions which will be expressed in such rulings.

.03. These operating rules are being published solely to provide assistance to taxpayers and their representatives in preparing ruling requests. These operating rules do not define, as a matter of law, the lower limits of “continuity of interest” or “substantially all of the properties”; nor do they define any other terms used in the Internal Revenue Code, Income Tax Regulations and prior Revenue Procedures discussed below.

.04. A requested ruling involving a question covered in Sec. 3 of this Revenue Procedure will ordinarily be issued if the applicable operating rule or rules set forth in Sec. 3 of this Revenue Procedure are complied with and if all other pertinent provisions of the Internal Revenue Code, Income Tax Regulations, Revenue Procedures and Revenue Rulings are satisfied.

3. Operating Rules for Issuing Ruling Letters

.01. The “substantially all” requirement of sections 354(b)(1)(A), 368(a)(1)(C), 368(a)(2)(B)(i), 368(a)(2)(D), and 368(a)(2)(E)(i) of the Code is satisfied if there is a transfer (and in the case of a surviving corporation under section 368(a)(2)(E)(i), the retention) of assets representing at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by the corporation immediately prior to the transfer. All payments to dissenters and all redemptions and distributions (except for regular, normal distributions) made by the corporation immediately preceding the transfer and which are part of the plan of reorganization will be considered as assets held by the corporation immediately prior to the transfer.

.02. The “continuity of interest” requirement of section 1.368-1(b) of the Income Tax Regulations is satisfied if there is continuing interest through stock ownership in the acquiring or transferee corporation (or a corporation in “control” thereof within the meaning of section 368(c) of the Code) on the part of the former shareholders of the acquired or transferor corporation which is equal in value, as of the effective date of the reorganization, to at least 50 percent of the value of all of the formerly outstanding stock of the acquired or transferor corporation as of the same date. It is not necessary that each shareholder of the acquired or transferor corporation receive in the exchange stock of the acquiring or transferee corporation, or a corporation in “control” thereof, which is equal in value to at least 50 percent of the value of his former stock interest in the acquired or transferor corporation, so long as one or more of the shareholders of the acquired or transferor corporation have a continuing interest through stock ownership in the acquiring or transferee corporation (or a corporation in “control” thereof) which is, in the aggregate, equal in value to at least 50 percent of the value of all of the formerly outstanding stock of the acquired or transferor corporation. Sales, redemptions, and other dispositions of stock occurring prior or subsequent to the exchange which are part of the plan of reorganization will be considered in determining whether there is a 50 percent continuing interest through stock ownership as of the effective date of the reorganization.

.03. In reorganizations under sections 368(a)(1)(A), 368(a)(1)(B), and 368(a)(1)(C) of the Code where the requisite stock or property has been acquired, it is not necessary that all of the stock of the acquiring corporation or a corporation in “control” thereof, which is to be issued in exchange therefor, be issued immediately provided (1) that all of the stock will be issued within five years from the date of the transfer of assets in the case of reorganizations under sections 368(a)(1)(A) and 368(a)(1)(C), or within five years from the date of the initial distribution in the case of reorganization under section 368(a)(1)(B). (2) there is a valid business reason for not issuing all of the stock immediately, such as the difficulty in determining the value of one or both of the corporations involved in the reorganization; (3) the maximum number of shares which may be issued in the exchange is stated; (4) at least fifty percent of the maximum number of shares of each class of stock which may be issued is issued in the initial distribution; (5) the agreement evidencing the right to receive stock in the future prohibits assignment (except by operation of law) or, in the alternative, if the agreement does not prohibit assignments, the right must not be evidenced by negotiable certificates of any kind and must not be readily marketable; and (6) such right can give rise to the receipt of only additional stock of the acquiring corporation or a corporation in “control” thereof, as the case may be. Stock issued as compensation, royalties or any other consideration other than in exchange for stock or assets will not be considered to have been received in the exchange. Until the final distribution of the total number of shares of stock to be issued in the exchange is made, the interim basis of the stock of the acquiring corporation received in the exchange by the shareholders of the acquired corporation (not including that portion of each share representing interest) will be determined, pursuant to section 358(a), as though the maximum number of shares to be issued (not including that portion of each share representing interest) had been received by the shareholders.<Page 570>

.04. The “substantially all of its assets” requirement of section 355(b)(2)(A) of the Code is satisfied if at least 90 percent of the fair market value of the gross assets of the corporation (assets undiminished by liabilities) consists of stock and securities of controlled corporations which are engaged in the active conduct of a trade or business as defined in section 355(b)(2).

.05. In determining stock ownership to be attributed to a trust or from a trust under the rules of sections 318(a)(2)(B)(i) and 313(a)(3)(B)(i) of the Code in those cases where a surviving spouse is entitled to all the income for life from the trust and also holds a power of appointment over the corpus of the trust, and in default of the exercise of the power the property held by the trust is to pass to the children of the surviving spouse, attribution will be computed as if the surviving spouse has exercised the power in favor of his or her children, so that they will be considered beneficiaries in the absence of evidence that the power has been differently exercised.

