OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR
ATTORNEY CC:

FROM: Deborah A. Butler
Assistant Chief Counsel CC:DOM:FS

SUBJECT:

This Field Service Advice responds to your memorandum dated December 15, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Corp A	=	.
Corp B	=	
Corp C	=	
Corp D	=	
Corp E	=	
Corp F	=	
Transaction Sub	=	
Sub 1	=	
Sub 2	=	.
Sub 3	=	
Sub 4	=	
Sub 5	=	
Sub 6	=	
Sub 7	=	

Sub 8 =
Sub 9 =
Sub 10 =
Business =
Business 1 =
Business 2 =
Date A =
Date B =
Date C =
Date D =
Date E =
Date F =
Date G =
Date H =
Date I =
Date J =
Date K =
Date L =
Date M =
Date N =
Date O =
Merger Agreement =

Individual A =
Individuals B& C =
$a =
$b =
$c =
$d =
$e =
$f =
$g =
$h =
$i =
$j =
$k =
$l =
A =
B =

C =
D =
E =
F =
G =
H =
I =
J =
K =
L =
M =
N =
Percent A =
Percent B =
Percent C =
Percent D =

ISSUES:

1. Whether Corp A may determine, by using the specific identification method described in Treas. Reg. ' 1.1012-1(c), the bases of the Transaction Sub stock it received in a single I.R.C. ' 351 transaction in exchange for the Acontributed@ stock, which Corp A acquired at different times and which had different bases?

2. Whether the actual fair market value instead of Corp A=s General Value methodology for valuing the contributed stock should be used to determine the value of the Transaction Sub stock attributable to specific shares of contributed stock?

3. Whether the contemporaneous ' 351 transfer of the stock of 9 separate corporations should be deemed a single integrated transaction or 9 independent transactions?

CONCLUSIONS:

1. Corp A may not determine, by using the specific identification method described in Treas. Reg. ' 1.1012-1(c), the bases of the Transaction Sub stock it received in a single I.R.C. ' 351 transaction in exchange for the Acontributed@ stock, which Corp A acquired at different times and which had different bases.

2. Assuming that Corp A may trace the Transaction Sub shares to the specific contributed shares of corporate stock, the actual fair market value instead of Corp A=s General Value methodology for valuing the contributed stock should be used for determining the number of share of Transaction Sub stock attributable to specific shares of the contributed stock.

3. Even assuming that, in principle, Corp A can both trace and use its General Value methodology, the contemporaneous I.R.C. ' 351 transfer of the stock of 9 separate corporations should be deemed a single integrated transaction.

Accordingly, Corp A cannot, as a factual matter, adequately identified which Transaction Sub stock corresponds to the various contributed corporate stock.

FACTS:

On Date A, Corp A and Corp B entered into a nonbinding agreement in which Corp A agreed to transfer certain Business assets to Corp B in exchange for Corp B common stock. The Business assets include Business licenses and related assets. This agreement was reduced to writing about a year later and formally executed by Corp A, Corp B, and others.

On Date B, Corp A and several of its subsidiaries joined together and formed Transaction Sub.[1] Together, they exchanging $a for Amount 1 shares of Transaction Sub.[2] The subsidiaries that joined in this enterprise with Corp A were Subs 1 through 5.

Corp A purchased Sub 6, 7 and Sub 8 from Individuals A, B and C.[3] Individual A owned Sub 6. Individual B and C owned Sub 7. Together, Individual A, B and C owned Sub 8. On Date C, Corp A entered into two Stock Purchase Agreements, one with Individual A and the other with the Individual B & C. Individual A agreed to sell Corp A all of the stock of Sub 6 (the Sub 6 Agreement) and agreed to sell Corp A all of the stock of Sub 7 (the Sub 7 Agreement).

On Date C, Individuals A, B and C entered into a letter of intent with Corp D, in which Corp

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[1]On Date G, Transaction Sub changed its name. Nevertheless, we will hereinafter refer to Transaction Sub as Transaction Sub for clarity purposes.

[2]Corp A received Percent A Transaction Sub shares, and its wholly-owned subsidiaries received the remaining Percent B Transaction Sub shares. Because Corp A is clearly the controlling shareholder, and that the minority shareholders are its wholly-owned subsidiaries, we will (for purposes of this advice) hereinafter refer to Corp A as the sole shareholder of Transaction Sub.

[3]These corporations are three of the nine corporations that Corp A ultimately transferred to Transaction Sub.

D stated its intent to acquire all the stock of Sub 8 in exchange for its own stock worth $b. The next day, Individuals A, B and C offered Corp A a right of first refusal with regard to the Sub 8 stock.

