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Particular Situations Where Tax Free Objective of Transfer under Section 351 May Be Frustrated

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CONCLUSION

More aspects of the pitfalls under section 351 will be discussed in a subsequent article.[56] The analysis thus far presented, however, indicates the need for careful compliance with the mechanical provisions of section 351. In most cases where a tax-free transfer of property to a new corporation is desired, there should be no difficulty in complying with the requirements of section 351. In many others, however, complexities exist, or the possibility of obtaining favorable treatment under section 351 may be uncertain due to the nature of the property being transferred or the technical requirements of the statute. While generally it will not be necessary, in some cases it may be desirable to request an advance ruling from the Internal Revenue Service that the proposed transfer is tax-free under section 351. It is unfortunate that the Internal Revenue Service has announced the policy that it will not issue rulings on the matter of transfers where "securities" are involved. The uncertainty as to this phase of section 351, and other applications of the law where the question involves the treatment of securities as debts, may speed the day in which clarifying legislation will be necessary. Such legislation has been proposed,[57] and may receive early consideration as part of a technical reform of our tax laws.

III

PARTICULAR SITUATIONS WHERE TAX FREE OBJECTIVE OF TRANSFER UNDER SECTION 351 MAY BE FRUSTRATED

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STOCK OR SECURITIES ISSUED FOR SERVICES

The purpose of section 351 is to permit transfers of property to a controlled corporation, in exchange for stock or securities, without recognition of taxable gain or loss at the time of the transfer. The statute expressly provides that stock or securities issued for services will not be considered as having been issued in exchange for property. The obvious consequence of this provision is that the receipt of stock issued as payment for past or future services constitutes ordinary income to the recip-

56. See discussion pp. 210-14.

57. H.R. 10591, 86th Cong., 2d Sess. § 18 (1960) which would amend § 317 to add a definition of indebtedness of a corporation. This bill contains recommendations of the American Bar Association.

ient.[1] Section 351 requires that transferors of property be in control of the corporation, and "control" is defined as ownership of eighty per cent of the stock. Thus, the issuance of more than twenty per cent of the stock, in payment for services, to a person who has transferred no property will render section 351 inapplicable to any transfers of property in exchange for stock of the corporation.[2] While section 351 requires that eighty per cent of the stock be issued to transferors of property, it does not require that the stock be issued in exchange for the property transferred. Thus, if more than twenty per cent of the stock is issued to a person who has performed services and has also transferred property to the corporation, that person will be classified as a "transferor" and all of the stock received by him (including stock received in recognition of services) will be taken into account in determining whether the transferors have the requisite eighty per cent control to qualify the transaction under section 351. The value of the stock issued for services will be taxable income to the recipient, but no gain or loss will be recognized on any of the transfers of property to the corporation.[3]

The Regulations draw a distinction between a case where stock is issued for services rendered or to be rendered to the corporation, and a case where the services were rendered to one of the transferors. The distinction is illustrated in the Regulations by the following example: *A* and *B* form a corporation, *A* transferring property worth $8,000 for 20 shares and *B* transferring property worth $2,000 for 80 shares. *B* had rendered services to *A*. *B* is deemed to have received 60 shares as taxable compensation, and *A* realized gain or loss measured by the difference between the cost basis and the fair market value of 60 shares, at the time of the exchange.[4] The theory of the Regulations is that the excessive amount of stock issued to *B* may be treated as if it had been issued to *A*, and transferred by *A* to *B* in satisfaction of a prior indebtedness.

In any situation where the action of the participants in the organization of a corporation discloses that stock has been issued for services, the foregoing rules will apply. In some situations, a disclosure may be ad-

1. Treas. Reg. § 1.351-1. (Hereinafter cited as Reg.).

2. Reg. § 1.351-1(a) (1) (i); *cf.* Mojonnier & Sons, 12 T.C. 837 (1949), *nonacq.*, 1949-2 CUM. BULL. 4.

3. The Regulations provide for an exception where the person who is being compensated for services transfers property of little value, and the primary purpose of his transfer is to qualify exchanges of property made by other persons. In such a case the stock issued to the person who performed services will not be taken into account in determining whether there is the requisite control by the transferors. Reg. § 1.351-1(a) (1) (ii).

