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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9361]

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Corporate Reorganizations; Transfers of Assets or Stock Following a Reorganization

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that provide guidance regarding the effect of certain transfers of assets or stock on the continuing qualification of transactions as reorganizations under section 368(a). This document also contains final regulations that provide guidance on the continuity of business enterprise requirement and the definitions of "qualified group" and "party to a reorganization." These regulations affect corporations and their shareholders.

DATES: Effective Date: These regulations are effective October 25, 2007.

Applicability Date: For dates of applicability, see §§1.368-1(d)(4)(iv), 1.368-1(d)(5), 1.368-2(f), 1.368-2(j)(3)(iv), and 1.368-2(k)(3).

FOR FURTHER INFORMATION CONTACT: Mary W. Lyons, at (202) 622-7930 (not a toll free number).

SUPPLEMENTARY INFORMATION:

Background

On August 18, 2004, the IRS and Treasury Department published a notice of proposed rulemaking (REG-130863-04) in the Federal Register (69 FR 51209) proposing regulations that would provide guidance regarding the effect of certain transfers of assets or stock on the qualification of a transaction as a reorganization under section 368(a) (the proposed regulations). The proposed regulations also included amendments to the continuity of business enterprise (COBE) regulations under §1.368-1(d) and the definition of a "party to a reorganization" under §1.368-2(f). The proposed regulations replaced an earlier proposal, dated March 2, 2004 (REG-165579-02) and published in the Federal Register (69 FR 9771), which was withdrawn. No public hearing regarding the proposed regulations was requested or

held. However, a number of comments were received, the most significant of which are discussed in this preamble.

The theory underlying the tax-free treatment afforded reorganizations described in section 368 is that such transactions "effect only a readjustment of continuing interest in property under modified corporate forms." See §1.368-1(b). The continuity of interest and continuity of business enterprise requirements are expressions of this principle. Earlier cases also implemented this principle through a concept that later became known as the prohibition of "remote" continuity of interest. Commonly viewed as arising out of the Supreme Court decisions in *Groman v. Commissioner*, 302 U.S. 82 (1937), and *Helvering v. Bashford*, 302 U.S. 454 (1938), remote continuity of interest focuses on the link between the former target corporation (T) shareholders and the T business assets following the reorganization.

Since the Supreme Court's decisions in *Groman* and *Bashford*, it has been recognized that other transactions, including transactions involving the same level of "remoteness" as addressed in the *Groman* and *Bashford* decisions, adequately preserve the link between the former T shareholders and the T business assets and therefore constitute mere readjustments of continuing interests. Accordingly, legislative, regulatory, and administrative developments have provided significantly more flexibility regarding transfers of stock and assets following otherwise tax-free reorganizations where this link is adequately maintained. For example, Congress enacted section 368(a)(2)(D) to expressly allow a triangular reorganization by permitting a controlled subsidiary to use its parent's stock as consideration in a merger. Similarly, the term "party to a reorganization" was broadened to include the parent in such a case.

In addition, Congress enacted section 368(a)(2)(C), which provides that a transaction otherwise qualifying under section 368(a)(1)(A), (B), (C), or (G) (where the requirements of section 354(b) are met) is not disqualified where part or all of the acquired assets or stock is transferred to a corporation that is controlled (as defined in section 368(c)) by the acquiring corporation. Section 1.368-2(k), as in effect prior to these final regulations, expanded the scope of section 368(a)(2)(C) by permitting successive transfers of the acquired assets or stock to one or more corporations, provided that the transferee corporation was controlled in each transfer by the transferor corporation. Administratively, the IRS and Treasury Department have since interpreted section 368(a)(2)(C) and §1.368-2(k) as permissive rather than exclusive or restrictive, concluding that certain transfers not specifically described in either of those provisions did not disqualify the reorganization. See Rev. Rul. 2001-24 (2001-1 CB 1290) permitting the transfer of acquiring subsidiary stock to a controlled subsidiary following a reorganization described in section 368(a)(1)(A) by reason of (a)(2)(D), and Rev. Rul. 2002-85 (2002-2 CB 986) permitting the transfer of acquired assets to a controlled subsidiary following a reorganization described in section 368(a)(1)(D).