On Date D, Corp A exercised its right of first refusal and entered into a Stock

Purchase Agreement with Individuals A, B and C, agreeing to purchase Sub 8 for $b cash, in exchange for all of the Sub 8 stock.

On Date F, Corp A and Corp B formally entered into the Merger Agreement. Major provisions of this agreement included the following: (1) Corp A would contribute certain Business assets to Transaction Sub, (2) Corp B would then merge into Transaction Sub, with Transaction Sub surviving; (3) Transaction Sub would immediately change its name; and (4) Corp A would receive B shares of Transaction Sub, and the former Corp B shareholders would receive the remaining shares. Corp A satisfied its obligations under the Merger Agreement by transferring to Transaction Sub licenses and other assets of substantial value that it possessed.[4] In addition, Corp A acquired the stock of 9 corporations and transferred them to Transaction Sub. Corp A acquired the following corporations on the following dates and for the following amounts: (1) Sub 4 in Date I for $c; (2) Sub 9 in Date J for $d; (3) Sub 7 in Date K for $e; (4) Sub 2 in Date L[5]; (5) Sub 8 in Date K for $b; (6) Sub 10 in Date M for $a; (7) Sub 5 in Date N for $f; (8) Sub 6 in Date L for $e; and (9) Sub 3 in Date O for $g.[6]

On Date G, several events occurred, however, the exact ordering of events is unknown. Corp A transferred the stock of the following 9 corporations to Transaction Sub: Sub 2 though 10.[7]

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[4] According to the Revenue Agent auditing the taxpayer, the value of these assets (not including the stock of the 9 corporations) was substantial. The agent estimates that the amount of these assets was between $h and $i.

[5] The purchase price paid for Sub 2 is not ascertainable from the documents provided by field counsel.

[6] Although Corp A purchased Subs 6, 7 and 8 in it is clear from Corp A=s own documents that it executed Stock Purchase Agreements for: (1) the purchase of Sub 7 and Sub 6 on Date C; and (2) the purchase of Sub 8 on Date D, the latter agreement modified the Date C, Stock Purchase Agreements. The acquisition date of however, comes from Corp A=s records.

[7] Although Corp A had purchased these corporations on different dates and for different prices, it transferred the stock of all 9 corporations into Transaction Sub on Date G, the closing date of the Merger Agreement.

On that same day, Corp A filed a ARestated Certificate of Incorporation of Transaction Sub@ with the Secretary of the State of Delaware. Corp A states that it filed this certificate to Arecapitalize@ Transaction Sub.[8]

Additionally, on Date G, Corp A sold C shares of Transaction Sub stock to Corp C[9] and Corp B merged into Transaction Sub, with Transaction Sub surviving and changing its name.[10] As a result of the merger, the former shareholders of Corp B received Percent C of the outstanding shares of Transaction Sub, and Corp A received Percent D.[11] As a result of the merger, Corp A received the following 2 classes of stock of Transaction Sub: Class A voting and Class B nonvoting shares. The Aterms@ of the stock of Transaction Sub that Corp A received are identical to the Aterms@ of the Transaction Sub stock that Corp A exchanged.

The Merger Agreement

The Merger Agreement does not specifically provide that Corp A would obtain certain designated corporations and transfer them into Transaction Sub. It does, however, provide that Corp A would obtain certain Business licenses and assets in certain territories. Business licenses and Business assets give the possessor the right and ability to operate in certain territories. Corp B intended to expand the number of territories in which, , it operated. Corp A agreed to obtain licenses that would enable Corp B to expand into various geographic regions. The Merger Agreement established territory requirements and delivery requirements. Prior to entering into the Merger Agreement, Corp A possessed several of these licenses . For example, Corp A owned many Business licenses (known as Business 2), and managed many systems (known as Business 1), which were not owned

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[8]Corp A=s statements that the allocation of shares derived out of a recapitalization. Regardless of whether there may have been some recapitalization, clearly there was a ' 351 exchange in which the 9 corporate stocks were contributed to Transaction Sub in exchange for stock. Hereinafter, the purported Arecapitalization@ will be recharacterized as the ' 351 transaction.

[9]See discussion below entitled ACorp C Stock Purchase Agreement.@

[10]It is unclear whether steps 2 occurred before step 3, or vice versa.

[11] A news article in the dated Date H, indicates that Corp A received Percent D of Transaction Sub stock as a result of the merger.

by Corp A, but by various individuals and businesses throughout the U.S. Most of the contracts Corp A had with Business 1 owners included preferential purchase options such as a Aright of first refusal.@ Corp A committed in the Merger Agreement to contribute to Transaction Sub many of the licenses that it already owned and also licenses that it did not yet own (both Business 1 and non-related Business licenses).

