Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:NED:BOS:TL-N-4403-99
MJGormley

date:

to: District Director, New England District
Attn: Alena Kraynack, Revenue Agent/Team Coordinator
Stoneham, MA

from: District Counsel, New England District, Boston

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subject: [redacted]: [redacted] **Leases**
UIL #: 167.14-11

DISCLOSURE STATEMENT

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FACTS

Reference is hereby made to your memorandum to this office dated July 12, 1999 and supporting documentation submitted to this office in August 1999. You have requested our advice concerning the above-captioned taxpayer and the validity of their apparent attempt to combine an asset acquisition with a stock purchase.

Specifically, [redacted] entered into an agreement in [redacted] of [redacted] to acquire [redacted]. The agreement provided that [redacted] would purchase all the preferred and common stock of [redacted] at a cost of [redacted] dollars in cash. [redacted] also agreed to assume all of [redacted]'s debt obligations. As a result, the overall value of the transaction was approximately [redacted] dollars. Regulatory approval was required for the acquisition and [redacted]'s stock was placed in escrow until the transaction was consummated. Approval was received on [redacted], and on the following day, [redacted] the stock was released from escrow. As a result, [redacted] became a wholly owned subsidiary of [redacted] on [redacted].

One day prior to the consummation of the stock transaction, on [redacted], [redacted], in a separate transaction, purchased [redacted] leases from [redacted]. The purchase was evidenced by a wire transfer in the amount of $[redacted] to [redacted]. The price was supported by a valuation done by [redacted] on [redacted]. The sale of these leases to [redacted] did not effect the prior agreed upon price per share of [redacted]'s stock. Following the acquisition of [redacted] by [redacted], [redacted] assigned these leases to [redacted]. [redacted] had been a subsidiary of [redacted] prior to the acquisition and remained a subsidiary of [redacted] after the acquisition. [redacted] has since claimed $[redacted] in additional amortization.

The purchase of the [redacted] leases from [redacted] was not supported by a separate contract of sale. Instead, the [redacted] stock purchase agreement was amended by [redacted] to provide for an "Asset Purchase". The amendment provided that [redacted] would have the right to elect to purchase certain assets immediately prior to the consummation of the [redacted], stock transaction. The assets to be purchased were not specified:

> <u>Asset Purchases</u> At the election of the Acquirer, the Acquirer shall have the right to elect to purchase from the Company, immediately prior to the transaction contemplated by this Agreement, certain assets of the Company at their fair market value, which purchases shall be contingent upon the consummation of the transactions contemplated by the Agreement; provided that the Acquirer and/or the Company shall bear any tax liabilities associated with or resulting from such asset purchases, including any transfer or similar taxes and any such tax liabilities shall not reduce or otherwise affect the purchase price payable hereunder to the Series C Preferred Stockholder, the Series A Preferred

Stockholder or the Common Stockholders.

You have questioned whether a taxable stock acquisition may be coupled with a taxable acquisition of assets. You note that a stock acquisition generally results in a carryover of basis unless an I.R.C. § 338 election is made. No such election was made by this taxpayer. Alternatively, a taxable purchase of assets will generally result in a taxpayer taking a cost basis in the acquired assets in accordance with I.R.C. § 1060.

LEGAL ANALYSIS

In accordance with I.R.C. § 338 and the regulations thereunder, if a corporation purchases an 80% or greater interest in another corporation during a period of no more than twelve months, it may elect to treat its stock purchase as an asset purchase. I.R.C. § 338(a). In that case, the target would recognize gain or loss as if it had sold its assets at fair market value. The old target is treated as a new corporation with a stepped-up basis in its assets. The overall effect is that the acquiring corporation receives the benefit of a stepped-up basis in the assets of the acquired corporation. The step-up election is irrevocable once made. Corporations that are eligible to make the election must treat related acquisitions consistently. If a corporation makes a qualified stock purchase of a target corporation and, within a consistency period, acquires an asset from the target or a target affiliate in a transaction that results in a stepped-up basis in the asset, either the basis of all the assets or none of them is stepped-up. The consistency rules can either prevent or require a step-up election, depending upon the circumstances..

Prior to the Tax Equity and Fiscal Responsibility Act of 1982, a number of avenues of tax avoidance were available to the acquiring corporation which were not consistent with the theory of treating a purchase of stock as the economic equivalent of the purchase of assets. Section 631 of TEFRA was intended to repeal the General Utilities doctrine, which under certain circumstances, permitted a corporation to distribute appreciated assets to its shareholders without recognizing gain. General Utilities and Operating Co. v. Commissioner, 36-1 USTC ¶ 9012, 296 US 200 (1936). Following the 1986 Act, the Code generally requires a corporation to recognize gain upon the distribution of appreciated property.

The Service subsequently determined that, in certain circumstances, the acquisition, or mere ownership, of stock of a member of an affiliated group results in avoidance of the repeal of the General Utilities doctrine. Specifically, the

consolidated return regulations had the potential to facilitate circumvention of the repeal of this doctrine. See 1994-1 C.B. 358; 1994 IRB 8. Thereafter, regulations were prescribed which provided for gain recognition by a member of a consolidated group under certain circumstances. See e.g., Treas. Reg. § 1.338-4(a)(2).[1] The regulations apply to ensure consistency where the target is a member of a consolidated group and gain or loss would not be properly recognized on any subsequent disposition of the target's appreciated property. Based on advice from the National Office, outside of these circumstances, a step-up in basis is permitted, even absent an I.R.C. § 338 election.

CONCLUSION

Given all of the above, where as here, the target is not a member of a consolidated group, and there is no potential for circumvention of the General Utilities doctrine, the taxpayer will be allowed a step-up in basis of the acquired assets. Accordingly, [redacted] is permitted to value the leases at their fair market value as of the date of acquisition. We note we offer no opinion on the accuracy of the valuation placed on the leases by [redacted]. Nor have we considered whether other requirements of the Code have been met regarding the overall acquisition. If you have any questions regarding this matter, please contact the undersigned at 617/565-7858.

MAUREEN T. O'BRIEN
Assistant District Counsel

By: _____
MICHELE J. GORMLEY
Senior Attorney

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[1] We note the 1995 regulation section reflects the 1994 amendment and is applicable in this case. Other amendments in 1997 and thereafter are not applicable.