The current regulations do not contain separate rules addressing remote continuity because the IRS and Treasury Department believe that these issues are adequately addressed by the rules adopted to implement the continuity of business enterprise requirement. See TD 8760 (63 FR 4174). Similarly, the rules relating to the continuity of business enterprise requirement have been broadened over the years to

permit transactions that adequately preserve the link between the former T shareholders and the T business assets. Under §1.368-1(d), as in effect prior to these final regulations, the COBE requirement generally is satisfied as long as a member of the qualified group (or, in certain cases, a partnership) either continues T's historic business or uses a significant portion of T's historic business assets in a business. A qualified group is defined in §1.368-1(d)(4)(ii), as in effect prior to these final regulations, as one or more chains of corporations connected through stock ownership with the issuing corporation, but only if the issuing corporation owns directly stock meeting the requirements of section 368(c) in at least one of the corporations, and stock meeting the requirements of section 368(c) in each of the corporations (other than the issuing corporation) is owned directly by one of the other corporations.

These final regulations continue the trend of broadening the rules regarding transfers of assets or stock following an otherwise tax-free reorganization where the transaction adequately preserves the link between the former T shareholders and the T business assets. Accordingly, the definition of a "qualified group" in §1.368-1(d)(4)(ii) and the rules regarding stock or asset transfers in §1.368-2(k) have been expanded. Conforming changes to §1.368-2(f), relating to the definition of "a party to a reorganization," also have been made.

A. Continuity of Business Enterprise (COBE) Regulations

Several commentators urged that the definition of "qualified group" under §1.368-1(d)(4)(ii) should not be restricted by the control requirement of section 368(c), but rather should be expanded to parallel the definition of an affiliated group under section 1504(a). The IRS and Treasury Department have declined to make this change, primarily because the section 368(c) definition of control is a major structural component underlying the statutory framework of the reorganization provisions. On the other hand, the IRS and Treasury Department have concluded that it is consistent with reorganization policy to expand the definition of a qualified group. Specifically, §1.368-1(d)(4)(ii), as revised by this Treasury decision, permits qualified group members to aggregate their direct stock ownership of a corporation in determining whether they own the requisite section 368(c) control in such corporation (provided that the issuing corporation owns directly stock meeting such control requirement in at least one other corporation). This aggregation concept is similar to the one found in section 1504(a). The IRS and Treasury Department believe that aggregating stock ownership within the qualified group adequately preserves the link between the former T shareholders and the T business assets while further facilitating the post-acquisition relocation of assets and stock as necessary within the group.

Finally, as discussed in section B.3. of this preamble, and in response to comments, the COBE regulations have been expanded to provide that if members of the qualified group own interests in a partnership that meets requirements equivalent to the control definition in section 368(c), any stock owned by such partnership is treated as owned by members of the qualified group. Thus, for example, following a reorganization under section 368(a)(1)(B), T remains a member of the qualified group upon a transfer of the T stock to a partnership in which members of the qualified group own all the interests. See section B.3. of this preamble. Similarly, a wholly owned subsidiary of a partnership in which members of the

qualified group own all the interests will be a member of the qualified group. Accordingly, following a reorganization under section 368(a)(1)(A), the acquiring corporation may transfer the T assets to the subsidiary (either directly or through the partnership) without violating the COBE requirement.

B. Section 1.368-2(k)

As provided in §1.368-1(a), a transaction must be evaluated under all relevant provisions of law, including the step transaction doctrine, in determining whether it qualifies as a reorganization under section 368(a). Section 1.368-2 provides guidance regarding whether a transaction satisfies the explicit statutory requirements of a particular reorganization. Section 1.368-2(k) generally provides that a transaction otherwise qualifying as a reorganization will not be disqualified as a result of certain subsequent transfers of assets or stock. The fact that a subsequent transfer of assets or stock is not described in §1.368-2(k) does not necessarily preclude reorganization qualification, but the overall transaction would then be subject to analysis under the step transaction doctrine.