Under the Merger Agreement, Corp A would receive D Transaction Sub shares if it contributed licenses and assets which allowed entry into the ACorp E Territory.@ Corp A would receive E shares if it contributed licenses and assets which allowed entry into the ACorp B Territory.@[12] Likewise, Corp A would receive F shares if it contributed licenses and assets which allowed entry in the Corp F Territory. The Merger Agreement established penalties for shortfalls, allowed for some substitutions, and rewarded Corp A for contributing excess .

The Merger Agreement included a mechanism for valuing the Corp A says that the Agreement established (for lack of a better term) General Values. Such values were determined based on factors such as the number of licenses acquired in a certain territory, the acquisition of licenses that allowed entry into dense population zones within territories[13], the acquisition of licenses that permitted the operation in numerous .

Pursuant to the Merger Agreement, Corp A received in total B shares of Transaction Sub stock for the Business systems it contributed to Transaction Sub. The B shares, included D for the Business assets in the Corp E territory, about E for the Business assets in the Corp B Territory, and F for the Business assets in the Corp F Territory.

Corp A allocated the Transaction Sub stock to the 9 corporations and to the assets that it contributed. The date of this allocation is unknown, but it is clear that it happened sometime before the I.R.C. ' 351 transaction.[14] Corp A states that the fair market value of

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[12]Presumably, this requirement involved Corp A acquiring licenses of independent operators (i.e., those operators that were not owned or connected with Corp B, but nonetheless operated in the ACorp B Territory.@)

[13]All territories included dense cities, less dense cities, and rural areas. The Merger Agreement valued licenses which allowed access to dense cities and their surrounding areas greater than those which allowed access to rural areas .

[14]A document, dated 2 days before the merger (a day before the corporations were contributed to Transaction Sub and the day the merger occurred), indicates that, at least as of that day, Corp A already had predetermined the allocation of Transaction Sub shares to the various 9 corporations.

each license was not available when it determined the allocation, therefore, it used the Group Values[15] in determining the allocation of the Transaction Sub shares.

Thus, the value allocated to a transferred corporation was not based on its value in the open market, but rather was based on the type of and number of license(s) which it possessed. If the license allowed the acquisition and utilization of numerous , and covered many territories, and if it allowed coverage in dense cities, it received a greater value than those licenses that did not allow such extensive coverage.

Using this methodology, Corp A determined that it had paid a premium for Sub 8. It acquired Sub 8 for $b, but according to Corp A=s valuation methodology, Sub 8 was only worth $j. Corp A also claimed that, although it purchased Sub 6 for $k, according to its

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[15]@Group Values@ appears to be a term derived from the Merger Agreement. Under the Agreement, each Territory was broken down into Groups. For example, the Corp E Territory was broken down into five Groups. were ›Grouped.= For example, in the Corp E Territory, Group I consisted of X number of , Group II consisted of Y number of , Group III consisted of Z number , and so on. Corp A had to deliver certain numbers of in each Group in each Territory. To help it accomplish this task, different Delivery Goals were established within each Group.

Group Value method, Sub 6=s actual value was $l.

The Corp C Stock Purchase Agreement

Prior to the effective date of Corp B=s merger into Transaction Sub, Corp A and Corp C entered into a Stock Purchase Agreement under which Corp A agreed to sell Corp C a portion of its stock holdings in Transaction Sub in exchange for $j. Under this agreement, Corp A agreed to sell C shares of voting common stock of ATransaction Sub@ to Corp C. The price included an amount for an option to purchase up to N more shares. On Date G, Corp A sold C shares of its Transaction Sub stock to Corp C.

Regarding the sale of stock to Corp C, Corp A claims to have matched the various Transaction Sub lots to specific lots of stock which it received in Transaction Sub. This allowed it to assign specific lots of Transaction Sub a carryover basis from specific lots of Transaction Sub. The result of assigning the bases for the Transaction Sub stock was that Corp A could then specify which stock was being sold to Corp C, and when, and thereby control how much gain or loss it would recognize on the sale.

Corp A=s asserts that it can specifically identify certain sold Transaction Sub shares as those shares traceable to the shares of Sub 8 stock that it contributed to Transaction Sub. If it can specifically identifying Transaction Sub stock that it sold in this manner, so Corp A=s argument goes, it would be entitled to deduct the loss resulting from the difference between the value of the Transaction Sub stock it sold to Corp C and that stock=s substituted basis: the basis, if Corp A=s argument is correct, that it had in the Sub 8 stock. Assuming that Corp A=s argument is correct, in order for it to specifically identify the Transaction Sub stock, it would have to be able to trace the Transaction Sub stock that it sold to Corp C to the pre-contributed Sub 8 stock. If allowed to specifically identify such stock, then the Transaction Sub stock would take the basis of the Sub 8 stock (known as Asubstituted basis@). For purposes of clarity, Corp A is not arguing that the Transaction Sub stock is equal in value to that of the Sub 8 stock. The value of the Transaction Sub stock will be a function of the aggregate values of all assets contributed to it.

