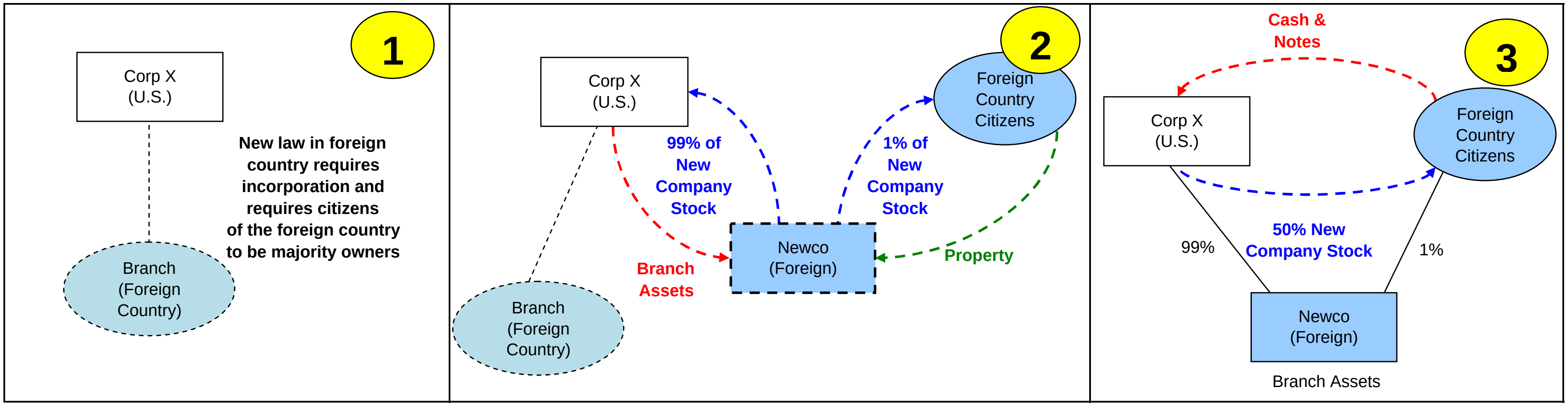
Revenue Ruling 79-194, Situation 2

Failed 351 Exchange: Accommodation Exchange

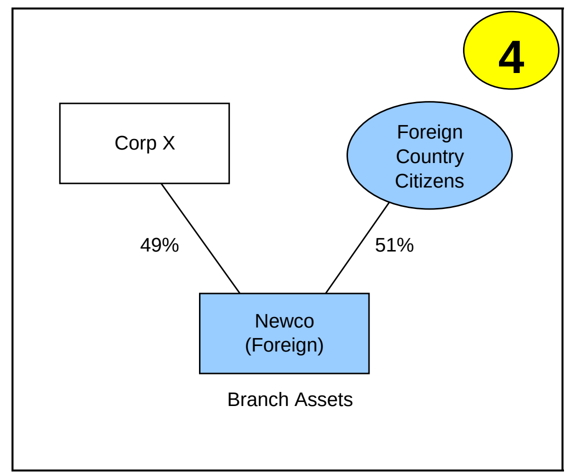
Initial Structure | **Contributions** | **Sale of Stock**



X, a domestic corporation, operates a branch in a foreign country. The foreign country enacted a nationalization law that required that the business that X's branch was engaged in be incorporated in the foreign country and that its citizens be the majority owners of such corporation. A governmental agency in the foreign country directed X to transfer all of the assets of its branch to a newly formed foreign country corporation that is, or will be, at least 51% owned by its citizens. Accordingly, X and a group of investors, who were citizens of the foreign country, pursuant to a binding agreement between them, transferred property to Newco, a corporation newly organized in the foreign country, in exchange for all of Newco's stock (a single class of voting common stock). X and the investors received 99% and one percent, respectively, of Newco's stock. Pursuant to the agreement, X sold an amount of its Newco stock for its fair market value to the investors to bring its ownership down to 49%; the investors would pay X in a series of yearly installments. Newco would not have been formed if the investors had not agreed to transfer property to it and their agreement to do so was conditioned on the sale by X to them of part of X's Newco stock. Further, the investors transferred property to Newco in order to become co-transferors with X, and they purchased X's Newco stock in lieu of the assets of X's branch because of the foreign governmental agency's directive. The transfer met the requirements of section 3.02(1) of Rev. Proc. 68-23, and X timely requested a ruling under section 367(a)(1), in accordance with Rev. Proc. 77-5. The fair market value of each asset transferred is in excess of its basis.

Since the sales of Newco stock by Z to the investors, and of Newco stock by X to the investors, were integral parts of the incorporations and pursuant to binding agreements entered into prior to the exchanges, the control requirement of section 351(a) is determined after the respective sales. See Hazeltine Corp. v. Commissioner, 89 F.2d 513 (3rd Cir. 1937), Intermountain Lumber Co. v. Commissioner, 65 T.C. 1025 (1976) and Rev. Rul. 70-522.

Ending Point



In Situation (2), after the sales were completed, 49% of the Newco stock was owned by X and 51% of the Newco stock was owned by the investors. Because the amount of stock issued directly to the investors for property is of relatively small value in comparison to the value of all the stock received by them in the transaction, the stock received by the investors is not taken into account in considering whether the transaction qualifies under section 351(a). Compare Treas. Reg. § 1.351-1(a)(1)(ii). Thus, for purposes of determining control under section 351, the investors were not transferors. Therefore, since the person (X) transferring property to Newco in exchange for Newco stock owned only 49% of the Newco stock "immediately after the exchange", the control requirement of section 351(a) is not satisfied.