These final regulations adopt the rules of the proposed regulations regarding subsequent transfers of assets or stock with certain modifications. Section 1.368-2(k), as revised by this Treasury decision, generally provides that a transaction otherwise qualifying as a reorganization under section 368(a) shall not be disqualified or recharacterized as a result of one or more subsequent transfers (or successive transfers) of assets or stock, provided that the COBE requirement is satisfied and the transfer(s) qualify as "distributions" or "other transfers" (as described in §1.368-2(k)(1), and as discussed in section B.1. and B.2., respectively, of this preamble).

1. Distributions

Proposed §1.368-2(k) would permit the acquiring corporation to distribute to certain shareholders part or all of the stock or assets acquired in a transaction otherwise qualifying as a reorganization without affecting its characterization as such. The proposed regulations would generally permit distributions to certain shareholders provided that no distributee receives "substantially all" of the acquired assets, including the assets of a corporation whose stock is acquired in the reorganization, or stock constituting control of the acquired corporation. This limitation reflected the concern that such a transaction might be more properly characterized as a direct acquisition by the distributee. For example, Rev. Rul. 67-274 (1967-2 CB 141) held that an acquisition of T stock in a purported reorganization under section 368(a)(1)(B) followed by a prearranged liquidation of T is treated as a reorganization under section 368(a)(1)(C); Rev. Rul. 72-405 (1972-2 CB 217) held that an acquisition of T in a forward triangular merger followed by a prearranged liquidation of the acquiring corporation is treated as a reorganization under section 368(a)(1)(C); and Rev. Rul. 2004-83 (2004-2 CB 157) held that a purchase of T stock from the common shareholder followed by a prearranged liquidation of T is treated as a reorganization under section 368(a)(1)(D).

Commentators raised an administrative concern that the parameters of the "substantially all" standard are less than certain, at least under case law, and, thus, requested that a safe harbor test be

adopted in the final regulations. The IRS and Treasury Department believe that this is a valid concern. Accordingly, these final regulations have adopted a different approach than the "substantially all" standard of the proposed regulations. The new approach in these final regulations focuses on whether the distribution consists of an amount of assets (disregarding any assets held by the acquiring corporation, or the merged corporation in the case of a reorganization under section 368(a)(1)(A) by reason of (a)(2)(E), prior to the transaction) that would result in the distributing corporation being treated as liquidated for Federal income tax purposes.

The IRS and Treasury Department believe that this approach will be easier for taxpayers to apply and the government to administer than the "substantially all" standard in the proposed regulations. In addition, this approach more fully preserves the analysis and conclusions set forth in Rev. Rul. 67-274, Rev. Rul. 72-405, and Rev. Rul. 2004-83, in the context of Congress having required the target corporation to liquidate in all asset reorganizations. Finally, this approach more consistently applies the principles of section 368(a)(2)(C) (which allows for transfers of all of the acquired assets or stock) to post-acquisition distributions.

Specifically, these final regulations provide that a transaction otherwise qualifying as a reorganization will not be disqualified or recharacterized as a result of one or more distributions of assets, stock of the acquired corporation, or both, provided the COBE requirement is satisfied and the distributions do not result in a liquidation of the distributing corporation for Federal income tax purposes (disregarding, for this purpose, assets held by the acquiring corporation, or the merged corporation in the case of a reorganization under section 368(a)(1)(A) by reason of (a)(2)(E), prior to the transaction). Additionally, in the case of distributions of stock of the acquired corporation, these final regulations only protect the transaction from disqualification or recharacterization if the distributions consist of less than all of the stock of the acquired corporation that was acquired in the transaction and do not cause the acquired corporation to cease to be a member of the qualified group.

