

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

Number: **AM 2020-005**

Release Date: 5/29/2020

CC:CORP:03: JNAron-Dine  
POSTN-106594-20

Third Party Communication: None  
Date of Communication: Not Applicable

UICL: 351.11-00, 358.02-00, 1223.12-00

date: May 22, 2020

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subject: Holding period following certain 351 transactions

This memorandum discusses the effect on a sole shareholder's holding period in corporate stock when the shareholder makes a transfer of money or other property to the corporation for no consideration. This memorandum may not be used or cited as precedent.

**ISSUE**

If a shareholder owns all the stock of a corporation, how does a transfer of money or other property by the shareholder to the corporation for no consideration (a "meaningless gesture transaction") affect the shareholder's holding period in the corporation's stock?

**CONCLUSION**

A meaningless gesture transaction is subject to section 351(a). Following a meaningless gesture transaction, the holding period of the portion of each share of the shareholder's stock attributable to the transaction is determined by referring to the transferred money or other property.

**BACKGROUND**

Various provisions of the Internal Revenue Code (Code) provide favorable treatment when taxpayers dispose of capital assets with holding periods that exceed designated periods of time. For example, individual taxpayers generally pay a lower rate of tax on gain recognized in a sale or exchange of capital assets held for more than one

year (“long-term capital gain”). See sections 1(h) and 1222(3) and (11). The same principles that apply to this benefit apply to benefits under other Code provisions that require minimum holding periods.

The Internal Revenue Service (Service) has become aware of transactions that purport to result in holding periods for corporate stock that are longer than the period of economic investment. Some of these transactions are described below.

### FACTS

In each of the following situations, on January 1, Year 1, an individual (“Shareholder”) contributes property with negligible value to a newly formed domestic corporation (“Corporation”), in exchange for all of Corporation’s stock (the “initial transfer”). Assume that all shares of stock issued to Shareholder are capital assets in Shareholder’s hands; that no transfer to Corporation is subject to section 351(d) or (e); and that section 351(g) does not apply to any stock of Corporation.

After the initial transfer, each situation continues as follows.

#### Situation 1

On August 1, Year 1, Shareholder transfers a substantial amount of money to Corporation for no consideration, and Corporation invests the money in property that appreciates in value. On February 1, Year 2, Shareholder sells all of the stock in Corporation for a price that reflects the unrealized appreciation in the property, so that gain is recognized to Shareholder. Shareholder claims that all of the stock has a holding period exceeding one year (from January 1, Year 1).

#### Situation 2

On March 1, Year 1, Shareholder invests a substantial amount of money in property that appreciates in value. On August 1, Year 1, Shareholder transfers the appreciated property to Corporation for no consideration. On February 1, Year 2, Shareholder sells all of the stock in Corporation for a price that reflects the unrealized appreciation in the property, so that gain is recognized to Shareholder. Shareholder claims that all the stock has a holding period exceeding one year (from January 1, Year 1).

### LAW AND ANALYSIS

In each of Situations 1 and 2, Shareholder recognizes no gain or loss on the initial transfer. Section 351(a).

Shareholder’s transfer to Corporation of money (Situation 1) or appreciated property (Situation 2) on August 1, Year 1 (each a “subsequent transfer”) is also a transfer to which section 351 applies, even though Shareholder does not receive any additional stock. *Lessinger v. Commissioner*, 872 F.2d 519, 522 (2d Cir. 1989) (“[T]he

exchange requirements of section 351 are met where a sole stockholder transfers property to a wholly-owned corporation even though no stock or securities are issued therefor. Issuance of new stock in this situation would be a meaningless gesture.”); see Rev. Rul. 64-155, 1964-1 C.B. 138 (treating contribution of appreciated property to wholly owned corporation as exchange described in section 351 even though transferor did not receive additional stock); see also *Jackson v. Commissioner*, 708 F.2d 1402, 1405 (9th Cir. 1983) (“We assume section 351 applies [to transfer of a joint venture interest to a controlled corporation] even though no exchange of stock occurred because the transfer was to a wholly owned corporation”); *Rosen v. Commissioner*, 62 T.C. 11, 19 (1974) (applying section 351 without discussing the fact that no stock appears to have been issued).