4. Reg. § 1.351-1(b). While the Regulations do not so state, the application of this theory of the transaction would presumably require the allowance to *A* of a business expense deduction in the same amount as that which is included as compensation income to *B*, assuming that the compensation would have been deductible if paid in cash.

visable because of the protection offered to the directors under state corporate law where the value of the services has been specifically determined.[5] In other situations, where the parties did not purport to issue stock for services, a factual question may be raised as to whether stock was in fact issued for a combination of services and property. For example, if a group of investors contribute cash for shares of a new corporation and an inventor, who will be active in the management of the business contributes patents, secret processes, or other intangibles in exchange for his stock, it could be asserted that too much stock had been issued for the intangibles and that the excess was issued for past and/or future services. Unless there is other evidence which contradicts the value placed upon the intangible property by the amount of stock issued for it, no part of the stock received by the inventor should be deemed to have been issued for services. There is authority for the proposition that a shareholder can forego compensation for services rendered to his corporation.[6] The fact that those who paid cash for their shares thereby agreed to the valuation of the intangible property contributed in exchange for other shares should be a persuasive factor supporting the conclusion that no compensation for services is involved.[7] The fact that the intangible property transferred may have been produced by the personal efforts of the transferor does not justify an assertion that stock received for such property is compensation for services.[8]

DISPROPORTIONATE STOCK DISTRIBUTIONS WHICH INVOLVE GIFTS RATHER THAN COMPENSATION

It has been held that the issuance of more than twenty per cent of a new corporation's stock to a person who did not transfer property to the corporation, but where the stock is issued in exchange for property transferred to the corporation by a party who intended a gift to the recipient of the stock, defeats the requisite control by the transferor, and gain is realized upon the transfer.[9] On the other hand, if a transferor receives all

5. See, *e.g.*, OHIO REV. CODE § 1701.19.

6. *Cf.* W. H. Weaver, 25 T.C. 1067 (1956); George M. Gross, 23 T.C. 756 (1955), *aff'd*, 236 F.2d 612 (2d Cir. 1956).

7. The agreement by other shareholders that the stock was issued for the property rather than for services should be as persuasive in this context as the agreement of the parties has been found to be in the analogous situation where parties having an adverse interest agree that a payment is, or is not, made for a covenant not to compete. *Cf.* Commissioner v. Gazette Tel. Co., 209 F.2d 926 (10th Cir. 1954).

8. Roberts Co., Inc. v. Commissioner, 5 T.C. 1 (1945), *acq.*, 1945 CUM. BULL. 6.

9. Fahs v. Florida Mach. & Foundry Co., 168 F.2d 957 (5th Cir. 1948). *But cf.* Reg. § 1.351-1(b)(1), which provides that in the case of a gift, the stock will be treated as if issued originally to the donor, and transferred by him to the donee. Such a view of the transaction would recognize at least momentary control by the transferor, and such control has been found to be sufficient in a gift situation. See Wilgard Realty Co. v. Commissioner, 127 F.2d 514 (2d Cir.), *cert. denied*, 317 U.S. 655 (1942).

of the stock of a new corporation, and immediately makes a gift of more than twenty per cent of it, the control requirement is satisfied, even though the purpose of the incorporation was to facilitate the making of the gift.[10] While the difference in the tax result based upon the formalities of the transaction does not seem justified, prudence suggests that the safer course to follow, whenever a gift of more than twenty per cent of the stock is contemplated, is to provide for the issuance of all of the stock to the transferor of property to the new corporation, followed by gifts of the stock to the donees.