These final regulations also clarify that certain indirect distributions of assets are treated under §1.368-2(k) in the same manner as a direct distribution of those assets. For example, such an indirect distribution of assets can occur where, following a transaction that otherwise qualifies as a reorganization under section 368(a)(1)(A), the acquiring corporation transfers a portion of the T assets to a partnership (or a corporation) in exchange for an interest in the transferee partnership (or stock in the transferee corporation) in an "other transfer" described in §1.368-2(k)(1)(ii), and then distributes that partnership interest (or stock) to a shareholder.

Finally, the IRS and Treasury Department believe that distributions of assets under these final regulations that involve the assumption of liabilities are distinguishable from the transaction analyzed in Rev. Rul. 70-107 (1970-1 CB 78). That ruling considered a transaction in which the acquiring corporation acquired all of the target corporation's assets in exchange for voting stock of the acquiring corporation's parent. In the transaction, the target corporation's liabilities were assumed in part by the acquiring corporation and in

part by the acquiring corporation's parent. The ruling holds that the parent corporation's direct assumption of some of the target corporation's liabilities violates the solely for voting stock requirement of section 368(a)(1)(C). These final regulations do not implicate the fact pattern addressed in Rev. Rul. 70-107.

2. Other transfers

Proposed §1.368-2(k) would provide, in part, that a transaction otherwise qualifying as a reorganization under section 368(a) would not be disqualified if any assets or stock of a party to the reorganization, other than the stock of the issuing corporation, is subsequently transferred to a member of the qualified group. Commentators asked that the reference to transfers of stock of the issuing corporation be removed, stating that the effect, if any, of a transfer of the stock of the issuing corporation is adequately addressed by the continuity of interest rules under §1.368-1(e). The IRS and Treasury Department agree. In response to this comment (and comments regarding the interaction with the definition of a party to the reorganization in §1.368-2(f)), this provision has been revised to refer to the assets or stock of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be.

Accordingly, these final regulations provide that a transaction otherwise qualifying as a reorganization will not be disqualified or recharacterized as a result of one or more transfers (that do not constitute distributions) of assets or stock, or both, of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, provided the COBE requirement is satisfied, and the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, does not terminate its corporate existence in connection with the transfer(s). In the case of transfers of stock of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, these final regulations only protect the transaction from disqualification or recharacterization if the transfers do not cause such corporation to cease to be a member of the qualified group.

3. Transfers of stock to partnerships

Example 3 of former §1.368-2(k), issued January 28, 1998 (63 FR 4174), involved a transfer of stock of the acquired corporation to a partnership. In the example, P acquired all the stock of T solely in exchange for P stock in a transaction that otherwise qualified as a reorganization under section 368(a)(1)(B). Immediately thereafter, P transferred the T stock to members of its qualified group, who then transferred the T stock to a partnership all of the interests in which were owned by such members. The example concludes that because the transfer of T stock to the partnership is not described in §1.368-2(k), the characterization of the transaction must be determined under relevant provisions of law, including the step transaction doctrine. The example further concludes that the transaction fails to meet the control requirement of a reorganization described in section 368(a)(1)(B) because immediately after the transaction the acquiring corporation does not have control of T. The preamble to the proposed regulations indicated that the IRS and Treasury Department were reexamining the conclusion set forth in Example 3 and requested comments in this regard. Consequently, Example 3 was not included in the proposed regulations. Comments were

received and considered in the course of studying this issue.

After further examination, the IRS and Treasury Department have concluded that transfers of stock of a corporation to a controlled partnership (that is, one in which members of the qualified group own interests meeting requirements equivalent to section 368(c)) adequately preserve the link between the former T shareholders and the T business assets. This section 368(c) equivalent control standard is applied to transfers of stock to a partnership in order to protect the section 368(c) control requirement applicable to triangular and stock acquisition reorganizations. Accordingly, these final regulations reverse the conclusion reached in Example 3 of former §1.368-2(k).