According to a document, dated 2 days before the merger, states, ACorp A will sell an aggregate of C voting shares to [Corp C]. The certificates to be transferred will be as follows:@

G	(Sub 10)
H	(Sub 5) (2 pieces)
I	(Sub 3) (2 pieces)
J	(Sub 4) (2 pieces)
K	(Sub 9)
L	(Sub 7)

M (Sub 8)
C

LAW AND ANALYSIS

I.R.C. ' 351 provides that no gain or loss shall be recognized if property is transferred to a corporation solely in exchange for its stock, and if the transferor or transferors control the corporation immediately after the exchange.

I.R.C. ' 358(a)(1) specifies that, in the case of an exchange to which section 351 applies, the basis of the property permitted to be received under that section without the recognition of gain or loss shall be the same as the basis of the property exchanged, decreased by the fair market value of any boot received by the taxpayer and increased by the amount of any gain (and by the amount of any dividend income) to the taxpayer recognized on the exchange.

I.R.C. ' 358(b)(1) directs that, under regulations prescribed by the Secretary, the basis determined under subsection (a)(1) shall be allocated among the properties permitted to be received without the recognition of gain or loss.

Treas. Reg. ' 1.358-2(b)(2) sets forth the rule for allocation of basis among the stock and securities received in a corporate organization exchange described in section 351. This provision requires that, if a transferor or property to the corporation receives stock or securities of more than one class, or both stock and securities, then the basis of the property transferred shall be allocated among all the stock and securities received in proportion to the fair market value of each class of stock and securities.

Rev. Rul. 85-164, 1985-2 C.B. 117, holds that the aggregate basis of different assets transferred to a controlled corporation in an exchange that meets the requirements of I.R.C. ' 351 is allocated among the stock and the securities received in the exchange in proportion to the fair market values of the stock and the securities, under Treas. Reg. '' 1.358-1 and 1.358-2(b)(2).

Rev. Rul. 68-55 (amplified in Rev. Rul. 85-164) holds that when the property is transferred to a corporation under I.R.C. ' 351(a) each asset must be considered transferred separately in exchange for a proportionate share of each of the various categories of the total consideration received.
G.C.M. 39418 (Oct. 14, 1983) provides that a transferor may not determine the bases or holding periods of stock and securities he received in a section 351 transfer by designating specific property to be exchanged for the stock or securities. The aggregate basis of the property transferred must be allocated between the stock and securities

received in proportion to the relative fair market values of each class. The fraction of each share of stock or security that is attributable to the transferor=s ownership of a capital asset or a section 1231 asset is treated as having a holding period that includes the period for which the transferor held that asset. The fraction of each share or security that is attributable to property that is neither a capital asset nor a section 1231 asset has a holding period beginning on the next day after the exchange.

1. Corp A Must Aggregate its Basis; It May Not Use the Specific Identification Method to Identify the Classes of Stock It Received in an I.R.C. ' 351 Transaction.

Corp A claims a deduction based on its assertion that it can specifically identify certain Transaction Sub shares it sold to Corp C as being traceable to the shares of the Sub 8 stock that Corp A contributed to Transaction Sub. If so, the amount of Corp A=s deduction would be the difference between the value of the Transaction Sub stock it sold to Corp C and that stock=s substituted basis, that is the basis that Corp A had in the Sub 8 stock. Simply put, Corp A is arguing that if it can specifically identify such Transaction Sub shares in this fashion, it is not required to aggregate its cost of, and hence its basis in, the contributed stock in determining its basis in the Transaction Sub stock. We disagree.

Congress enacted I.R.C. ' 358(b), which delegated to the Secretary authority to prescribe rules that would govern the allocation of basis among nonrecognition properties received in corporate organizations and reorganizations. S. Rep. No. 1622, 83rd Cong., 2d Sess., 271; H. Rep. No. 2543, 83rd Cong., 2d Sess., 48-49. The present regulations were adopted in 1955 under that authority.

Treas. Reg. ' 1.358-2(b)(2) sets forth the rule for allocation of basis among the stock and securities received in a corporate organization exchange described in section 351. It requires that, if a transferor or property to the corporation receives stock or securities of more than one class, or both stock and securities, then the basis of the property transferred shall be allocated among all the stock and securities received in proportion to the fair market value of each class of stock and securities. No tracing or identification of specific property traded for particular stock or securities is permitted by the provision.[16] G.C.M. 39418.