ASSUMPTION OF LIABILITY

Section 357(a) provides as a general rule that an assumption of a liability, or an acquisition of property subject to a liability,[11] shall not be treated as money or other property, and shall not be excluded from the tax-free provisions of section 351. Without this provision, gain would be realized, under the "boot" provision of section 351(b)[12] to the extent of the amount of the liabilities assumed.

There are two important exceptions to the rule that assumed liabilities are to be disregarded for the purpose of applying section 351. Section 357(b) provides that the assumption of a liability will not be disregarded if the principal purpose of the assumption was to avoid federal income tax on the exchange, or if it was not for a bona fide business purpose. Under section 357(c), if the liability assumed exceeds the basis of the property transferred, the excess of the liability over basis shall be taxable gain.[13]

The Regulations contain no examples of situations where tax avoid-

10. Wilgard Realty Co. v. Commissioner, 127 F.2d 514 (2d Cir.), *cert. denied,* 317 U.S. 655 (1942).

11. Since the Code treats the acquisition of property subject to a liability in the same manner as an assumption of a liability, all references herein to an assumption of liability are equally applicable to an acquisition of property subject to a liability.

12. The reason for the enactment of the predecessor to INT. REV. CODE OF 1954, § 357 (Hereinafter cited as §) was a holding by the Supreme Court in United States v. Hendler, 303 U.S. 564 (1938), that an assumption of liabilities in connection with a transfer to a controlled corporation resulted in a realized gain, under the "boot" provision which was a predecessor to INT. REV. CODE OF 1954, § 351(b).

13. Under § 357(b), if *any* liability of a transferor is assumed for a tax avoidance purpose, or without a bona fide business purpose, gain is recognized to the extent of *all* assumed liabilities of that transferor. Under § 357(c) the excess of liabilities over basis is probably determined by reference to the total basis for *all* property transferred by the particular transferor. *Cf.* Reg. § 1.357-2(a). Whether the recognized gain is taxable as capital gain or ordinary income depends upon the character of the assets transferred. If both capital and noncapital assets are transferred, an allocation of the gain to the various assets is made on the basis of the relative fair market values of the assets transferred. Reg. § 1.357-2(b), Example 2. If the gain is realized with respect to depreciable property by a person who owns more than 80% of the stock, however, it will be taxable as ordinary income under § 1239. See Rev. Rul. 60-302, 1960 INT. REV. BULL. NO. 38, at 10; W. H. Weaver, 32 T.C. 411 (1959), *aff'd sub nom.* Bryan v. Commissioner, 60-2 U.S. Tax Cas. ¶ 9603 (4th Cir. July 13, 1960).

ance purpose or lack of business purpose will be deemed to be present. Case law casts little light on the matter, since the decided cases involve situations where the liability assumed exceeded the basis of the property, and this fact alone was decisive in the determination by the courts that there was a tax avoidance purpose for the transaction.[14] These cases involved transactions which occurred prior to the enactment of section 357(c), which is designed to deal with this specific situation.[15]

The prohibited tax avoidance purpose would presumably be present in any situation where a debt is incurred by the transferor in anticipation of an assumption of that debt by the transferee corporation in connection with a transfer to that corporation, when the proceeds of the loan are retained by the transferor. The effect of such a transaction is the same as a transfer of property to the corporation in exchange for stock and cash. Gain on such a transaction would be taxable under section 351(b), to the extent of the cash received. Such an assumption of a liability as an alternative to the receipt of taxable boot would be an example of a tax avoidance purpose.

In any case where an assumed indebtedness is not incurred in connection with the acquisition of the property transferred, or in the course of the business which is transferred to the controlled corporation, there is a risk that section 357(b) may be applicable, and gain may be recognized to the extent of the assumed liabilities.