To accommodate these policy considerations, the final regulations permit both distributions of stock of the acquired corporation and other transfers of stock of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, provided the transfer of stock does not cause the transferred corporation to cease to be a member of the COBE qualified group. To that end, as described in section A. of this preamble, the COBE regulations have been expanded to provide that if members of the qualified group own interests in a partnership that meet requirements equivalent to the control definition in section 368(c), any stock owned by such partnership is attributed to and treated as owned by members of the qualified group. Accordingly, this full stock attribution rule treats partnerships in a manner similar to members of the COBE qualified group.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small businesses.

Drafting Information

The principal author of these final regulations is Mary W. Lyons of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

Availability of IRS Documents

IRS revenue rulings, procedures, and notices cited in this preamble are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

List of Subjects in 26 CFR part 1

Income taxes, Reporting and record keeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.368-1 is amended as follows:

1. Paragraph (d)(4)(ii) is revised.
2. Paragraph (d)(4)(iii)(D) is added.
3. Paragraph (d)(4)(iv) is revised.
4. Paragraph (d)(5) introductory text is revised.
5. In paragraph (d)(5), Examples 7 through 12 are redesignated as Examples 8 through 13, respectively, and new Examples 7, 14, and 15 are added.
6. In paragraph (d)(5), the first sentences of paragraph (i) in redesignated Examples 9, 10, and 12 are revised.

The revisions and additions read as follows:

§1.368-1 Purpose and scope of exception of reorganization exchanges.

* * * * *

(d) * * *

(4) * * *

(ii) Qualified group. A qualified group is one or more chains of corporations connected through stock ownership with the issuing corporation, but only if the issuing corporation owns directly stock meeting the requirements of section 368(c) in at least one other corporation, and stock meeting the requirements of section 368(c) in each of the corporations (except the issuing corporation) is owned directly (or indirectly as provided in paragraph (d)(4)(iii)(D) of this section) by one or more of the other corporations.

(iii) * * *

(D) Stock attributed from certain partnerships. Solely for purposes of paragraph (d)(4)(ii) of this section, if members of the qualified group own interests in a partnership meeting requirements equivalent to section 368(c) (a section 368(c) controlled partnership), any stock owned by the section 368(c) controlled partnership shall be treated as owned by members of the qualified group. Solely for purposes of determining whether a lower-tier partnership is a section 368(c) controlled partnership, any interest in a lower-tier partnership that is owned by a section 368(c) controlled partnership shall be treated as owned by members of the qualified group.

(iv) Effective/applicability dates. Paragraphs (d)(4)(i) and (d)(4)(iii) (other than paragraph (d)(4)(iii)(D)) of this section apply to transactions occurring after January 28, 1998, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times thereafter. Paragraphs (d)(4)(ii) and (d)(4)(iii)(D) of this section apply to transactions occurring on or after October 25, 2007, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times after that.

(5) Examples. The following examples illustrate this paragraph (d). All the corporations have only one class of stock outstanding. The preceding sentence and paragraph (d)(5) Example 6 and Example 8 through Example 13 apply to transactions occurring after January 28, 1998, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times thereafter. Paragraph (d)(5) Example 7, Example 14, and Example 15 apply to transactions occurring on or after October 25, 2007, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times after that. The examples read as follows:

* * * * *

Example 7. Transfers of acquired stock to members of the qualified group - continuity of business enterprise satisfied. (i) Facts. The facts are the same as Example 6, except that, instead of P acquiring the assets of T, HC acquires all of the outstanding stock of T in exchange solely for stock of P. In addition, as part of the plan of reorganization, HC transfers 10 percent of the stock of T to each of subsidiaries S-1 through S-10. T will continue to operate an auto parts distributorship. Without regard to whether the transaction satisfies the COBE requirement, the transaction qualifies as a triangular B reorganization (as defined in §1.358-6(b)(2)(iv)).

(ii) Continuity of business enterprise. Under paragraph (d)(4)(i) of this section, P is treated as holding the assets and conducting the business of T because T is a member of the qualified group (as defined in paragraph (d)(4)(ii) of this section). The COBE requirement of paragraph (d)(1) of this section is satisfied.

