

Revenue Ruling 2007-8

Rev. Rul. 2007-8; 2007 IRB LEXIS 59

February 12, 2007

ISSUE

Does § 357(c)(1) of the Internal Revenue Code apply to transactions that qualify as reorganizations described in §§ 368(a)(1)(A), (C), (D) (provided the requirements of § 354(b)(1) are satisfied), or (G) (provided the requirements of § 354(b)(1) are satisfied) and to which § 351 applies?

FACTS

Situation 1. A, an individual, owned all of the stock of corporation X and corporation Y. Y acquired all of the assets of X in exchange for an amount of Y stock constituting § 368(c) control and the assumption by Y of X's liabilities. Pursuant to the plan, X liquidated and distributed the Y stock to A. At the time of the acquisition, the sum of the X liabilities assumed by Y exceeded X's total adjusted basis in the property transferred to Y. Further, the value of X's assets transferred to Y exceeded the amount of X's liabilities assumed by Y, and, immediately after the exchange, the value of Y's assets exceeded the amount of Y's liabilities. The transaction qualified as a reorganization described in § 368(a)(1)(D) and as an exchange to which § 351 applied.

Situation 2. A, an individual, owned all of the stock of corporation X. B, an individual unrelated to A, owned all of the stock of corporation Y. Y acquired all of the assets of X in exchange for Y voting stock and the assumption by Y of X's liabilities. Pursuant to the plan, X liquidated and distributed the Y voting stock to A. At the time of the acquisition, the sum of the X liabilities assumed by Y exceeded X's total adjusted basis in the property transferred to Y. Further, the value of X's assets transferred to Y exceeded the amount of X's liabilities assumed by Y, and, immediately after the exchange, the value of Y's assets exceeded the amount of Y's liabilities. Simultaneously, and as part of the overall plan, B contributed property to Y in exchange for additional Y stock so that immediately after the transaction, B held more than 50 percent of the vote and of the value of all the stock of Y. The Y stock issued to X along with the Y stock issued to and held by B immediately after the transaction constituted § 368(c) control of Y. The transfer by X of all of its assets to Y in exchange for Y voting stock and assumption of liabilities, followed by the liquidation of X, qualified as a reorganization described in § 368(a)(1)(C). Further, X's transfer of assets to Y in exchange for Y voting stock along with B's transfer of property to Y in exchange for additional Y stock was an exchange to which § 351 applied.

LAW AND ANALYSIS

Section 357(a) provides that if, as part of the consideration in an exchange to which § 351 or § 361 applies, a liability of the taxpayer is assumed by another party to the exchange then such assumption shall not be treated as money or other property. However, in the case of certain exchanges, § 357(c)(1) provides that the transferor is required to recognize gain if the sum of the amount of liabilities assumed exceeds the total of the adjusted basis of the property transferred. Prior to the enactment of The American Jobs Creation Act of 2004 (Public Law 108-357, 188 Stat. 1418) (the Jobs Act), § 357(c)(1) applied in the case of an exchange (A) to which § 351 applied, or (B) to which § 361 applied by reason of a plan of reorganization within the meaning of § 368(a)(1)(D). The Jobs Act amended § 357(c)(1)(B), limiting the application of § 357(c)(1) to exchanges to which § 351 applies, or to which § 361 applies by reason of a plan of reorganization within the meaning of § 368(a)(1)(D) with respect to which stock or securities of the corporation to which the assets are transferred are distributed in a transaction that qualifies under § 355. Thus, as amended, § 357(c) no longer applies to an acquisitive § 368(a)(1)(D) reorganization - i.e., one that satisfies the requirements of § 354(b)(1).

The legislative history to the Jobs Act amendment to § 357(c)(1)(B) explains Congress's intent in removing acquisitive § 368(a)(1)(D) reorganizations from the application of § 357(c)(1), as follows:

The Committee believes that ... the [transferee] should be permitted to assume liabilities of the [transferor] without application of the rule of *section 357(c)*. This is because in an acquisitive reorganization under *section 368(a)(1)(D)*, the transferor must generally transfer substantially all of its assets to the acquiring corporation and then go out of existence. Assumption of its liabilities by the acquiring corporation thus does not enrich the transferor corporation, which ceases to exist, and whose liability was limited to its assets in any event, by corporate form. The Committee believes that it was appropriate to conform the treatment of acquisitive reorganizations under *section 368(a)(1)(D)* to that of other acquisitive reorganizations.

S. Rep. No. 192, 108th Cong., 1st Sess. 185 (2003).

The Jobs Act amendment to § 357(c)(1)(B) excluded acquisitive § 368(a)(1)(D) reorganizations from the application of § 357(c)(1), because in such transactions the transferor ceases to exist and cannot be enriched by the assumption of its liabilities. The Jobs Act legislative history states that the amendment was made to conform the treatment of § 368(a)(1)(D) acquisitive reorganizations to the treatment of other acquisitive reorganizations. Therefore, the intent of the Jobs Act amendment to § 357(c)(1)(B) was to exclude reorganizations from the application of § 357(c)(1) unless described in § 357(c)(1)(B), regardless of whether such reorganizations are also exchanges to which § 351 applies.

In the transactions set forth in both Situation 1 and Situation 2, the transferor corporation ceases to exist and, therefore, cannot be enriched as a result of the assumption of its liabilities. In accordance with the above reasoning, in both Situation 1 and Situation 2, § 357(c)(1) does not apply to X's transfer of assets to Y in exchange for Y stock and assumption of X's liabilities notwithstanding the fact that such transfers were also exchanges to which § 351 applied.

In addition, under § 368(a)(3)(C), if a reorganization qualifies under § 368(a)(1)(G) and under any other subparagraph of § 368(a)(1) or under § 332 or § 351, then, other than for purposes of § 357(c)(1), the transaction will be treated as qualifying only under § 368(a)(1)(G). However, because § 357(c)(1) is no longer applicable to a transaction that qualifies as a reorganization described in § 368(a)(1)(A), (C), or (D) (provided the requirements of § 354(b)(1) are satisfied), it is also no longer applicable to a reorganization described in § 368(a)(1)(G) (provided the requirements of § 354(b)(1) are satisfied), regardless of whether § 351 applies.

HOLDING

Section 357(c)(1) does not apply to transactions that qualify as reorganizations described in §§ 368(a)(1)(A), (C), (D) (provided the requirements of § 354(b)(1) are satisfied), or (G) (provided the requirements of § 354(b)(1) are satisfied) and to which § 351 applies.

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 75-161, 1975-1 C.B. 114, and Rev. Rul. 76-188, 1976-1 C.B. 99, are obsolete. Rev. Rul. 78-330, 1978-2 C.B. 147, is modified to the extent it holds that § 357(c)(1) is applicable to a transaction that qualifies as a reorganization described in § 368(a)(1)(A) or (D) (that satisfies the requirements of § 354(b)(1)).

DRAFTING INFORMATION

The principal author of this revenue ruling is Rebecca O. Burch of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Rebecca O. Burch at (202) 622-7550 (not a toll-free call).