

Some of the option holders of Y also owned stock of Y so that they received both X voting stock and X options in the transaction. The X options contained the same terms as the Y options except for relating to X stock with the number of shares being twice the number of shares of Y stock. The substitution of options was not a modification of the Y options, as defined in section 425(h)(3) of the Code, so that it was not considered the granting of new options under section 425(h)(1) of the Code.

Section 368(a)(1)(B) of the Code provides, in part, that a reorganization includes the acquisition by one corporation, in exchange solely for all or part of its voting stock, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation.

Section 1.368-2(c) of the Income Tax Regulations provides in pertinent part:

In order to qualify as a "reorganization" under section 368(a)(1)(B), the acquisition by the acquiring corporation of stock of another corporation must be in exchange solely for all or a part of the voting stock of the acquiring corporation, and the acquiring corporation must be in control of the other corporation immediately after the transaction. If, for example, Corporation X, in one transaction exchanges nonvoting preferred stock or bonds in addition to all or a part of its voting stock in the acquisition of stock of Corporation Y, the transaction is not a reorganization under section 368(a)(1)(B). (Emphasis added).

In the instant case, although the substitution of options occurred as part of the overall transaction, the Y shareholders received exclusively X voting stock as consideration for the stock of Y. Shareholders owning stock of Y and who did not hold any Y options before the transaction did not receive options of X as a result of the transaction. Since the options contained the same terms as would have applied to the purchase

of Y stock under the Y options, no additional benefits inured to the shareholders on the substitution of the options.

Accordingly, in the instant case, only voting stock was utilized as consideration "in the acquisition of stock" within the meaning of section 1.368-2(c) of the regulations and the "solely for \* \* \* voting stock" requirement contained in section 368(a)(1)(B) of the Code is satisfied.

#### Section 508—Special Rules With Respect to Section 501(c)(3) Organizations

Two samples of governing instruments of private foundations provide a guide for determining whether they meet the requirements of section 508(e) of the Code.

#### Rev. Rul. 70-270

Advice has been requested whether the governing instrument provisions set out in the two situations below meet the requirements of section 508(e) of the Internal Revenue Code of 1954. In each situation the organization is a private foundation as defined in section 509(a) of the Code and, apart from the charter restrictions imposed by section 508(e), qualifies for exemption from Federal income tax as a charitable organization described in section 501(c)(3).

Section 508(e) of the Code (as added by section 101(a) of the Tax Reform Act of 1960, Public Law 91-172, C. B. 1960-8, 10) provides that a private foundation shall not be exempt under section 501(a) unless its governing instrument includes provisions the effects of which are:

- (A) to require its income for each taxable year to be distributed at such time and in such manner as not to subject the foundation to tax under section 4912, and
- (B) to prohibit the foundation from engaging in any act of self-dealing (as

defined in section 4911(d)), from retaining any excess business holdings (as defined in section 4913(c)), from making any investments in such manner as to subject the foundation to tax under section 4914, and from making any taxable expenditures (as defined in section 4945(d)).

*Situation 1.* The organization's articles of incorporation include the following provisions:

#### GENERAL

(1) The corporation shall distribute its income for each taxable year at such time and in such manner as not to become subject to the tax on undistributed income imposed by section 4912 of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

(2) The corporation shall not engage in any act of self-dealing as defined in section 4911(d) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

(3) The corporation shall not retain any excess business holdings as defined in section 4913(c) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

(4) The corporation shall not make any investments in such manner as to subject it to tax under section 4914 of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

(5) The corporation shall not make any taxable expenditures as defined in section 4945(d) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

The provisions set out above require the organization to distribute its income in such manner as to avoid the imposition of tax under section 4912 of the Code, and prohibit the organization from engaging in any acts contrary to sections 4911, 4913, 4914, and 4915. Accordingly, it is held that the provisions meet the requirements of section 508(e) of the Code.

*Situation 2.* The organization's creating document is a trust indenture. The indenture includes the following provisions:

Any other provisions of this instrument notwithstanding, the trustee shall distribute its income for each taxable year at such time and in such manner as not to become subject to the tax on undistributed income

imposed by section 4912 of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

Any other provisions of this instrument notwithstanding, the trustee shall not engage in any act of self-dealing as defined in section 4911(d) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws; nor retain any excess business holdings as defined in section 4913(c) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws; nor make any investments in such manner as to incur tax liability under section 4914 of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws; nor make any taxable expenditures as defined in section 4945(d) of the Internal Revenue Code of 1954, or corresponding provisions of any subsequent Federal tax laws.

The provisions set out above require the organization to distribute its income in such manner as to avoid the imposition of tax under section 4912 of the Code, and prohibit the organization from engaging in any acts contrary to sections 4911, 4913, 4914, and 4915. Accordingly, it is held that the provisions meet the requirements of section 508(e) of the Code.

#### Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001-1: Computation of gain or loss. (Also Sections 354, 1012; 1.354-1, 1.1012-1.)

Tax consequences to an acquired corporation and its shareholders where the corporation transfers stock received for its assets in a section 368(a)(1)(C) reorganization to discharge certain liabilities and the shareholders assume a liability.

#### Rev. Rul. 70-271

Advice has been requested concerning the tax treatment to a corporation and its shareholders, upon the discharge or assumption of one of the corporation's liabilities, following an acquisition of its assets pursuant to a