Treas. Reg. ' 1.358-2(a) applies when there is (1) a transfer of property, (2) in a ' 351 transaction, and (3) the taxpayer receives back two or more classes of stock.[17] Thus, it

[16]The regulations are not unmindful of the concept of tracing and provide for limited tracing in certain situations not applicable here. See Treas. Reg. ' 1.358-2(a).

[17]Although 2 classes of stock were issued here, arguably this provision would apply with equal force in precluding the use of specific identification where only one stock is issued.

clearly applies to this case. Corp A transferred property (i.e., stock of 9 corporations) to Transaction Sub. Under I.R.C. ' 317(a), Aproperty@ means money, securities, and any other property; except that such term does not include stock in the corporation making the distribution. Here, since Corp A is not exchanging its own stock, the exception to ' 317 is not applicable. The exchange occurred pursuant to a ' 351 transaction. Corp A received in the '351 exchange two classes of Transaction Sub stock: Class A voting stock and Class B nonvoting stock.

There are good reasons for not allowing tracing in I.R.C. ' 351 transactions. G.C.M. 39418 provides the following rationale:

> In the ordinary case, any attempt by the parties to identify specific properties as exchanged for particular stock or debt would be entirely lacking in arm=s-length dealing. In every such case, therefore, the Commissioner would be required to examine the transaction to determine whether it comported with arm=s-length standards; and if securities were involved, whether these constituted valid debt under the various criteria developed by the courts. In all cases it would be necessary to examine both the fair market values of the properties transferred and the fair market values of the stock or securities received, to ascertain whether the purported specific exchanges complies with arm=s-length standards. Further, it would be essential in every case to examine the purported exchanges for potential tax avoidance, since one or more of the alleged exchanges might be a sham designed artificially to increase depreciation deductions, or charges against current income, or to convert ordinary income into long-term capital gain. All such problems are avoided by the present regulation, which simply requires that the adjusted basis of the property transferred be allocated among the stock and securities received in proportion to the fair market values of each class. In this manner, all the taxpayer=s basis is apportioned to all the stock and securities he receives in accordance with arm=s-length standards; it is necessary to value only the stock and securities he receives (and not the property he transferred); and the potential for tax avoidance is minimized, with a consequent reduction of administrative burden on the Commissioner.

Id. (Citations omitted); see also Nassau Lens Co. v. Commissioner, 35 T.C. 268 (1960).

Because Treas. Reg. ' 1.358-2(a) applies to the facts of this case. It mandates that the taxpayer aggregate the basis of the property it contributed (here, the stock of its subsidiaries), and allocate that basis between the classes of Transaction Sub stock it received in proportion to the relative fair market values of each class of that stock. Accordingly, Corp A may not determine the bases or holding periods of the Transaction Sub stock it received in the ' 351 transaction by designating specific property to be

exchanged for the stock. It must aggregate its basis in the property transferred and allocate that aggregated basis between the two classes of stock it received in proportion to the relative fair market values of each class of such stock.

2. Corp A Did Not Adequately Allocate Sufficient Transaction Sub Shares to the Sub 8 Stock.

Assuming for purposes of argument that the Court allows Corp A to trace the Transaction Sub stock thereby allowing Corp A to use a substituted basis in the sold stock attributable to specific shares of contributed stock, we think that another argument can be made here. Corp A=s asserts that it paid a Apremium@ for Sub 8, and that with respect to the Merger Agreement, the stock of Sub 8 was not worth the price paid for it. Corp A=s allocated Transaction Sub stock based on the type of and number of license(s) which each contributed corporation possessed. Using this AGrand Value@ methodology, Corp A allocated about $j worth of Transaction Sub stock to the Sub 8 stock contributed, even though it paid $b for Sub 8 in the open market. Likewise, employing the same AGrand Value@ methodology, Corp A asserts that, although it purchased Sub 6 for $k, the true value of Sub 6 is established by the Merger Agreement. Corp A asserts that Sub 6 was worth much more than $k and, therefore, allocated about $l worth of Transaction Sub stock to it. We believe, however, that too few shares of Transaction Sub stock were allocated to Sub 8, and too many were allocated to Sub 6. If uncorrected, Corp A could spread the $b basis it has in the contributed Sub 8 stock over too few shares of Transaction Sub, thereby creating an uneconomic loss for itself on the sale of these shares of Transaction Sub.

