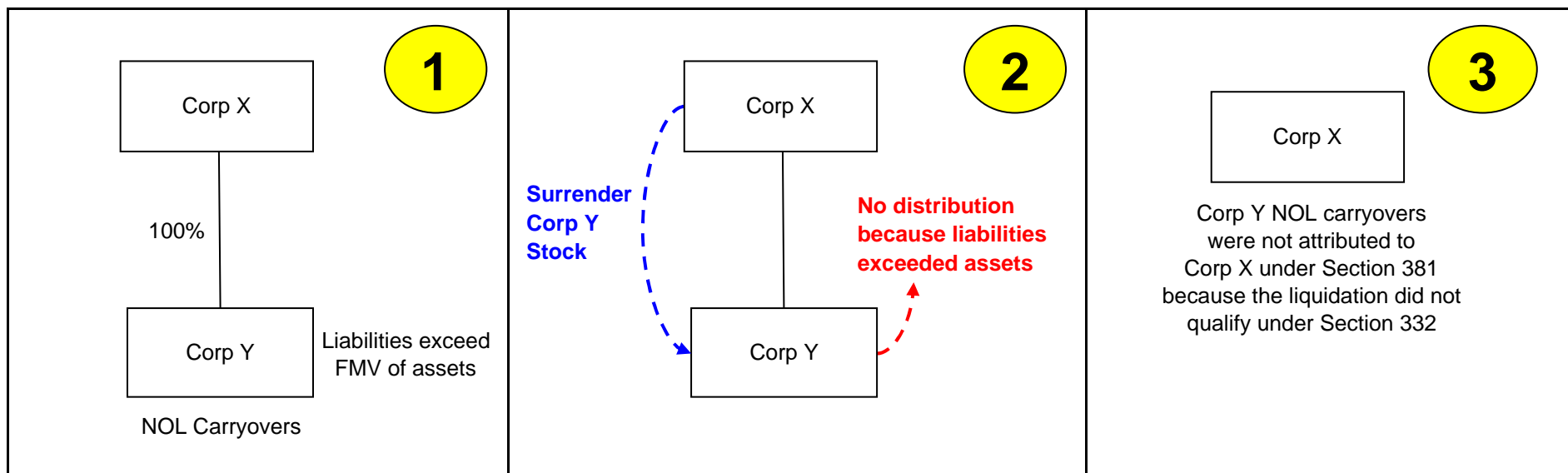


Initial Structure

Liquidation

Ending Point



Y corporation was a wholly-owned subsidiary of X corporation. Pursuant to a plan of liquidation and within the taxable year of its adoption, Y distributed all of its property to X and X assumed all of Y's liabilities. The liabilities of Y exceeded the fair market value of its assets on the date of distribution. Y had sustained operating losses in prior years that resulted in a net operating loss carryover as of the date of distribution. X now desires to avail itself of Y's net operating loss carryover under the provisions of section 381. Section 381(a)(1) provides, in part, that in the case of the acquisition of assets of a corporation in a distribution to which section 332 applies then, under section 381(c), the net operating losses of the distributor corporation may be carried over and deducted from the taxable income of the acquiring corporation.

Reg. 1.332-2(b) provides that section 332 applies only to those cases in which the recipient corporation receives at least partial payment for the stock that it owns in the liquidating corporation. Since the liabilities of Y on the date of distribution exceeded the fair market value of its assets, X assumed a net liability of Y. Therefore, since the assets of Y were insufficient to pay its liabilities, X received no payment for the Y stock that it owned and the transaction does not qualify as a distribution under section 332.

Accordingly, under the circumstances of this case, since the distribution by Y of all its properties to its parent X does not qualify as a liquidation under section 332, the net operating loss of Y may not be carried over and availed of by X under section 381.