REINCORPORATION

Before concluding that the tax consequences of a transfer to a controlled corporation will be governed by section 351, it is necessary to consider whether events occurring prior or subsequent to the transfer may so alter the character of the transaction as to require the conclusion that the entire transaction constitutes a reorganization, or involves a disguised dividend under other provisions of the Internal Revenue Code. The phrase "step transaction" is the usual label used to describe any situation where successive steps taken in accordance with a single plan have an overall effect which justifies a different tax treatment than that which would result if each step were treated separately. The step transaction

14. *Cf.* Bryan v. Commissioner, 60-2 U.S. Tax Cas. ¶ 9603 (4th Cir. July 13, 1960); Jack L. Easson, 33 T.C. No. 109 (Feb. 29, 1960).

15. Section 357 provides that in any case where both subsections (b) and (c) are applicable, (b) shall control. Since under (b) the total gain on the exchange is recognized up to the total amount of liabilities assumed, a larger tax usually will result from the application of (b) than from the application of (c), which limits the gain to the excess of the assumed liabilities over the cost basis of the property transferred. In Bryan v. Commissioner, 60-2 U.S. Tax Cas. ¶ 9603 (4th Cir. Dec. 24, 1960), it was held that the very fact that the liabilities assumed exceeded the basis of the property transferred, established a tax avoidance purpose, and therefore gain was realized under (b). In view of this holding, it is likely that there will be few cases in which (c) is found to be applicable.

doctrine has been applied frequently in situations where an existing corporation is liquidated, and a new corporation is formed which receives the assets of the old corporation and carries on the same business with subtantially the same shareholders.[16] The frequency of litigation in this area is understandable, if we consider the many favorable tax results which could be achieved if the liquidation of the old corporation and the incorporation of the new one were separately treated under sections 331 and 351 respectively. Such treatment would permit: the withdrawal of assets from the continuing corporate enterprise at capital gain rates, rather than at the usual ordinary income rates applicable to dividends; the creation of indebtedness of the new corporation in the form of securities without tax consequences, whereas the issuance of securities as a dividend would result in ordinary income tax; a stepped-up cost basis for the inventory and depreciable assets transferred to the new corporation, at the cost of a capital gains tax on liquidation of the old corporation; a new $100,000 accumulated earnings credit under section 535 for the new corporation; elimination of the earnings and profits and other burdensome tax attributes of the old corporation; or, if the venture has not prospered, realization of a recognized loss without terminating the business.

In the past, attempts to achieve these objectives have been frustrated by a series of decisions which have characterized the entire transaction as a (D) reorganization under section 112(g) of the 1939 Code. A number of cases have held that such a reorganization occurred where assets were transferred to a new controlled corporation prior to the liquidation of the old corporation.[17] It has made no difference whether the assets were transferred to the new corporation for stock, or purportedly sold to the new corporation for cash.[18] The result is not changed if the old corporation is first liquidated and the assets then transferred by the shareholders to a new controlled corporation.[19] In all of these cases, the

16. For a collection of the cases involving this problem, see MacLean, *Problems of Reincorporation and Related Proposals of Subchapter C Advisory Group,* 13 TAX L. REV. 407 (1958). For a discussion of this and other applications of the step transaction doctrine, see Mintz & Plumb, *Step Transactions in Corporate Reorganizations,* N.Y.U. 12TH INST. ON FED. TAX 247 (1954).

17. *E.g.,* Liddon v. Commissioner, 230 F.2d 304 (6th Cir. 1956); Lewis v. Commissioner, 176 F.2d 646 (1st Cir. 1949); Love v. Commissioner, 113 F.2d 236 (3d Cir. 1940).

18. *E.g.,* Liddon v. Commissioner, 230 F.2d 304 (6th Cir. 1956); Pebble Springs Distilling Co. v. Commissioner, 23 T.C. 196, *aff'd,* 231 F.2d 288 (7th Cir.), *cert. denied,* 352 U.S. 836 (1956). *But cf.* Allied Stores Corp., 19 CCH Tax Ct. Mem. 1149 (Sept. 30, 1960), where it was held that a sale by the liquidating company to an existing corporation controlled by the same shareholder was not a (D) reorganization.

