

II. GENERAL STATEMENT

(a) *Purchase of stock.*—Under present law if one corporation purchases 80 percent or more of the stock of another within a 12-month period and then causes the corporation acquired to be liquidated within 2 years of the last purchase, the basis of the assets it receives is the amount it paid for the stock. However, in order to prevent manipulation, stock purchased from a person related to the buyer by the attribution rules (under sec. 318) is not treated as stock “purchased.”

Cases have been called to your committee’s attention where it is necessary to acquire control of one corporation in order to obtain an 80 percent or greater stock interest in another corporation. For example, assume that one corporation desires to purchase the stock of a second corporation and does in fact purchase 45 percent of its stock directly. However, 40 percent of the stock of the second corporation is owned by a third corporation, and the third corporation does not wish to sell the stock of the second corporation. In order to acquire the stock of the second corporation, therefore, the first corporation purchases over 50 percent of the third corporation’s stock and then causes this corporation to sell to it the 40 percent of the stock of second corporation owned by the third. However, since at the time of the sale, the first corporation owns more than 50 percent of the stock of the third corporation, the two corporations are classified as related under the attribution rules (sec. 318). Accordingly, under present law, the first corporation is not treated as the purchaser of more than 80 percent of the stock of the second although it acquired directly or indirectly all of this stock for cash within a 12-month period.

This bill eliminates the problem described above by amending present law so that it provides that stock purchased from a subsidiary is to be treated as purchased, if a controlling interest in a subsidiary was purchased within a 12-month period. The bill also provides that the 12-month period within which the desired stock must be acquired begins with the date of the first direct acquisition by purchase of such stock, or the date on which 50 percent of the stock of the corporation holding such stock was acquired, whichever is earlier. The new definition of “purchase” applies with respect to acquisitions of stock after December 31, 1965. The provision for measuring the time period of stock acquisition applies with respect to distributions made after the date of enactment of the bill.

(b) *Installment notes.*—When one corporation buys more than 80 percent of the stock of another within 12 months and causes the corporation acquired to be liquidated within 2 years of the last acquisition of stock, the basis of the assets acquired is the amount paid for the stock (properly allocated). In such a case, generally no gain is recognized to the distributing corporation (unless it is a corporation which elected 341(f) treatment to avoid danger of being treated as a collapsible corporation, or unless the sections dealing with the recapture of depreciation apply).

If the property received on a liquidation of the type described above (to which sec. 334(b)(2) applies) consists of installment notes, then the gain which would normally be taxed on the sale or collection of such notes may, in whole or in part, permanently escape income taxation. This would result if the basis of such notes were raised to the amount paid for them by the acquiring corporation even though no gain were recognized to the distributing corporation.