

**MEMO# 7674**

February 29, 1996

## **TREASURY ANNOUNCEMENT ON CORPORATE CONVERSION PROPOSAL**

1 See Institute Memorandum to Tax Committee No. 4-96, Operations Committee No. 2-96 and Transfer Agent Advisory Committee No. 5-96, dated January 25, 1996. 2 See Institute Memorandum to Tax Members No. 9-88, dated February 12, 1988. 3 See Institute Memorandum to Tax Members No. 47-88, dated August 15, 1988. February 29, 1996 TO: TAX COMMITTEE No. 7-96 RE: TREASURY ANNOUNCEMENT ON CORPORATE CONVERSION PROPOSAL \_\_\_\_\_ As we previously informed you, the Clinton Administration recently proposed several legislative changes designed to raise revenues.<sup>1</sup> One of the proposals would modify the rules under Internal Revenue Code section 1374, which postpones gain recognition upon the conversion of a Subchapter C corporation to a Subchapter S corporation, to require immediate gain recognition for any conversion on or after December 7, 1995 of a Subchapter C corporation with stock valued at more than \$5 million at the time of conversion. Pursuant to IRS Notice 88-19, rules similar to those contained in section 1374 apply to conversions and mergers of Subchapter C corporations into RICs.<sup>2</sup> IRS Notice 88-96 modified Notice 88-19 to provide, however, that rules analogous to section 1374 will not apply, and no gain recognition will be required, when a Subchapter C corporation converts to a RIC and the corporation (1) qualified as a RIC prior to becoming a Subchapter C corporation and (2) failed Subchapter M for only one year.<sup>3</sup> The attached Treasury Department News Release announces the following changes/clarifications to the Administration's section 1374 legislative proposal. First, the effective date for the proposal would be postponed to January 1, 1997. Second, the effect of the proposed section 1374 modification on Notice 88-19 and conversions and mergers of Subchapter C corporations into RICs is clarified. Specifically, the IRS intends to revise Notice 88-19 to conform to the proposed amendment to section 1374 -- thereby requiring immediate gain recognition where the converting/merging Subchapter C corporation has a capitalization of more than \$5 million -- with an effective date similar to the statutory proposal. The Institute understands that the Treasury News Release does not mention Notice 88-96 because the section 1374 proposal is not intended to have any impact on the safe harbor provided by Notice 88-96 for RICs that fail Subchapter M for a single year. We will keep you informed of developments. Keith D. Lawson Associate Counsel - Tax Attachment