19. Bard-Parker Co., Inc. v. Commissioner, 218 F.2d 52 (2d Cir. 1954), *cert. denied,* 349 U.S. 906 (1955); Survaunt v. Commissioner, 162 F.2d 753 (8th Cir. 1947); Ethel K. Lesser, 26 T.C. 306 (1956). While the Sixth Circuit gave effect to the separate steps of liquidation and reincorporation in United States v. Arcade Co., 203 F.2d 203 (6th Cir. 1953), this decision is of doubtful value as a precedent in view of the subsequent holding of the same court in Liddon v. Commissioner, 230 F.2d 304 (6th Cir. 1956).

courts have found that a reorganization occurred if the liquidation of the old corporation, and the formation of the new corporation, were actions taken in accordance with a plan conceived before the first step was taken. Treatment of the transaction as a reorganization has been avoided only where the taxpayer has successfully demonstrated that at the time of the liquidation of the old corporation, there was no plan to reincorporate, and that the reincorporation occurred a number of months later, because of circumstances which arose after the liquidation.[20]

Because of changes made in the definition of a (D) reorganization in the 1954 Code, it is no longer possible to classify a reincorporation as a (D) reorganization.[21] This does not mean, however, that the way is now open to achieve the desirable tax results described above. The Regulations are replete with warnings that a liquidation and reincorporation might still be treated as a reorganization, or that the liquidation and reincorporation might be disregarded entirely for tax purposes, and the new corporation treated as a continuation of the old corporate entity.[22] It has been suggested that the Internal Revenue Service cannot effectively deal with a reincorporation under the 1954 Code. Elaborate revisions of the definition of reorganization have been proposed for the purpose of remedying this situation.[23] On the other hand, some commentators believe reincorporations can be classified as recapitalizations under (E), or mere changes in identity or form under (F) of the present definition of a reorganization in section 368(a)(1).[24] The Regulations strongly suggest that the Internal Revenue Service will take this position.[25]

Under the 1939 Code it was possible to defeat an attempt to treat a reincorporation as a (D) reorganization, by arranging to have more than twenty per cent of the stock of the new corporation owned by persons who were not shareholders of the old corporation, since one of the requirements for a (D) reorganization was that the assets be transferred to a corporation controlled by shareholders of the transferor.[26] In the context of the 1954 Code, as indicated above, a reincorporation is likely to be classified as either an (E) (recapitalization) or (F) (mere change in identity) reorganization, or as a continuance of the existence of the

20. Charles R. Mathis, Jr., 19 T.C. 1123 (1953).

21. For a definition of a (D) reorganization see § 368(a)(1)(D). For a discussion of these changes, see MacLean, *Problems of Reincorporation and Related Proposals of Subchapter C Advisory Group,* 13 TAX L. REV. 407, 413 (1958).

22. Reg. §§ 1.301(a), 1.331-1(c), 1.351-2(d).

23. See MacLean, *Problems of Reincorporation and Related Proposals of Subchapter C Advisory Group,* 13 TAX L. REV. 407 (1958) and the proposal of the Subchapter C Advisory Group discussed therein at 419-37.

24. See Bittker, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS 401 (2d ed. 1958).

25. See Reg. §§ 1.301-1(a), 1.331-1(c), 1.351-2(d).

26. *Cf.* Austin Transit, Inc., 20 T.C. 849 (1953), *acq.*, 1954-1 CUM. BULL. 3.

old corporation without reference to any reorganization provision. Therefore, the fact that shareholders of the old corporation do not control the new corporation will not provide a sure defense against the assertion of the step transaction doctrine. On the contrary, a recently announced policy of the Service suggests that ownership of even a small amount of the stock of the old and the new corporations by the same persons might justify the application of the doctrine. T.I.R. 310[27] provides that no advance rulings will be issued with respect to the tax treatment of any transaction which involves "the liquidation of a corporation, preceded or followed by the reincorporation of all or a part of the business and assets, where the shareholders of the liquidating corporation own more than a nominal amount of the stock of the new transferee corporation; or where a liquidation is followed by the sale of the corporate assets by the shareholders to another corporation in which such shareholders own more than a nominal amount of the stock."[28]

