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Advice has been requested concerning the proper Federal income tax treatment of amounts received by a shareholder pursuant to a series of distributions in complete liquidation of a corporation under the circumstances described below.

On October 1, 1966, X corporation adopted a plan of complete liquidation. Under the plan X intended to distribute all of its assets, other than those required to meet claims, to its sole shareholder, A, within the 12-month period beginning on the date of adoption of the plan. A, a calendar year taxpayer, had acquired 40 percent of the 200 outstanding shares of X stock (first block) at a cost of 80x dollars (or 1x dollar per share) on January 1, 1960, and had acquired the remaining 60 percent of X stock (second block) at a cost of 360x dollars (or 3 x dollars per share) on February 10, 1963.

On November 1, 1966, X sold all its assets for 1,000x dollars (500x dollars cash and negotiable notes with a fair market value of 500x dollars). On December 1, 1966, X distributed 500x dollars to A pursuant to its plan of liquidation. At that time the adjusted basis of each of A's blocks of stock in X was its cost.

On January 2, 1967, X distributed to A all its remaining assets worth 500x dollars and A surrendered all his stock to X for cancellation.

The liquidating distributions described above fall within the ambit of section 346(a)(1) of the Internal Revenue Code of 1954 which provides that a distribution will be treated as in partial liquidation of a corporation if it is one of a series of distributions in redemption of all of the stock of a corporation pursuant to a plan of complete liquidation.

Where a shareholder holds a single block of stock (namely, a group of shares of the same class of stock acquired in the same transaction <Page 142> at the same cost) and receives a series of distributions in complete liquidation of the corporation, the distributions will first be applied against the total adjusted basis of his stock and gain will be recognized only after an amount equal to his adjusted basis has been fully recovered. Florence M. Quinn, 35 B.T.A. 412 (1937), acquiescence, C.B. 1937-1, 21; Arthur Letts, Jr., 30 B.T.A. 800 (1934), affirmed on other grounds, 84 F.2d 760 (1936). However, where a shareholder holds more than one block of stock and receives a single distribution in complete liquidation of the corporation, the distribution must be allocated ratably among the various blocks of stock. Section 1.331-1(e) of the Income Tax Regulations; Norman Cooledge, 40 B.T.A. 110 (1939). Gain or loss must, therefore, be computed separately with respect to each block of stock.

Similarly, where a shareholder owns more than one block of stock and receives a series of distributions in complete liquidation of the corporation, each distribution must be allocated ratably among the several blocks of stock in the proportion that the number of shares in a particular block bears to the total number of shares outstanding. Gain or loss must be computed separately with respect to each block of stock and gain will be recognized only after the adjusted basis of each block has been recovered. Once the adjusted basis of a specific block of stock has been recovered, all subsequent distributions allocable to that block will be recognized as gain in their entirety.

Any losses resulting from a complete liquidation will be recognized only after the corporation has made its final distribution. Dresser et al. v. United States,55 F.2d 499 (Ct. Cl. 1932), Ct. D. 503, C.B. XI-1, 267, certiorari denied, 287 U.S. 635. See, however, Commissioner v. Winthrop,98 F.2d 74 (1938), affirming 36 B.T.A. 314 (1937), acquiescence, C.B. 1940-1, 5, and G.C.M. 21966, C.B. 1940-1, 130, where a loss was sustained and allowed in the year the last substantial distribution was made because the amount of the final distribution was then determinable with reasonable certainty.

The foregoing principles dealing with complete liquidations pursuant to section 346(a)(1) of the Code apply without regard to whether or not there is a surrender of any stock prior to the final distribution.

Applying the relevant principles to this case, A's Federal income tax return for the taxable year ended December 31, 1966, should disclose a gain of 120x dollars resulting from the distribution made on December 1, 1966, in that 200x dollars (40 percent) is prorated to the first block which has an adjusted basis of 80x dollars. No gain is recognized in 1966 as to the second block since A has not recovered his adjusted basis of 360x dollars in that block. A's return for the taxable year ended December 31, 1967, should disclose gains of 200x dollars and 240 x dollars resulting from the January 2, 1967, distribution. The total prorated amount of 200x dollars is recognized on the first block since the entire basis of that block was previously recovered. Gain of 240 x dollars is recognized on the second block since 60x dollars of the 300x dollars prorated distribution represents a recovery of basis (300x dollars of the basis was recovered in 1966) and the remaining portion is recognized as gain.