.06. In reorganizations under sections 368(a)(1)(A), 368(a)(1)(B), and 368(a)(1)(C) of the Code where the requisite stock or property has been acquired, a portion of the stock of the acquiring corporation, or a corporation in “control” thereof, that is issued in the exchange may be placed in escrow by the exchanging shareholders, or may otherwise be made subject to a condition pursuant to the agreement or plan of reorganization, for possible return to the acquiring corporation under specified conditions provided (1) there is a valid business reason for establishing the arrangement; (2) the stock subject to such arrangement appears as issued and outstanding on the balance sheet of the acquiring corporation and such stock is, in fact, legally outstanding under applicable state law; (3) all dividends paid on such stock will be distributed currently to the exchanging shareholders; (4) all voting rights of such stock (if any) are exercisable by or on behalf of the shareholders or their authorized agent; (5) no shares of such stock are subject to restrictions requiring their return to the issuing corporation because of death, failure to continue employment or similar restrictions; (6) all such stock is released from the arrangement within 5 years from the date of consummation of the reorganization (except where there is a bona fide dispute as to whom the stock should be released to); and (7) at least 50 percent of the number of shares of each class of stock issued initially to the shareholders (exclusive of shares of stock to be issued at a later date as described in.03 above) is not subject to the arrangement.

.07. When a person transfers property to a corporation in exchange for stock or securities of such corporation and the primary purpose of the transfer is to qualify under section 351 of the Code the exchanges of property by other persons transferring property, the property transferred will not be considered to be of relatively small value, within the meaning of section 1.351-1(a)(1)(ii) of the regulations, if the fair market value of the property transferred is equal to, or in excess of, 10 percent of the fair market value of the stock and securities already owned (or to be received for services) by such person.

4. Rulings with Respect to Convertible Stock

A ruling will usually be issued to the effect that preferred stock that is convertible into common stock which is received in a reorganization by exchanging shareholders, who will receive no common stock as a result of the reorganization and who in the aggregate will own after the reorganization less than one percent of the common stock of the corporation issuing the convertible preferred stock, will not be “section 306 stock,” within the meaning of section 306(c) of the Code, provided the convertible preferred stock will be widely held or it is represented that there will not be any conversion of the convertible preferred stock pursuant to a concerted plan which will result in both preferred and common stock being held by an exchanging shareholder. In all other cases, opinion will be reserved as to what part, if any, of the convertible preferred stock will constitute “section 306 stock,” unless the conditions of Section 5 of this Revenue Procedure would apply if the convertible preferred stock is assumed to be “section 306 stock.”

5. Rulings Under

Section 306(b)(4) of the Code

.01. A ruling will usually be issued under section 306(b)(4) of the Code to the effect that a distribution of “section 306 stock” (other than a distribution under section 305, or, in the case of any recapitalization under section 368(a)(1)(E), a distribution which has the effect of a pro rata stock dividend, that is, a distribution under section 305) and the disposition or redemption of the “section 306 stock” is not pursuant to a plan of tax avoidance if the stock of the issuing corporation is widely held and

(a) the “section 306 stock” is not by its terms redeemable for at least five years from the date of issuance; and

(b) it is represented that there will be no redemption of the “section 306 stock,” by tender or otherwise, within the five-year period.

.02. A ruling will usually be issued under section 306(b)(4) of the Code to the effect that a distribution of “section 306 stock” (other than a distribution under section 305, or, in the case of any recapitalization under section 368(a)(1)(E), a distribution which has the effect of a pro rata stock dividend, that is, a distribution under section 305) and the disposition of the “section 306 stock,” other than by redemption and other than in anticipation of a redemption, is not pursuant to a plan of tax avoidance if the stock of the issuing corporation is widely held and

1(a) the “section 306 stock” is by its terms redeemable within five years from the date of issuance, or<Page 571>

(b) the “section 306 stock” is not redeemable within five years from the date of issuance but the issuing corporation will not represent that there will be no redemption (as a result of a change in the terms of the stock, an invitation for tenders or otherwise) within five years from the date of issuance.

6. Rulings Under Section 341(b) of the Code.

All of the facts and circumstances will be considered in a request for a ruling that a corporation has not been “formed or availed of” with a view to the action described in section 341(b) of the Code, and therefore, is not a “collapsible corporation” as defined in section 341(b), when the enterprise (1) has been in existence for at least 20 years, (2) has had substantially the same owners during that period, and (3) has conducted substantially the same trade or business during that period.

7. Effect on Other Documents

Rev. Proc. 74-26, Rev. Proc. 75-24, Rev. Proc. 76-22, and Rev. Proc. 76-26 are superseded. Rev. Proc. 77-27 is superseded in part insofar as it amplifies Rev. Proc. 74-26.

8. Inquiries

Inquiries in regard to this Revenue Procedure should refer to its number and should be addressed to the Assistant Commissioner (Technical), Attention: T:C:R, Internal Revenue Service, Washington, D.C. 20224.