Rev. Rul. 59-259 (IRS RRU), 1959-2 C.B. 115, 1959 WL 12262

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

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26 CFR 1.368-2: Definition of terms.

(Also Section 351; 1.351-1.)

***1** The term 'control' as defined in section 368(c) of the Internal Revenue Code of 1954 requires the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of voting stock and the ownership of at least 80 percent of the total number of shares of each class of outstanding non-voting stock.

Advice has been requested whether 'control' as defined in section 368(c) of the Internal Revenue Code of 1954 requires ownership of at least 80 percent of the total number of shares of each class of nonvoting stock for the purposes of section 351 of the Code.

Certain persons transferred property to a corporation in exchange for voting and non-voting stock, *i.e.*, 8***o*** percent of the Class A voting common stock, 83 percent of the Class A non-voting common stock, and 22 percent of the non-voting preferred stock. However, due to the relative number of non-voting common and preferred shares outstanding, these persons owned more than 80 percent of the total number of shares of the outstanding non-voting stock.

Section 351 of the Code provides, in effect, that no gain or loss shall be recognized to the transferors of property to a corporation if immediately after the transfer, the transferors are in 'control' of the corporation as defined by section 368(c) of the Code.

Section 368(c) of such Code in defining 'control' states, in part, as follows:

> * * * the term 'control' means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and *at least 80 percent of the total number of shares of all other classes of stock of the corporation*. [Italics supplied.]

The legislative history of section 368(c) of the Code indicates a congressional intent that ownership of *each* class of non-voting stock is required. The provisions of what is now section 368(c) of the Code were first enacted into law as section 202(c)(3) of the Revenue Act of 1921. That section as originally passed by the House of Representatives (H.R. 8245, 67th Cong.,* (1921)), defined 'control' as the ownership of:

> * * * at least 80 per centum of the voting stock and 80 per centum of all other classes of stock of the corporation * * *.

The section was reported out of the Senate and enacted into law in a form substantially identical to its present form, retaining the reference to classes of non-voting stock. It is apparent, therefore, that the words 'classes of stock' as used in section 368(c) of the Code refers to ownership of 80 percent of the total number of shares of each class of non-voting stock, as there is no other logical reason for retaining the words 'classes of stock' in section 202(c)(3) of the Revenue Act of 1921.

Moreover, percentage ownership of the number of non-voting shares outstanding, as contrasted to percentage ownership of each class of non-voting shares, is ordinarily of no significance and can lead to results which are inconsistent with the statutory scheme and clear congressional purpose. Ownership of large numbers of non-voting shares in a multi-class stock structure would not necessarily assure, in itself, the continuation of substantial proprietary interests in modified corporate forms as contemplated by the statute. See section 1.368-1 of the Income Tax Regulations.

***2** In view of the foregoing, it is held that 'control' as defined by section 368(c) requires ownership of stock possessing at least 80 percent of the total combined voting power of all classes of voting stock and the ownership of at least 80 percent of the total number of shares of each class of outstanding non-voting stock. Therefore, a transfer of property under the above circumstances does not constitute a transfer to a controlled corporation within the purview of section 351 of the Code.

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