Section 304.—Redemption Through Use of Related Corporations

26 CFR 1.304–2: Acquisition by related corporation (other than subsidiary).

If, pursuant to an integrated plan, a parent corporation sells the stock of a wholly owned subsidiary for cash to another wholly owned subsidiary and the acquired subsidiary completely liquidates into the acquiring subsidiary, the transaction is treated as a reorganization under § 368(a)(1)(D). See Rev. Rul. 2004-83, page 157.

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

Corporate reorganizations. This ruling provides that if, pursuant to an integrated plan, a parent corporation sells the stock of a subsidiary to another subsidiary and the acquired subsidiary liquidates into the acquiring subsidiary, the transaction is a reorganization under section 368(a)(1)(D) of the Code.

Rev. Rul. 2004–83

ISSUE

Under the facts described below, what is the proper tax treatment if, pursuant to an integrated plan, a parent corporation sells the stock of a wholly owned subsidiary for cash to another wholly owned subsidiary and the acquired subsidiary completely liquidates into the acquiring subsidiary.

FACTS

Situation 1

Corporation P owns all the stock of Corporation S and Corporation T. P, S, and T are members of a consolidated group. As part of an integrated plan, S purchases all the stock of T from P for cash and T completely liquidates into S. Assume that if T had sold its assets directly to S and T had completely liquidated into P, the transaction would have qualified as a reorganization under § 368(a)(1)(D) of the Internal Revenue Code.

Situation 2

The facts are the same as in Situation 1 except that P, S, and T are not members of a consolidated group.

LAW

Section 368(a)(1)(D) provides that a reorganization includes a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction that qualifies under § 354, 355, or 356.

In Rev. Rul. 70–240, 1970–1 C.B. 81, B owned all the outstanding stock of Corporation X and Corporation Y. X sold its operating assets to Y for cash equal to their fair market value and used its remaining assets to pay its debts. X then liquidated and B received a liquidating distribution in exchange for his X stock. The ruling

concludes that the transfer by X of its operating assets to Y is regarded as the acquisition by Y of substantially all the assets of X and is a reorganization under § 368(a)(1)(D). *Accord Atlas Tool Co. v. Commissioner*, 70 T.C. 86 (1978), *aff'd*, 614 F.2d 860 (3rd Cir. 1980), *cert. denied*, 449 U.S. 836 (1980); *Armour v. Commissioner*, 43 T.C. 295 (1964).

In determining whether a transaction qualifies as a reorganization under § 368(a), the transaction must be evaluated under relevant provisions of law, including the step transaction doctrine. Section 1.368–1(a) of the Income Tax Regulations. The step transaction doctrine "treats a series of formally separate 'steps' as a single transaction if such steps are in substance integrated, interdependent, and focused toward a particular result." *Penrod v. Commissioner*, 88 T.C. 1415, 1428 (1987).

In Rev. Rul. 67–274, 1967–2 C.B. 141, pursuant to a plan of reorganization, Corporation Y acquired all the stock of Corporation X in exchange for voting stock of Y. Thereafter, X completely liquidated into Y. The ruling concludes that the two steps do not qualify as a reorganization under § 368(a)(1)(B) followed by a liquidation under § 332, but instead qualify as a single acquisition of X's assets in a reorganization under § 368(a)(1)(C). *See also* Rev. Rul. 72–405, 1972–2 C.B. 217 (treating the acquisition of the assets of a target corporation in a forward triangular merger followed by the liquidation of the acquiring subsidiary as a reorganization under § 368(a)(1)(C)); Rev. Rul. 2001–46, 2001–2 C.B. 321 (applying the approach reflected in Rev. Rul. 67–274 to a stock acquisition followed by a merger of the acquired corporation into the acquiring corporation).

Section 1.1361–4(a)(2) provides that if an S corporation makes a QSub election with respect to a subsidiary (an election to disregard a subsidiary as an entity separate from its S corporation parent), the subsidiary is deemed to have liquidated into the S corporation. In Example 3 of § 1.1361–4(a)(2)(ii), pursuant to a plan, Individual A contributes all the outstanding stock of Y to his wholly owned S corporation, X, and immediately causes X to make a QSub election for Y. The example concludes that the transaction is a reorganization under § 368(a)(1)(D), assuming the other conditions for reorganization treatment are satisfied.

Section 304(a)(1) provides, in general, for purposes of §§ 302 and 303, if one or more persons are in control of each of two corporations and, in return for property, one of the corporations acquires stock in the other corporation from the person (or persons) so in control, then such property shall be treated as a distribution in redemption of the stock of the corporation acquiring such stock.

Section 1.1502–80(b), which relates to consolidated returns, provides that § 304 does not apply to any acquisition of stock of a corporation in an intercompany transaction.

ANALYSIS

In Situation 1, because P, S, and T are members of a consolidated group, and S's purchase of the T stock from P is an intercompany transaction under § 1.1502–80(b), § 304 cannot apply to P's sale of T stock to S. As described above, if T had transferred its assets directly to S and T had completely liquidated into P, the stock sale and liquidation would have qualified as a reorganization under § 368(a)(1)(D). Consistent with Rev. Ruls. 67–274 and 72–405 and Example 3 of § 1.1361–4(a)(2)(ii), the step transaction doctrine applies to treat the stock sale and liquidation as a reorganization under § 368(a)(1)(D). Authorities that reject the application of the step transaction doctrine based on the policy of § 338, such as § 1.338–3(d) and Rev. Rul. 90–95, 1990–2 C.B. 67, are not relevant in this case because there is no purchase of T stock within the meaning of § 338(h)(3)(A) and § 1.338–3(b).

Situation 2 differs from Situation 1 only in that P, S, and T are not members of a consolidated group. As a result, if the step transaction doctrine does not apply to step together the stock sale and liquidation, the stock sale would be treated as a distribution in redemption of the S stock under § 304(a)(1) and the liquidation of T into S would qualify as a liquidation under § 332.

There is no policy that requires § 304 to be applied when § 368(a)(1)(D) would otherwise apply. *See* J. Comm. on Tax'n., 98th Cong. 2nd Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984* 192 (Comm. Print 1984). Moreover, the legislative history to the Deficit Reduction Act of 1984, P.L. 98–369, 1984–3 (Vol. 1) C.B. 1, indicates that § 304 was not intended to override reorganization treatment. *See* H.R. Rep. No. 98–432 Pt. 2, 1624 (1984). Accordingly, in Situation 2, as in Situation 1, the step transaction doctrine applies to treat the stock sale and liquidation as a reorganization under § 368(a)(1)(D).

HOLDING

Under the facts presented, if, pursuant to an integrated plan, a parent corporation sells the stock of a wholly owned subsidiary for cash to another wholly owned subsidiary and the acquired subsidiary completely liquidates into the acquiring subsidiary, the transaction is treated as a reorganization under § 368(a)(1)(D).

DRAFTING INFORMATION

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