Individual A owned all the stock of X corporation, which was incorporated in State O. Individual B, who is unrelated to A, owned all the stock of Y corporation, which was incorporated in State P. A and B determined that the businesses operated by X and Y could be improved if their interests in X and Y were combined while at the same time preserving the separate corporate existence of X and Y. A and B also decided that the laws of State P were more favorable to the operation of the combined enterprise. To carry out their plan, A and B transferred all of their stock in X and Y to a newly organized corporation, Z, incorporated in State P, in exchange for, respectively, 60 percent and 40 percent of all of the outstanding stock of Z. In addition, B received from Z 10x dollars in cash. The consideration received by A and B was in each case equal to the fair market value of the stock exchanged. As part of this plan, X then distributed all of its assets to Z in complete liquidation, and Y remained as a wholly owned subsidiary of Z.

The transfer by A of A’s X stock to Z and, as part of the overall transaction, the liquidation of X by Z are interdependent steps in an overall reorganization plan the substance of which is treated for Federal income tax purposes as an acquisition by Z of all of the assets of X solely in exchange for Z voting stock in a transaction qualifying as a reorganization under section 368(a)(1)(C), followed by a distribution by X of the Z stock to A in exchange for all of A’s X stock. Accordingly, no gain or loss is recognized by X upon the exchange of its property solely for Z stock as provided by section 361(a), and no gain or loss is recognized to A on the exchange of A’s X stock solely for voting stock of Z as provided in section 354(a).

Furthermore, the transfer by X of its property to Z in liquidation and the transfer by B of B’s Y stock to Z is a transaction within the provisions of section 351(a) since X and B are in control of Z immediately after the exchanges within the meaning of section 368(c). Pursuant to section 351(c) of the distribution by X of the Z stock to A does not violate the control requirement of section 368(c). Accordingly, no loss is recognized to B and no gain is recognized to B in excess of the 10x dollars received by B, as provided in section 351(b), upon the exchange of B’s Y stock solely for cash and voting stock of Z. See Rev. Rul. 68-357. Rev. Rul. 68-349 states that the organization of the new corporation is considered under the circumstances to be merely a continuation of the transferor corporation. Rev. Rul. 68-349 is distinguishable from the instant case in that Z was not employed solely for the purpose of enabling B to transfer B’s Y stock without the recognition of gain and was not merely a continuation of X. See also Rev. Rul. 54-96, Rev. Rul. 68-357 and Rev. Rule 84-44.

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