Taxpayer did not adequately allocate sufficient Transaction Sub shares to the Sub 8 stock. The facts strongly imply that the fair market value of Sub 8 stock was $b. Corp A paid $b on the open market for Sub 8. At the time Corp A purchased Sub 8 pursuant to its right of first refusal, Individuals A, B and C held Corp D=s offer to purchase Sub 8 for $b in Corp D stock. Thus, these two facts alone belie Corp A=s assertion that it paid a Apremium@ for the Sub 8 stock. Further, as Corp A indicates, it was a seller=s market at the time it purchased Sub 8. In a document it submitted to the Service, Corp A admitted that, when it was acquiring these corporations, Aat the same time companies such as Corp B, Corp F, Corp D and others were also trying to purchase licenses throughout the U.S.@

Corp A=s assertion that it paid a Apremium@ for Sub 8 appears, however, not to be a statement about the value of Sub 8 stock on the open market. In a document that it supplied to the Service, Corp A states,

> Since the Fair Market Value of each license was not available, the Group values were utilized in determining the allocation of the Transaction Sub shares between Corp A, and the various Sub 1 business subsidiaries ([Subs 2 through 10]). As previously mentioned, Corp A received in total B shares

of Transaction Sub stock for the Business systems it contributed to Transaction Sub (D for the Business assets in the Corp E Territory, E for the Business assets in the Corp B Territory, and F for the Business assets in the Corp F Territory).

Corp A then proceeds to describe how the value allocated to a transferred corporation was based on the type of and number of licenses which it possessed. If the license allowed the acquisition and utilization of numerous , covered many territories, and allowed coverage in dense cities, it received a greater Group Value than licenses that did not allow such extensive coverage.

Corp A=s valuation methodology is flawed. Fair market value of an asset, not its relative value vis ›a vis the other contributed stock set forth in the Merger Agreement, is the standard. Applying Corp A=s valuation fails to reflect the real economic character of the transaction. It allocates too little stock to one corporation, here Sub 8, and too much stock to others.

In Treas. Reg. ' 1.351-1(b)(1)[18], in a situation where the exchanges were not equal (and thereby it is analogous to our situation), the regulation shows that I.R.C. ' 351 contemplates equal exchanges of property for stock received. Where, as in the situation described in the regulation, the exchange is disproportionate, the regulations remedy the situation by assuming an equal exchange and then account for the disproportionate aspect by assuming a gift was given or compensation was paid at the shareholder level..

Further, applying Corp A=s methodology here would produce a result that does not clearly reflect income. Corp A not only contributed the stock of the 9 subsidiaries to Transaction Sub, it also contributed its own assets, having a value of between $h and $i. It would lead to strange results indeed, if one were to determine the amount of realized gain by separately allocating the fair market value of each category of consideration received to

[18]The regulation provides, AWhere property is transferred to a corporation by two or more persons in exchange for stock or securities . . . it is not required that the stock and securities received by each be substantially in proportion to his interest in the property immediately prior to the transfer. However, where the stock and securities received are received in disproportion to such interest, the entire transaction will be given tax effect in accordance with its true nature, and in appropriate cases the transaction may be treated as if the stock and securities had been used to make gifts to pay compensation, or to satisfy obligations of the transferor of any kind.@ (Citations omitted). It provides an example of a father and son organizing a corporation and each transferring property to the corporation, but the value of the property is disproportionate to the value of the stock each receives. The regulation strongly implies that the Service should reorder or recharacterize to reflect their true economic effect.

the transferred assets in proportion to: (1) the relative values of each lot of stock as determined under the Merger Agreement, and (2) the relative open market values of the nonstock assets.

Thus it is the fair market value, rather than the relative value of the Sub 8 stock as determined under the Merger Agreement, that is determinative of how much Transaction Sub stock should be allocated to the contributed Sub 8 stock.

Accordingly, Since Corp A did not adequately allocate sufficient Transaction Sub shares to the Sub 8 stock, the Service should adjust the number of shares of Transaction Sub stock to properly reflect the true value of the Sub 8 stock.

3. Transfers of the Stock of 9 Corporations Were in Substance Parts of a Single Integrated Transaction.

The contemporaneous I.R.C. ' 351 transfer of the stock of 9 separate corporations constitute a single integrated transaction. All of these steps of this transaction were planned and accomplished pursuant to the Merger Agreement. Corp A transferred 9 corporations for a pre-established amount of stock. Factually, this was an all for all transaction and the allocation of the Transaction Sub was after the fact and only done for tax purposes. Accordingly, Corp A cannot, as a factual matter, adequately identify which Transaction Sub stock corresponds to the various contributed corporate stock.

