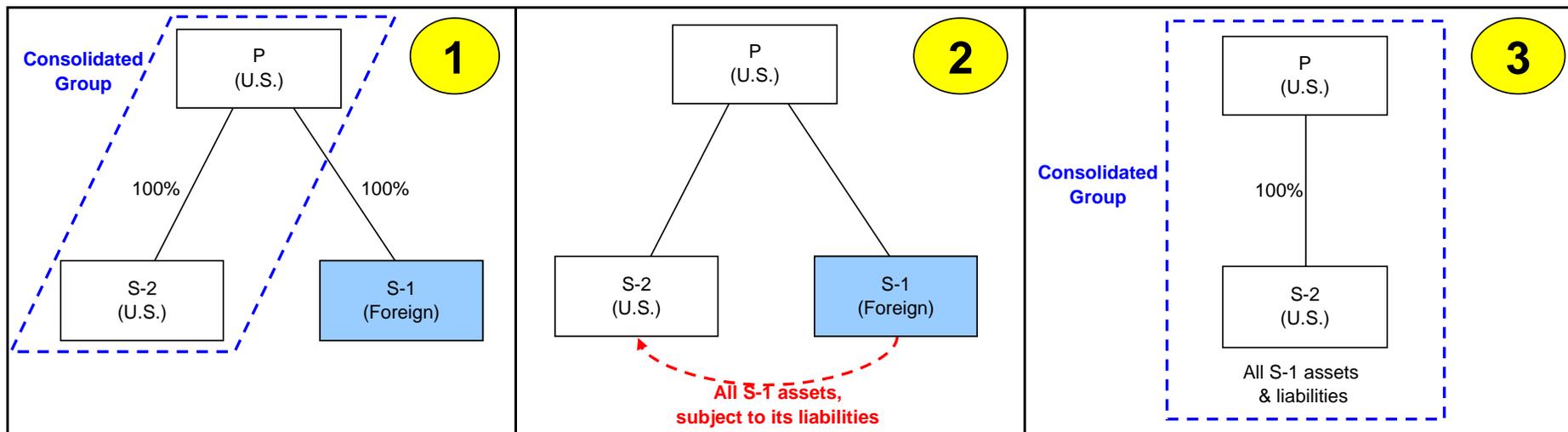


Initial Structure

S-1 Transfers Assets to S-2

Ending Point



Reg. 1.1502-34 provides in part:

For purposes of §§1.1502-1 through 1.1502-80, in determining the stock ownership of a member of the group in another corporation (the "issuing corporation) for purposes of determining the application of section . . . 332(b)(1) . . . , there shall be included stock owned by all other members of the group in the issuing corporation. Thus, assume that members A, B, and C each own 33 1/3 percent of the stock issued by D. In such case, A, B, and C shall each be treated as meeting the 80-percent stock ownership requirement for purposes of section 332

The issue in the ruling was whether S-2 was deemed to own the shares of S-1 pursuant to Reg. 1.1502-34, such that S-1's transfer of its assets and liabilities to S-2 would be treated as a section 332 liquidation. The ruling holds that Reg. 1.1502-34 does not attribute the stock of S-1 to S-2 for purposes of determining the applicability of section 332(b)(1), "since S-2 does not own any stock of S-1".

Rev. Rul. 89-46, modifying Rev. Rul. 74-598, agrees that Rev. Rul. 74-598 was correct in its ultimate conclusion that section 332 does not apply. However, Rev. Rul. 89-46 holds that it is not because S-2 did not own any stock of S-1. Rather, the ruling holds that the transfer does not meet the requirement of section 332(b)(2) or (3) that the distribution be in complete cancellation or redemption of the liquidating corporation's stock. It is important to note that while Reg. 1.1502-34 may make section 332 applicable to make the transaction nontaxable to the shareholders, the regulation does not apply to nonrecognition treatment at the corporate level under section 337. See section 337(c).

In Revenue Ruling 75-383, it was held, under facts identical to those above, that the transaction qualified as an "inbound" section 368(a)(1)(D) reorganization, provided that the transaction meets the business purpose and continuity of interest requirements.