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Internal Revenue Service (I.R.S.)
Revenue Ruling

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26 CFR 1.351-2: Receipt of property.

(Also Section 1245; 1.1245-4.)
***1** In determining the amount of gain recognized under section 351(b) of the Internal Revenue Code of 1954 where several assets were transferred to a corporation, each asset must be considered transferred separately in exchange for a portion of each category of consideration received. The fair market value of each category of consideration received is separately allocated to the transferred assets in proportion to the relative fair market values of the transferred assets. Where as a result of such allocation there is a realized loss with respect to any asset, such loss is not recognized under section 351(b)(2) of the Code.

Advice has been requested as to the correct method of determining the amount and character of the gain to be recognized by Corporation *X* under section 351(b) of the Internal Revenue Code of 1954 under the circumstances described below.

Corporation *Y* was organized by *X* and *A*, an individual who owned no stock in *X*. *A* transferred 20*x* dollars to *Y* in exchange for stock of *Y* having a fair market value of 20*x* dollars and *X* transferred to *Y* three separate assets and received in exchange stock of *Y* having a fair market value of 100*x* dollars plus cash of 10*x* dollars.

In accordance with the facts set forth in the table below if *X* had sold at fair market value each of the three assets it transferred to *Y*, the result would have been as follows:

	Asset I	**Asset II**	**Asset III**
Character of asset	Capital asset held more than 6 months.	Capital asset held not more than 6 months.	Section 1245 property.
Fair market value	$22x	$33x	$55x
Adjusted basis	40x	20x	25x
Gain (loss)	(18x)	$13x	$30x
Character of gain or loss	Long-term capital loss.	Short-term capital gain.	Ordinary income.

The facts in the instant case disclose that with respect to the section 1245 property the depreciation subject to recapture exceeds the amount of gain that would be recognized on a sale at fair market value. Therefore, all of such gain would be treated as ordinary income under section 1245(a)(1) of the Code.

Under section 351(a) of the Code, no gain or loss is recognized if property is transferred to a corporation solely in exchange for its stock and immediately after the exchange the transferor is in control of the corporation. If section 351(a) of the Code would apply to an exchange but for the fact that there is received, in addition to the property permitted to be received without recognition of gain, other property or money, then under section 351(b) of the Code gain (if any) to the recipient will be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property received, and no loss to the recipient will be recognized.

***2** The first question presented is how to determine the amount of gain to be recognized under section 351(b) of the Code. The general rule is that each asset transferred must be considered to have been separately exchanged. See the authorities cited in Revenue Ruling 67-192, C.B. 1967-2, 140, and in Revenue Ruling 68-23, page 144, this Bulletin, which hold that there is no netting of gains and losses for purposes of applying sections 367 and 356(c) of the Code. Thus, for purposes of making computations under section 351(b) of the Code, it is not proper to total the bases of the various assets transferred and to subtract this total from the fair market value of the total consideration received in the exchange. Moreover, any treatment other than an asset-by-asset approach would have the effect of allowing losses that are specifically disallowed by section 351(b)(2) of the Code.

The second question presented is how, for purposes of making computations under section 351(b) of the Code, to allocate the cash and stock received to the amount realized as to each asset transferred in the exchange. The asset-by-asset approach for computing the amount of gain realized in the exchange requires that for this purpose the fair market value of each category of consideration received must be separately allocated to the transferred assets in proportion to the relative fair market values of the transferred assets. See section 1.1245-4(c)(1) of the Income Tax Regulations which, for the same reasons, requires that for purposes of computing the amount of gain to which section 1245 of the Code applies each category of consideration received must be allocated to the properties transferred in proportion to their relative fair market values.

Accordingly, the amount and character of the gain recognized in the exchange should be computed as follows:

	Total	**Asset I**	**Asset II**	**Asset III**
Fair market value of asset transferred	$110x	$22x	$33x	$55x
Percent of total fair market value		20%	30%	50%
Fair market value of Y stock received in exchange	$100x	$20x	$30x	$50x
Cash received in exchange	10x	2x	3x	5x
Amount realized	$110x	$22x	$33x	$55x
Adjusted basis		40x	20x	25x
Gain (loss) realized		($18x)	$13x	$30x

Under section 351(b)(2) of the Code the loss of 18*x* dollars realized on the exchange of Asset Number I is not recognized. Such loss may not be used to offset the gains realized on the exchanges of the other assets. Under section 351(b)(1) of the Code, the gain of 13*x* dollars realized on the exchange of Asset Number II will be recognized as short-term capital gain in the amount of 3*x* dollars, the amount of cash received. Under sections 351(b)(1) and 1245(b)(3) of the Code, the gain of 30*x* dollars realized on the exchange of Asset Number III will be recognized as ordinary income in the amount of 5*x* dollars, the amount of cash received.