



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

OFFICE OF  
CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR WILLIAM C. SHOUSE  
SENIOR ATTORNEY CC:SER

FROM: STEVEN J. HANKIN  
CHIEF, CORPORATE BRANCH, FIELD SERVICE DIVISION  
CC:DOM:FS:CORP

SUBJECT:

This Field Service Advice responds to your memorandum dated October 22, 1998. 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.

LEGEND:

Seller A =  
Seller B =  
Seller C =

For-profit Corporation 1 =  
For-profit Corporation 2 =  
For-profit Corporation 3 =

Taxpayer =  
Buyer A =  
Buyer B =

Buyer C =  
Corporation X =

ISSUE:

Whether the transfer by a tax-exempt corporation of its assets into a newly formed, wholly-owned subsidiary followed thereafter by the sale, pursuant to a pre-existing binding commitment, of the subsidiary's stock to an unrelated corporation qualifies under I.R.C. § 351.

CONCLUSION:

No. The transfer by a tax-exempt corporation of its assets into a newly formed, wholly-owned subsidiary followed thereafter by the sale of the subsidiary's stock to an unrelated corporation, pursuant to a pre-existing binding commitment, does not qualify under I.R.C. § 351.

FACTS:

Taxpayer is the parent of a consolidated group. Members of Taxpayer's consolidated group engaged in three substantially similar transactions.

The first transaction involved Seller A, For-profit Corporation 1, and Buyer A. The second transaction involved Seller B, For-profit Corporation 2, and Buyer B. The third transaction involved Seller C, For-profit Corporation 3, and Buyer C and Corporation X. Since the forms of all three transactions are essentially the same,<sup>1</sup> Seller A, B, and C will all be referred to as Seller, For-profit Corporation 1, 2 and 3 will all be referred to as For-profit Corporation, and Buyer 1, 2 and 3 will be referred to as Buyer.

Seller, a tax-exempt entity, entered into a sales agreement with Buyer, an unrelated corporation, to sell the stock of For-profit Corporation to Buyer. Seller transferred assets to For-profit Corporation in exchange for all of the stock of For-profit Corporation and, pursuant to a binding commitment, immediately sold the stock of For-profit Corporation to Buyer.

In Taxpayer's view, the obligation to transfer caused the incorporation and stock sale transactions to be collapsed together, with the result that Seller, an entity that has been recognized by the Service as tax exempt under I.R.C. § 501(c)(3), was not in control of For-profit Corporation immediately after the transfer of the assets. Thus, the transaction does not qualify under I.R.C. § 351 and Seller instead is treated as having sold the assets to Buyer. Seller realized gain on the transfer of the assets, but was exempted from taxation on this gain. Buyer took a fair market

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<sup>1</sup>The one exception is transaction 3, which varies only slightly from the other two. In transaction 3, Seller C sells For-profit Corporation 3 to Buyer C, and about 6 months later, For-profit Corporation 3 contributes some of the assets to Corporation X, an entity owned by Corporation 3.

value basis in the assets and contributed them to For-profit Corporation in exchange for For-profit Corporation stock.



#### LAW AND ANALYSIS:

I.R.C. § 351(a) provides that no gain or loss will be 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(s) are in control (as defined in § 368(c)) of the corporation.

I.R.C. § 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.

I.R.C. § 362(a) provides that a corporation’s basis in property acquired in a transaction to which § 351 applies will be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on the transfer.

In Rev. Rul. 70-140, 1970-1 C.B. 73, A, an individual, transferred the assets of his sole proprietorship to corporation X, which, pursuant to an integrated plan, was acquired by Y, an unrelated corporation, in an I.R.C. § 368(a)(1)(B) reorganization. Disregarding the transfer from A to X, the ruling held that A had, in effect, transferred his sole proprietorship assets directly to Y followed by a transfer of the assets from Y to the capital of X. I.R.C. § 351 was not applicable to the transfer of the assets from A to Y because A was not in control of Y immediately after the transfer.

I.R.C. § 351 requires the transferor to be in “control” (within the meaning of § 368(c)) of the corporation immediately after the exchange. The Service has adopted the position that the I.R.C. § 368(c) “control” requirement is not met in the case of § 351 transactions when the transferor has a binding commitment to sell stock, if such sale would leave the transferor with insufficient stock to satisfy the I.R.C. § 368(c) control test. See e.g., Rev. Rul. 83-23, 1983-1 C.B. 82; Rev. Rul. 79-194, 1979-1 C.B. 145; Rev. Rul. 79-70, 1979-1 C.B. 144; Rev. Rul. 78-294, 1978-2 C.B. 41; Rev. Rul. 70-522, 1970-2 C.B. 81; Intermountain Lumber Company v. Commissioner, 65 T.C. 1025 (1976).

In order to comply with the sales agreement, Seller was obligated to immediately dispose of the stock of For-profit Corporation to Buyer. Since the two steps of the transaction here were taken pursuant to a binding commitment, they may not be considered independently of each other for federal income tax purposes. We conclude, therefore, that the statutory requirement of I.R.C. § 351 is not met here because the transfer of the assets to For-profit Corporation was pursuant to a binding commitment to sell the stock of For-profit Corporation to Buyer. Thus, the Seller, the transferor, did not have the necessary "control" to make I.R.C. § 351 applicable to this case.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS: None.

Please let us know if you have any further questions.

cc: Assistant Regional Counsel (LC) CC  
Assistant Regional Counsel (TC) CC