The 9 corporate stock transfers whereby Transaction Sub was formed and provided with its assets is equivalent, for tax purposes, to a single integrated transaction under I.R.C. ' 351. See Sherwood Memorial Gardens, Inc. v. Commissioner, 42 T.C. 211, 232 n. 19 (1964) (initial minimal capitalization and subsequent furnishing of land and money of the taxpayer, a corporation formed to be a cemetery, deemed to be a single integrated transaction under I.R.C. ' 351). See also D=Angelo Associates, Inc. v. Commissioner, 70 T.C. 121 (1978) (stock exchange and the asset acquisition were in substance parts of a single integrated transaction involving the formation and capitalization of the corporation).

Transaction Sub was organized on Date B, with nominal capitalization of $a. It was formed for the purpose of operating many businesses over large geographic regions and many . Its purpose was to be accomplished by Corp A transferring Business assets to it and by its subsequent merger with Corp B. Since Transaction Sub=s formal capitalization was inadequate to carry out the purpose for which it was formed, Transaction Sub remained a shell until the date of the merger, Date G, at which time Corp A transferred to it a substantial amount of assets and the stock of 9 corporations. Immediately after the transfer, Corp B merged into Transaction Sub, and Transaction Sub changed its name. All of these steps were planned and accomplished pursuant to the Merger Agreement, and

therefore should be viewed as a single integrated transaction, not as a series of independent transactions.

The Tax Court in D=Angelo, stated,

> Sequential protocol is of marginal relevance in determining whether contemporaneous events should be viewed as a single integrated transaction or as independent transactions. Rather, the boundaries are defined by including events contemplated for the success of the business plans from which they emanate.

Id. At 130.

Under the terms of the Date E Merger Agreement, Corp A was to receive B shares of Transaction Sub stock if it contributed certain Business assets and Business licenses covering certain territories and . This agreement was entered into before Corp A had acquired all of the assets that it intended to contribute to Transaction Sub. The Merger Agreement was formally entered into after Transaction Sub was incorporated but prior to the acquisition of several corporations that ultimately were transferred to Transaction Sub. Thus, as of Date E, the date Corp A entered into the Merger Agreement, Corp A could not have known what assets it would subsequently transfer to Transaction Sub in exchange for the B shares.

Because the assets were transferred at one time in exchange for the pre-negotiated B shares, Corp A cannot persuasively argue that it exchanged certain corporate stock for certain Transaction Sub stock. In reality, Corp A exchanged one aggregate Alump@ of property, consisting of various assets to Transaction Sub, in exchange for one lump amount of Transaction Sub stock. Therefore, we see no justification for concluding that the cost of some particular lot of contributed shares bore any relation to any particular Transaction Sub shares. Accordingly, we believe that the identification of the Transaction Sub shares received with those exchanged

is impossible under these facts. Stock received by Corp A in this **one** I.R.C. **'** 351 transfer does not constitute stock acquired at different times or at different prices. On Date G, Corp A received B Transaction Sub shares in exchange for the total of assets and contributed shares (i.e., substantial assets and the stock of the 9 corporations) it transferred to Transaction Sub.

As in D=Angelo, it is clear here that the success of this corporate undertaking motivated: (1) the transfer of 9 corporations, (2) the transfer of Business licenses, and (3) Corp B=s merger into Transaction Sub. Thus, the transaction by which Corp A provided Transaction Sub with the minimum amount for incorporation, received in exchange Amount

1 shares of voting common stock, furnished Transaction Sub with 9 Business corporations, and the contemporaneous merger of Corp B into Transaction Sub, were merely related steps in a single integrated transaction whereby Aproperty was transferred to a corporation solely in change for stock . . . in such corporation and immediately after the exchange such persons or persons were in control of the corporation.@

Because the transfer of the 9 corporations were merely related steps in a single integrated transaction, an all for all exchange (the stock of 9 corporations for B shares of Transaction Sub), Corp A cannot adequately identify any particular Transaction Sub shares that correspond to the Sub 8 stock. Accordingly, because Corp A cannot as a factual matter specifically identify such stock, it must aggregate its basis in the property transferred and allocate that aggregated basis between the two classes of stock it received in proportion to the relative fair market values of each class of such stock. See Rev. Rul. 85-164, 1985-2 C.B. 117 (AThe [aggregate basis] holding would be unaffected if [taxpayer] were to make a transfer in exchange for securities at separate times, and the transfer were part of a single integrated transaction@); Rev. Rul. 85-154, 1985-2 C.B. 117 (Ataxpayer may not allocate high basis, long-term property to one block of stock and low basis, short-term property to another, when the properties are transferred as a part of a single integrated transaction@).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

There are several areas of concern with regard to this case. First, although we believe we have a solid position with regard to the first issue (see above), there are certain litigating hazards inherent in taking this position. The litigating hazards arise from several sources. An early revenue ruling, Rev. Rul. 55-355, 1955-1 C.B. 418, stated, A**it is fairly well settled that where identification is lacking**, an average basis must be used for stock of another corporation received in a nontaxable exchange pursuant to a reorganization under section 112(g)(1) of the code of 1939.@ (Emphasis added). This revenue ruling is distinguishable from our present case. It describes the state of the law under the 1939 Code and therefore came before the enactment of the I.R.C. ' 358(b) statute, and the above emphasized language was arguably dicta. In addition, the ruling=s language does not conclude how a specific identification might be made. It can also be argued that the ruling=s language is only assuming a situation where there is no specific identification and not concluding that in fact specific identification is possible. Finally, the ruling=s language was specifically addressed to a reorganization and not a ' 351 exchange presented in the instant case.