TRANSFERS OF STOCK SHORTLY AFTER INCORPORATION

Under section 351, it is required that the transferors be in control "immediately after the exchange." Where the transferors receive all of the stock of the new corporation in exchange for property, and shortly thereafter sell or otherwise dispose of more than twenty per cent of the stock, is this control requirement satisfied? The many cases dealing with this problem involve an approach to the step transaction doctrine different from that used in the reincorporation cases discussed in the preceding section.[29] In the reincorporation cases the inquiry has been whether or not the steps taken were taken in accordance with a preconceived plan. In cases involving transfers of stock shortly after incorporation the courts have applied a so called "mutual interdependence" test. The most frequently quoted statement of this test is that of the Tax Court in *American Bantam Car Company*:[30]

> Were the steps so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series?

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27. Released March 3, 1961. Prior to the amendment announced in T.I.R. 310, Revenue Procedure 60-6, 1960 INT. REV. BULL. No. 12, at 27, provided that rulings would not be issued only where the shareholders of the liquidating corporation owned more than 50 per-cent of the voting stock of the transferee corporation.

28. T.I.R. 310 released March 3, 1961 also provides that rulings can no longer be obtained on the qualification under § 337 of sales made in liquidation, if more than a nominal amount of the stock of the selling and purchasing corporations is held by the same persons.

29. See cases discussed in Mintz & Plumb, *Step Transactions In Corporate Reorganizations*, N.Y.U. 12TH INST. ON FED. TAX 247, 253-60 (1954).

30. 11 T.C. 397, 405 (1948), *aff'd*, 177 F.2d 512 (3d Cir. 1949), *cert. denied*, 339 U.S. 920 (1950).

In applying this test, the courts have uniformly held that the requisite control was destroyed, whenever the transferors were bound, by a contract entered into prior to the exchange, to sell or otherwise dispose of more than twenty per cent of the stock received on the exchange of property for stock of the new corporation.[31] This has been the result where the shares of the new corporation were sold,[32] or where they were transferred in payment for services.[33] If a person who makes no transfers to the new corporation holds an unconditional option to acquire more than twenty per cent of the stock received by the transferors, it has been held that the transferors do not have the requisite control.[34] On the other hand, the existence of such an option which is never exercised does not defeat the requisite control.[35] Where the option is contingent upon the optionee's success in marketing securities of the new corporation, its existence does not defeat the requisite control, even though the option is in fact exercised.[36]

Immediate voluntary re-transfer of shares received by a transferor of property to a new corporation will not destroy the requisite control. Thus, where the transferor exchanges property for the stock of a new corporation in order to make gifts to members of his family, and he immediately donates more than twenty per cent of the stock received, it has been held that he has the requisite control.[37] Section 351 expressly recognizes that a distribution by a corporate transferor of the stock received upon the exchange does not disqualify the transaction.[38]

A section 351 transaction will often involve a plan for a public offering by the new corporation. In the cases which have involved the effect of such public offerings upon the control requirement, the courts have found that the public offering, while contemplated, was not such an essential feature of the incorporation plan that the transfer of assets to the new corporation would have been a fruitless step if the public offering were not carried out.[39] It would seem, however, that the result

31. *E.g.*, May Broadcasting Co. v. United States, 200 F.2d 852 (8th Cir. 1953); S. Klein On the Square, Inc. v. Commissioner, 188 F.2d 127 (2d Cir.), *cert. denied*, 342 U.S. 824 (1951); Manhattan Building Co., 27 T.C. 1032 (1957), *acq.*, 1957-2 CUM. BULL. 5.

