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Rev. Rul. 85-48

ISSUE

What is the proper federal income tax treatment of amounts received by a shareholder pursuant to a series of distributions in complete liquidation of a multiple-shareholder corporation under the circumstances described below?

FACTS

Corporation X adopted a plan of complete liquidation on January 31, 1981, pursuant to which it intended to distribute all its assets (other than those required to meet claims) to its shareholders <Page 127> within a 12-month period beginning on the date of adoption of the plan. A, a calendar year taxpayer, had acquired 10 of the 100 outstanding shares of X stock (first block) at a cost of 10x dollars (1x dollar per share) on January 1, 1975. A had acquired an additional 20 of the 100 outstanding shares (second block) at a cost of 40xdollars (2x dollars per share) on January 1, 1980. The remaining 70 outstanding shares of X stock were owned by persons other than A.

On February 15, 1981, X sold all its assets for 600x dollars. On June 1, 1981, X distributed 150x dollars to its shareholders including 45x dollars to A pursuant to its plan of liquidation. At that time, A's adjusted basis in each block of shares was equal to A's cost. On January 1, 1982, X distributed the remaining 450x dollars to its shareholders including 135x dollars to A in its final liquidating distribution pursuant to the plan.

LAW AND ANALYSIS

Section 346(a) of the Internal Revenue Code provides that a distribution will be treated as in complete liquidation of a corporation if the distribution is one of a series of distributions in redemption of all the stock of the corporation pursuant to a plan.

Rev. Rul. 68-348, 1968-2 C.B. 141, provides that where a sole shareholder owns more than one block of shares of a corporation and receives a series of distributions in complete liquidation of the corporation, each distribution must be allocated ratably among the several blocks of shares in the proportion that the number of shares in a particularly block bears to the total number of shares outstanding. Where a corporation has multiple shareholders, liquidation distributions must be allocated among blocks of shares held by different shareholders as well as among different blocks of shares owned by a particular shareholder. Rev. Rul. 79-10, 1979-1 C.B. 140, holds that distributions under a plan of complete liquidation made by a corporation having a single class of stock will be treated as pro-rata distributions among all the outstanding shares of the corporation. Consistent with Rev. Rul. 68-348, the liquidation distributions allocated to a particular shareholder must be allocated among the several blocks of shares owned by the shareholder in the proportion that the number of shares in a particular block bears to the total number of shares owned by that shareholder.

HOLDING

Applying this principle to the situation described above, of the 45 x dollars distributed to A on June 1, 1981, 15 x dollars (10/30 × 45) is allocated to the first block of shares, which has an adjusted basis of 10x dollars, producing a gain of 5x dollars, and 30x dollars (20/30 × 45) is allocated to the second block of shares, which has an adjusted basis of 40x dollars, producing no recognition of gain. Hence, A's federal income tax return for the year ended December 31, 1981, should show gain of 5x dollars resulting from the distribution on June 1, 1981. After the June 1, 1981, distribution, A's adjusted basis for the shares of X stock is zero for the first block and 10x dollars for the second block.

Of the 135x dollars distributed to A on January 1, 1982, 45x dollars (10/30 × 135) is allocated to the first block of shares, producing a gain of 45x dollars, and 90 x dollars (20/30 × 135) is allocated to the second block of shares, producing a gain of 80x dollars. Thus, A's return for the taxable year ended December 31, 1982, should show gains of 45x dollars and 80x dollars resulting from the January 1, 1982, distribution.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 68-348 is amplified.