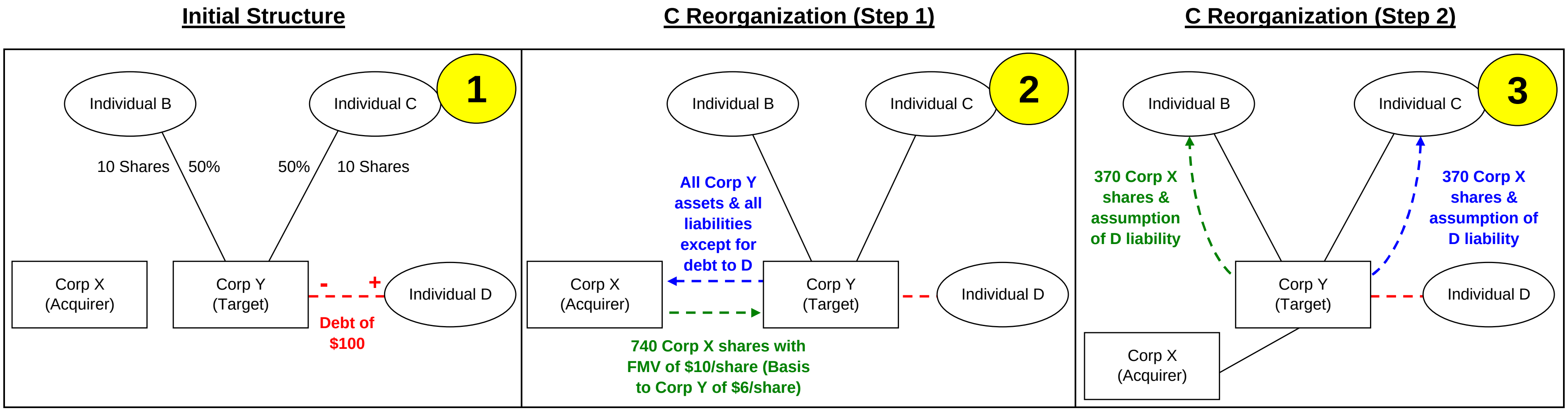
Revenue Ruling 70-271, Situation 3

C Reorg: Shareholders Assume Corp Liabilities



Individuals B and C each owned ten of the twenty shares of corporation Y's only class of outstanding stock. Corporation X, pursuant to a plan of reorganization described in section 368(a)(1)(C), acquired all the assets of corporation Y solely in exchange for 740 shares of X voting stock having a fair market value of 10x dollars per share and the assumption by X of all but one of the liabilities of Y. Y's basis in the shares of X was 6x dollars per share pursuant to the provisions of section 358. Pursuant to the plan Y dissolved. An outstanding indebtedness in the amount of 100x dollars was owed by Y to D, an individual who held no stock in Y. Neither B nor C was a creditor of Y. After the exchange of its assets for the stock of X, Y transferred 370 shares of X stock to each of its two shareholders, B and C who simultaneously assumed the 100x dollars indebtedness of Y to D. Their shares of stock in Y were cancelled.

The assumption by B and C of a liability of Y in the amount of 100x dollars does not result in the recognition of gain to Y since the assumption is viewed as a capital expenditure by B and C resulting in an additional investment in the stock of X. Reg. 1.263(a)-2(f). See Revenue Ruling 67-411, where the payment by shareholders of liabilities of an acquired corporation following a reorganization under section 368(a)(1)(C) was treated as a capital investment in the stock of the acquiring corporation.