32. See cases cited note 30, *supra*.

33. Columbia Oil & Gas Co., 41 B.T.A. 38 (1940), *acq.*, 1940-1 CUM. BULL. 2, *aff'd on other grounds*, 118 F.2d 459 (5th Cir. 1941); *cf.* Mojonnier & Sons, Inc., 12 T.C. 837 (1949), *nonacq.*, 1949-2 CUM. BULL. 4.

34. Barker v. United States, 200 F.2d 223 (9th Cir. 1952).

35. Commissioner v. National Bellas Hess, Inc., 220 F.2d 415 (8th Cir. 1955).

36. American Bantam Car Co., 11 T.C. 397 (1948), *aff'd*, 177 F.2d 513 (3d Cir. 1949), *cert. denied*, 339 U.S. 920 (1950).

37. Wilgard Realty Co. v. Commissioner, 127 F.2d 514 (2d Cir.), *cert. denied*, 317 U.S. 655 (1942); *cf.* John C. O'Conner, 16 CCH Tax Ct. Mem. 213 (1957), where a voluntary transfer of shares in payment of a creditor's claim did not defeat the requisite control.

38. § 351(c).

39. Commissioner v. National Bellas Hess, Inc., 220 F.2d 415 (8th Cir. 1955); Scientific

should be no different where the public offering is a mutually interdependent step with the transfer of assets to a new corporation. In such a case the purchasers of the stock on the public offering should be regarded as additional transferors, and the entire transaction should still qualify under section 351.[40] This principle has been recognized in several cases under the 1939 Code involving sales of additional stock to a specific group of investors,[41] but there have been no cases in which sales of stock to the public have been regarded as section 351 transfers.[42] Prudence therefore suggests that every effort be made to avoid commitments for public offerings by the new corporation of more than twenty per cent of its stock, until after the exchange of property for stock of the new corporation has been completed.

BUSINESS PURPOSE — IS IT A REQUIREMENT FOR QUALIFYING UNDER SECTION 351?

Revenue Ruling 55-36[43] deals with the tax consequences of a situation where an individual transferred stock of *A* Corporation, which was about to be liquidated, to a new corporation (*B* Corporation) in exchange for all of its stock and bonds. He immediately transferred the *B* Corporation stock to a charity, which in turn caused the liquidation of *B* Corporation, and assumed the obligation under its bonds. The individual's plan was to make subsequent gifts of the bonds to the charity from time to time, thus not only avoiding capital gain upon the liquidation of *A* Corporation, but also spreading his charitable deduction over a number of years. The Service noted that *B* Corporation, like the corporation involved in *Gregory v. Helvering*,[44] did not remain in existence after the transaction. The Service concluded that there was no business purpose for the transfer to *B* Corporation and that section 112(b)(5) of the 1939 Code, the predecessor of section 351, did not apply. This

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Instrument Co., 17 T.C. 1253 (1952), *aff'd*, 202 F.2d 155 (6th Cir. 1953); American Bantam Car Co., 11 T.C. 397 (1948), *aff'd*, 177 F.2d 512 (3d Cir. 1949), *cert. denied*, 339 U.S. 920 (1950).

40. Those who purchase stock for cash qualify as transferors. Halliburton v. Commissioner, 78 F.2d 265 (9th Cir. 1935); George M. Holstein, III, 23 T.C. 923 (1955).

41. The approach suggested in the text was taken in the *Halliburton* case and other cases in which the issue was whether there was compliance with the "proportionate interest" requirement of § 112(b)(5) of the 1939 Code, which is no longer applicable under the 1954 Code.

42. Where stock is sold to the public through underwriters, it might be argued that the underwriters are the "transferors," and that resale to the public defeats the required control by the "transferors." It would seem, however, that if the step transaction doctrine is applied to the end that it requires consideration of the sale of the stock to the public, for purposes of determining who really receives control, the doctrine should also be applied for the purpose of recognizing that the underwriters serve only as a conduit, and that the ultimate purchasers in the public offering should be recognized as the true transferors.

43. 1955-1 CUM. BULL. 340.

44. 293 U.S. 465 (1935).