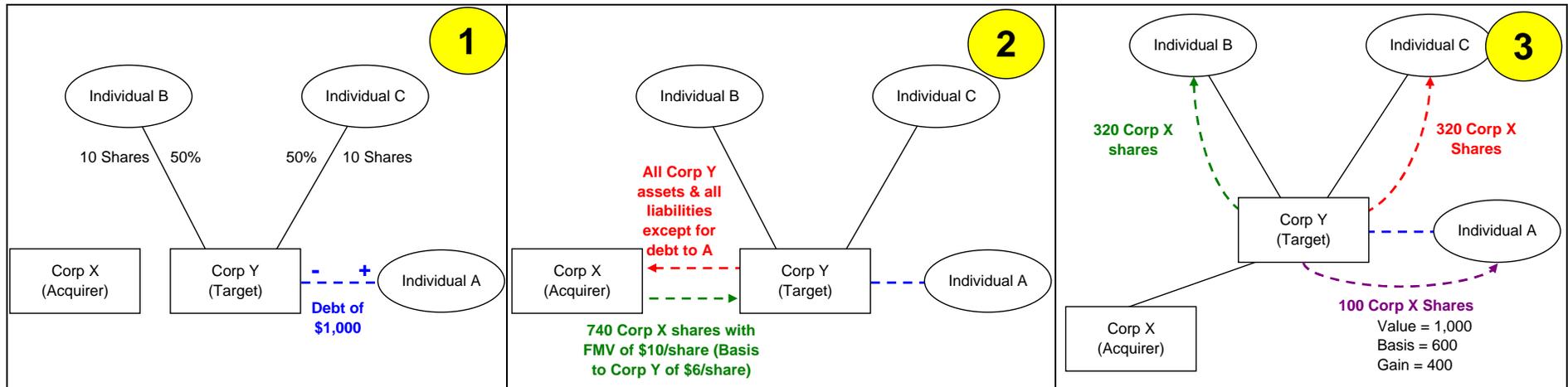


**C Reorg: Gain on Stock Used To Discharge Liabilities**

**Initial Structure**

**C Reorganization (Step 1)**

**C Reorganization (Step 2)**



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 1,000x dollars owed by Y to A, an individual who held no stock in Y, was discharged by the transfer by Y of 100 shares of the stock of X to A.

Y discharged an indebtedness of 1,000x dollars by transferring property to its creditor, A. In this transaction Y realized income measured by the difference between its basis in the 100 shares of X stock transferred (600x dollars) and the fair market value thereof (1,000x dollars). See *United States v. Thomas Crawley Davis*, 370 U.S. 65 (1962), *E. F. Simms*, 28 B.T.A. 988, 1029 (1933), where it was held that the transfer of stock in satisfaction of an outstanding obligation is the equivalent of a sale pursuant to section 1001, and results in the realization of gain to the transferor. Thus, gain in the amount of 400x dollars was realized and recognized by Y pursuant to sections 1001 and 1002.