After the subsequent transfer in each Situation, Shareholder’s stock in Corporation has a split basis and a split holding period to reflect the initial transfer and the subsequent transfer. Cf. Rev. Rul. 85-164, 1985-2 C.B. 117 (shares of stock received in an exchange to which section 351 applies, for property with different bases and holding periods, have split bases and split holding periods for purposes of determining long-term or short-term capital gain or loss); Rev. Rul. 62-140, 1962-2 C.B. 181 (shareholder has split basis and split holding period after transferring money to exercise conversion right in convertible debenture, with the portion attributable to the money having holding period dating from the transfer).

In both Situation 1 and Situation 2, the split basis and split holding period of Shareholder’s stock reflect the economics of the transactions. After the subsequent transfer in each of the situations, a portion of the value of each share is attributable to the value added by the subsequent transfer, and the basis of Shareholder’s stock includes the transferred money or the basis of the transferred property. Splitting the basis of each share of stock is consistent with the treatment of a section 351 exchange in which a transferor transfers several assets to a corporation, in exchange for stock and securities of the transferee corporation and other property. See Rev. Rul. 68-55, 1968-1 C.B. 140 (each asset considered transferred separately in exchange for a portion of each category of consideration received; fair market value of each category of consideration received allocated among transferred assets in proportion to their relative fair market values).<sup>1</sup>

Including the amount of the money or the basis of the transferred property in the stock’s basis without a corresponding adjustment to the stock’s holding period would be

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<sup>1</sup> The same issue may arise in an acquisitive reorganization if a single shareholder owns all the stock in both the acquiring corporation and the target corporation. If no acquiring corporation stock is issued, the shareholder may designate which pre-existing shares in the acquiring corporation take their basis and holding period from the surrendered target stock and which from the pre-existing acquiring stock, so long as that designation is consistent with the terms of the reorganization. Treas. Reg. § 1.358-2(a)(2)(iii)(A), (a)(2)(vii), (c) Example (11). This designation of shares applies only to reorganizations, not to section 351 exchanges. For treatment of transactions that qualify as both reorganizations and section 351 exchanges, see Treas. Reg. § 1.358-2(a)(2)(viii).

inconsistent with the principle that the holding period of property tracks the sources of the property's basis. See, e.g., section 1223(1).

Accordingly, in Situation 1, the portion of each share attributable to the money transferred in the subsequent transfer has basis equal to the amount of the money and a holding period dating from the subsequent transfer. In Situation 2, the basis and holding period of the portion of each share attributable to the property transferred in the subsequent transfer are determined by referring to that property. Thus, in both Situation 1 and Situation 2, to the extent attributable to the subsequent transfer, Shareholder's stock has a holding period less than one year at the time of the sale of the stock on February 1, Year 2. The gain attributable to the sale of this portion of the Corporation stock is short-term capital gain.

Situations 1 and 2 illustrate two common forms of transactions that, as the Service understands it, are being recommended to taxpayers as a means of artificially extending holding periods. Depending on the facts and circumstances, the same analysis could apply to similar situations, such as transactions in which (i) Shareholder is not an individual; (ii) Shareholder initially acquires Corporation's stock in a taxable transaction; (iii) Corporation is not a domestic corporation; (iv) the relative values of the initial transfer and the subsequent transfer are different from those described in Situations 1 and 2; (v) stock of Corporation is issued in the subsequent transfer, but the value of such stock does not reflect the value of the money or property transferred to it in the subsequent transfer; (vi) Shareholder is not the sole shareholder of Corporation, but the relationship between Shareholder and other shareholders is such that the subsequent transfer for no consideration represents compensation, a gift, or another transfer of value from Shareholder to the other shareholders; or (vii) Shareholder does not dispose of all of Corporation's stock in a single transaction.

### RECOMMENDATION

We recommend that the Service challenge transactions in which a shareholder's purported holding period in stock of a wholly owned corporation ignores the effect of meaningless gesture transactions. Depending on the facts and circumstances, the Service may challenge the transaction on other grounds as well, including that the transaction lacks economic substance; that the form of the transaction does not correspond to its substance; or that a purportedly tax-free transfer to a corporation lacks business purpose or constitutes an ineffective assignment of income or conduit transaction. In appropriate cases, the Service also may impose accuracy-related penalties.

If you have any additional questions on this matter, please contact Jeremy Aron-Dine at (202) 317-5116.

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