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Example 9. * * * (i) Facts. The facts are the same as Example 8, except that S-3 transfers the historic T business to PRS in exchange for a 1 percent interest in PRS.

(ii) * * *

Example 10. * * * (i) Facts. The facts are the same as Example 8, except that S-3 transfers the historic T business to PRS in exchange for a 33 1/3 percent interest in PRS, and no member of P's qualified group performs active and substantial management functions for the ski boot business operated in PRS.

* * * * *

Example 12. * * * (i) Facts. The facts are the same as Example 11,

except that S-1 transfers all the T assets to PRS, and P and X each transfer cash to PRS in exchange for partnership interests. * * *

* * * * *

Example 14. Transfer of acquired stock to a partnership - continuity of business enterprise satisfied. (i) Facts. Pursuant to a plan of reorganization, the T shareholders transfer all of their T stock to a subsidiary of P, S-1, solely in exchange for P stock. In addition, as part of the plan of reorganization, S-1 transfers the T stock to its subsidiary, S-2, and S-2 transfers the T stock to its subsidiary, S-3. S-2 and S-3 form a new partnership, PRS. Immediately thereafter, S-3 transfers all of the T stock to PRS in exchange for an 80 percent interest in PRS, and S-2 transfers cash to PRS in exchange for a 20 percent interest in PRS.

(ii) Continuity of business enterprise. Members of the qualified group, in the aggregate, own all of the interests in PRS. Because these interests in PRS meet requirements equivalent to section 368(c), under paragraph (d)(4)(iii)(D) of this section, the T stock owned by PRS is treated as owned by members of the qualified group. P is treated as holding all of the businesses and assets of T because T is a member of the qualified group (as defined in paragraph (d)(4)(ii) of this section). The COBE requirement of paragraph (d)(1) of this section is satisfied because P is treated as continuing T's business.

Example 15. Transfer of acquired stock to a partnership - continuity of business enterprise not satisfied. (i) Facts. The facts are the same as in Example 14, except that S-3 and U, an unrelated corporation, form a new partnership, PRS, and, immediately thereafter, S-3 transfers all of the T stock to PRS in exchange for a 50 percent interest in PRS, and U transfers cash to PRS in exchange for a 50 percent interest in PRS.

(ii) Continuity of business enterprise. Members of the qualified group, in the aggregate, own 50 percent of the interests in PRS. Because these interests in PRS do not meet requirements equivalent to section 368(c), the T stock owned by PRS is not treated as owned by members of the qualified group under paragraph (d)(4)(iii)(D) of this section. P is not treated as holding all of the businesses and assets of T because T has ceased to be a member of the qualified group (as defined in paragraph (d)(4)(ii) of this section). The COBE requirement of paragraph (d)(1) of this section is not satisfied because P is not treated as continuing T's business or using T's historic business assets in a business.

* * * * *

Par. 3. Section 1.368-2 is amended by:

1. Adding three sentences at the end of paragraph (f).
2. Revising paragraphs (j)(3)(ii) and (iv).
3. Removing the first sentence of paragraph (j)(3)(iii) and adding two new sentences at the beginning of the paragraph.
4. Revising paragraph (k).

The additions and the revisions read as follows:

§1.368-2 Definition of terms.

* * * * *

(f) * * * If a transaction otherwise qualifies as a reorganization under section 368(a)(1)(B) or as a reverse triangular merger (as defined in

§1.358-6(b)(2)(iii)), the target corporation (in the case of a transaction that otherwise qualifies as a reorganization under section 368(a)(1)(B)) or the surviving corporation (in the case of a transaction that otherwise qualifies as a reverse triangular merger) remains a party to the reorganization even though its stock or assets are transferred in a transaction described in paragraph (k) of this section. If a transaction otherwise qualifies as a forward triangular merger (as defined in §1.358-6(b)(2)(i)), a triangular B reorganization (as defined in §1.358-6(b)(2)(iv)), a triangular C reorganization (as defined in §1.358-6(b)(2)(ii)), or a reorganization under section 368(a)(1)(G) by reason of section 368(a)(2)(D), the acquiring corporation remains a party to the reorganization even though its stock is transferred in a transaction described in paragraph (k) of this section. The two preceding sentences apply to transactions occurring on or after October 25, 2007, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times after that.

