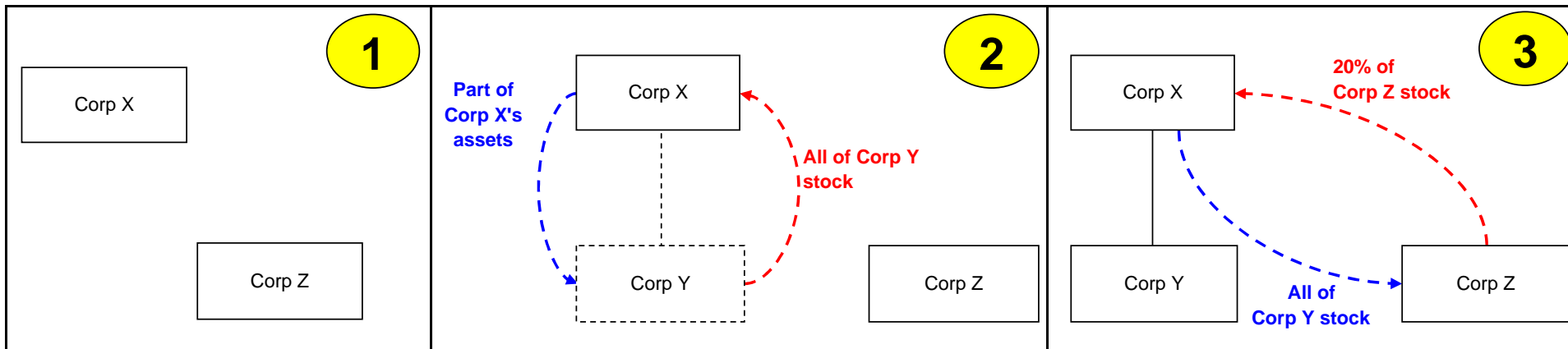


Busted 351: Two-step Exchange

Initial Structure

Contribution

Stock Exchange



Under the facts presented in Revenue Ruling 54-96, X corporation organized a new corporation Y, transferring part of its assets in exchange for all stock of Y. X thereafter, as part of a prearranged plan, transferred all of the stock of Y to an unrelated corporation, Z, in exchange for which Z issued to X 20 percent of Z's voting stock.

The Service held that the two steps were part of a prearranged, integrated plan and may not be considered independently of each other. Consequently, since X corporation was not in control of the Y corporation after transferring a part of its assets to that corporation, it did not constitute a reorganization as defined in the predecessor to section 368, nor did it constitute a tax-free transfer under the predecessor to section 351. The last two sentences of Revenue Ruling 54-96 read as follows:

The basis of the stock of Y in the hands of Z will be its fair market value at the time it is received by Z. The basis to Y corporation of the assets received by Y will be their fair market value at the time of receipt.

The above-quoted statements in Revenue Ruling 54-96, relating to the basis of the Y stock in the hands of Z and the basis of the assets received by Y, are based on the assumption that the three parcels of property involved (the assets transferred to Y, the Y stock, and the Z stock) all have the same fair market value. The quoted statements are not applicable to any case in which this assumption is incorrect.

Since the prior ruling may give the impression that evidence as to the fair market value of the assets is directly controlling, the last two sentences of Revenue Ruling 54-96, are revised to read as follows: "Under the facts of the instant case the basis to Y of the assets of X received by it and the basis to Z of the Y stock will both be the same as the fair market value of the Z stock received by X."

Ending Point