The revenue ruling is not the only source which creates litigating hazards, however. Another problem source is Bloch v. Commissioner, 148 F.2d 452 (9th Cir. 1945). This case also came before the enactment of the I.R.C. ' 358(b) statute and it is not cited again

by the courts. It is, however, cited by Bittker & Eustice in their treatise entitled Federal Income Taxation of Corporations and Shareholders for the proposition that the average-cost rule is inapplicable if precise identification is feasible. This treatise also cites Leonard Osrow v. Commissioner, 49 T.C. 333 (1968), acq. Osrow involved a recapitalization, not a I.R.C. ' 351 exchange. We do not believe that these cases create a significant problem for us because they are both involve reorganizations (not ' 351 exchanges) and Bloch is a pre-' 358(b) case. We note also that several years ago, the National Office issued a private letter ruling where we allowed the taxpayer to specifically identify stock that it exchanged for stock in a merger situation.

Nonetheless, we think that the position we have taken in the main text is defensible. There are many cases that support our position, albeit all of them are pre-I.R.C. ' 358(b) and none of them involve an ' 351 exchange. A nonexhaustive list of these cases are: Von Gunten v. Commissioner, 28 B.T.A. 702 (1933); Commissioner v. Oliver, 78 F.2d 561 (3rd Cir. 1935); Helvering v. Stifel, 75 F.2d 583 (4th Cir. 1935); Commissioner v. Bolender, 82 F.2d 591 (7th Cir. 1936); Commissioner v. Case, 86 F.2d 996 (7th Cir. 1936); Robert J. Mehan v. United States, 38-1 USTC & 9087 (1937); Crespi v. Commissioner, 44 B.T.A. 990 (1941); Arrott v. Commissioner, 136 F.2d 449 (3rd Cir. 1943); Big Wolf Corporation v. Commissioner, 2 T.C. 751 (1943); and Fleischmann v. Commissioner, 40 B.T.A. 672, 688 (1939).

The second area of concern deals with [redacted] statements that the allocation of shares derived out of a recapitalization. Regardless of whether there may have been some recapitalization, clearly there was a ' 351 exchange in which the [redacted] corporate stocks were contributed to Transaction Sub in exchange for stock. We do not believe that [redacted] would contest this point. [redacted] filed a Restated Certificate of Incorporation of Transaction Sub, apparently in part to accomplish the I.R.C. ' 351 transaction. But this fact is not entirely free from doubt. Three statements made by [redacted] suggest that there may have been a recapitalization that occurred in [redacted]: (1) [redacted] stated that when it transferred the stock of the 9 corporations to Transaction Sub, no additional stock was issued to it with regard to ASub 8, Sub 10, Sub 6, Sub 9 or Sub 7@ by Transaction Sub with regard to these transfers Abecause shares were already issued for these entities in [the recapitalization]@; (2) In another statement, [redacted] stated, AIn [redacted], all shares of Transaction Sub that correspond to the above purchases, were issued to [redacted] within the original [redacted] shares of Transaction Sub stock attributable to [redacted]@; and (3) In responding to the Service=s inquiry as to why [redacted] did not file I.R.C. ' 351 transfer statements for the transfers of 9 corporations [redacted] responded,

> Transferor=s/Transferee=s Statements do not exist for Sub 8, Sub 10, Sub 6, Sub 9 or Sub 7 related to the contribution of the stock of these companies by [redacted], to Transaction Sub No additional stock was issued by Transaction

Sub in [redacted] related to these contributions. The shares of Transaction Sub stock attributable to these contributions were issued to [redacted], in [redacted], within the original [redacted] shares of Transaction Sub stock attributable to

Regardless of whether there may have been some recapitalization, clearly there was a 351 in which the 9 corporate stocks were contributed to Transaction Sub in exchange for stock.

If you have any further questions, please call (202) 622-7930.

Deborah A. Butler
Assistant Chief Counsel

By: _____
STEVEN J. HANKIN
Special Counsel
Associate Chief Counsel (Domestic)