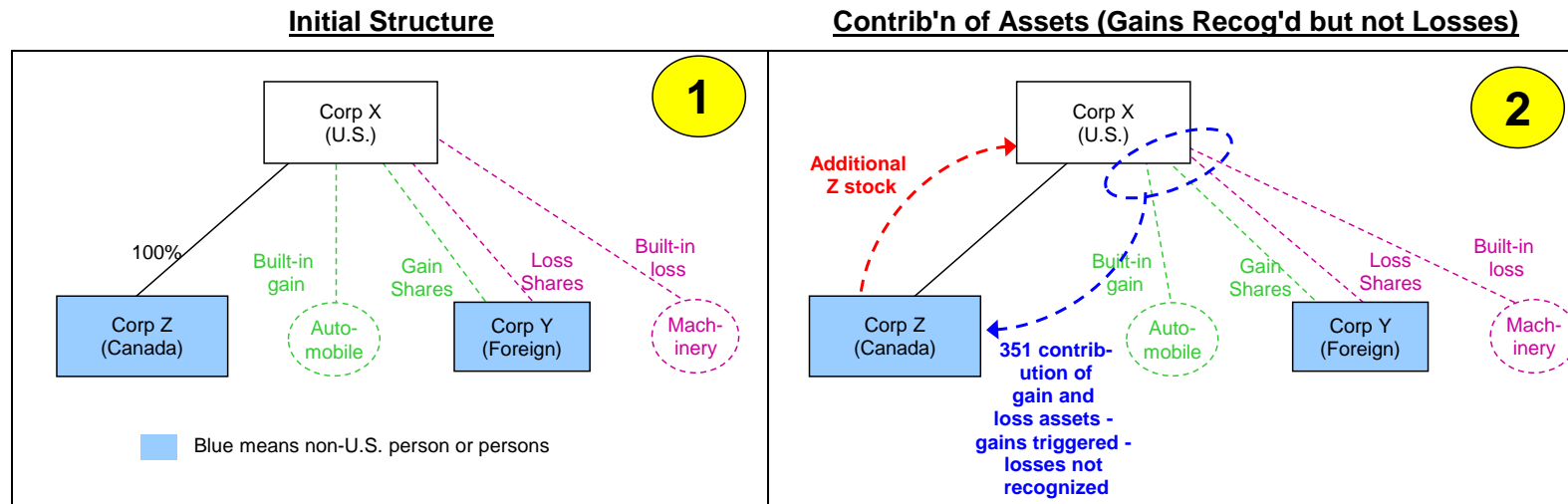


Section 367 Triggers Gain, but not Loss, in Outbound 351 Transaction



Corp X, a domestic corporation, transferred an automobile and a piece of machinery used in its business and 1000 shares of stock of foreign corporation Corp Y to Corp Z, a wholly owned foreign subsidiary operating a business in Canada in exchange for additional Corp Z stock. The automobile had a market value in excess of its adjusted basis for Federal income tax purposes, but the value of the machinery was less than its adjusted basis. The shares of Corp Y had been purchased by Corp X on several occasions. As a result, Corp X's basis in some of the Corp Y stock was greater than the fair market value of the Corp Y stock, and Corp X's basis in the remainder of the Corp Y stock was less than its fair market value. Prior to the exchange, Corp X had not, pursuant to section 367, established to the satisfaction of the Commissioner that the exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes [old rules].

Under section 351 no gain or loss is recognized if property is transferred to a corporation in exchange for its stock if immediately after the exchange the transferor is in control of the corporation. Under section 367, however, the nonrecognition provisions of section 351 are not applicable to the gains where a taxpayer has not established to the satisfaction of the Commissioner that the exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax [old rules]. Consequently, the realized gain on the transfer of the property from Corp X to Corp Z was recognized.

In determining the amount of gain to be recognized, each item of property transferred is considered to have been separately exchanged. See *Aaron F. Williams v. McGowan*, 152 F. 2d 570 (1945) and *United States Holding Co.*, 44 T.C. 323 (1965). Accordingly, in determining the amount of gain recognized, each item of property transferred in the above-described transaction is to be treated as the subject of a separate exchange. Thus, the realized gain on the transfer of the automobile and the appreciated shares of Corp Y stock is to be recognized without regard to section 351.

Since section 367 applies only to those transactions upon which gain is realized, the loss realized on the exchange of those shares of Corp Y stock which have a basis greater than their fair market value and the loss realized on the exchange of machinery will not be recognized under the provisions of section 351.