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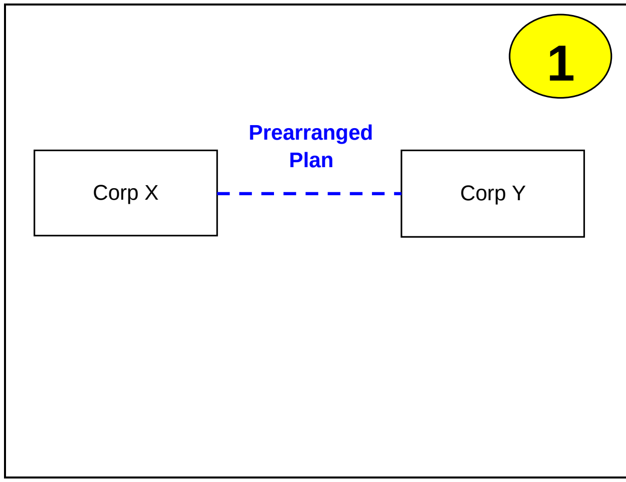
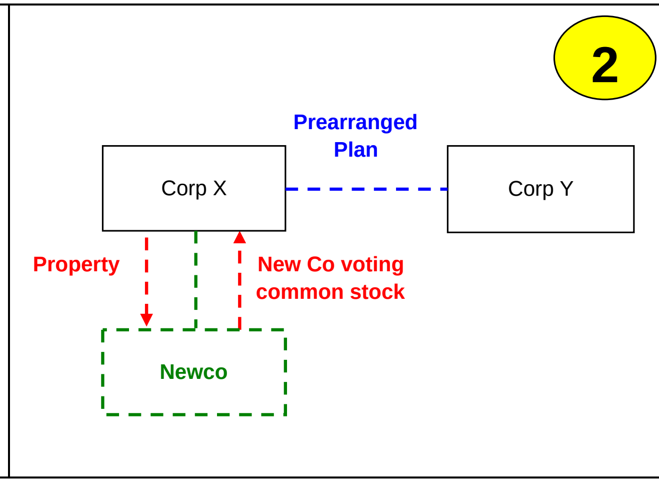
Revenue Ruling 79-70

Busted 351 Via Prearranged Plan to Sell Stock

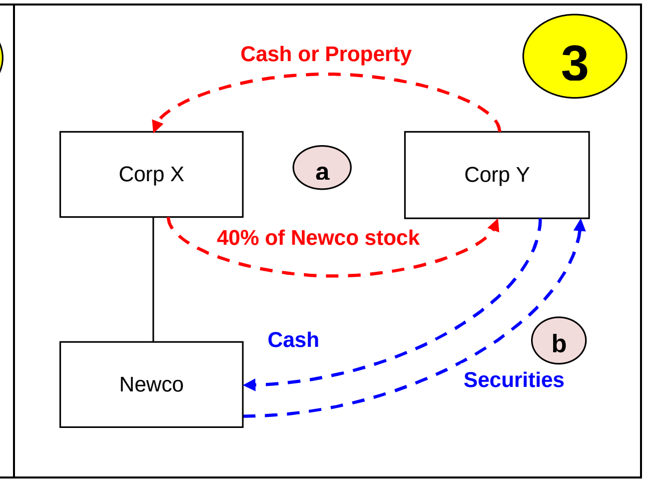
Initial Structure



Formation of New Company



Sale of Stock & Issuance of Securities



Corp X transferred property to a newly organized corporation, Newco, in exchange for all of its stock, a single class of voting common stock, and under a prearranged binding agreement that was an integral part of the incorporation, Corp X sold 40% of Newco stock to Corp Y. Corp Y also purchased securities for cash from Newco. The 80% control requirement of section 351(a) of the Code was not satisfied, and gain or loss to Corp X will be recognized.

Section 351(a) provides that no gain or loss will be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control of the corporation. Section 368(c) defines control for purposes of section 351(a) to mean the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote.

Since the sale of Newco stock by Corp X to Corp Y was an integral part of the incorporation and pursuant to a binding agreement entered into prior to the exchange, the control requirement of section 351(a) is determined after the sale. See Hazeltine Corp. v. Commissioner, 89 F.2d 513 (3rd Cir. 1937), Intermountain Lumber Co. v. Commissioner, 65 T.C. 1025 (1975), and Rev. Rul. 70-522. After the sale was completed 60% of the Newco stock was owned by Corp X and 40% was owned by Corp Y. However, since Corp Y was not a "transferor" of property to Newco with respect to Newco stock, Corp Y's ownership of the Newco stock purchased from X cannot be counted in determining whether the control requirement of section 351(a) was met. The fact that Corp Y transferred cash to Newco in exchange for securities as part of the transaction does not make Y a transferor for purposes of the control requirement of section 351(a). See Rev. Rul. 73-472 and Rev. Rul. 73-473.

Ending Point