* * * * *

(j) * * *

(3) * * *

(ii) Except as provided in paragraph (k) of this section, the controlling corporation must control the surviving corporation immediately after the transaction.

(iii) After the transaction, the surviving corporation must hold substantially all of its own properties and substantially all of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction). The surviving corporation may transfer such properties as provided in paragraph (k) of this section. * * *

(iv) Paragraph (j)(3)(ii) and the first two sentences of paragraph (j)(3)(iii) of this section apply to transactions occurring on or after October 25, 2007, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times thereafter. The remainder of paragraph (j)(3)(iii) of this section applies to transactions occurring after January 28, 1998, except that it does not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times after that.

* * * * *

(k) Certain transfers of assets or stock in reorganizations--(1)

General rule. A transaction otherwise qualifying as a reorganization under section 368(a) shall not be disqualified or recharacterized as a result of one or more subsequent transfers (or successive transfers) of assets or stock, provided that the requirements of §1.368-1(d) are satisfied and the transfer(s) are described in either paragraph (k)(1)(i) or (k)(1)(ii) of this section.

(i) Distributions. One or more distributions to shareholders (including distribution(s) that involve the assumption of liabilities) are described in this paragraph (k)(1)(i) if--

(A) The property distributed consists of--

(1) Assets of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, or an interest in an entity received in exchange for such assets in a transfer described in paragraph (k)(1)(ii) of this section;

(2) Stock of the acquired corporation provided that such distribution(s) of stock do not cause the acquired corporation to cease to be a member of the qualified group (as defined in §1.368-1(d)(4)(ii)); or

(3) A combination thereof; and

(B) The aggregate of such distributions does not consist of--

(1) An amount of assets of the acquired corporation, the acquiring corporation (disregarding assets held prior to the potential reorganization), or the surviving corporation (disregarding assets of the merged corporation), as the case may be, that would result in a liquidation of such corporation for Federal income tax purposes; or

(2) All of the stock of the acquired corporation that was acquired in the transaction.

(ii) Other Transfers. One or more other transfers are described in this paragraph (k)(1)(ii) if--

(A) The transfer(s) are not described in paragraph (k)(1)(i) of this section;

(B) The property transferred consists of--

(1) Part or all of the assets of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be;

(2) Part or all of the stock of the acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, provided that such transfer(s) of stock do not cause such corporation to cease to be a member of the qualified group (as defined in §1.368-1(d)(4)(ii)); or

(3) A combination thereof; and

(C) The acquired corporation, the acquiring corporation, or the surviving corporation, as the case may be, does not terminate its corporate existence in connection with the transfer(s).

(2) Examples. The following examples illustrate the application of this paragraph (k). Except as otherwise noted, P is the issuing corporation, and T is an unrelated target corporation. All corporations have only one class of stock outstanding. T operates a bakery that supplies delectable pastries and cookies to local retail stores. The acquiring corporate group produces a variety of baked goods for nationwide distribution. Except as otherwise noted, P owns all of the stock of S-1 and 80 percent of the stock of S-4, S-1 owns 80 percent of the stock of S-2 and 50 percent of the stock of S-5, S-2 owns 80 percent of the stock of S-3, and S-4 owns the remaining 50 percent of the stock of S-5. The examples are as follows:

Example 1. Transfers of acquired assets to members of the qualified group after a reorganization under section 368(a)(1)(C). (i) Facts. Pursuant to a plan of reorganization, T transfers all of its assets to S-1 solely in exchange for P stock, which T distributes to its shareholders, and S-1's assumption of T's liabilities. In addition, pursuant to the plan, S-1 transfers all of the T assets to S-2, and S-2 transfers all of the T assets to S-3.

(ii) Analysis. Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the successive transfers of all of the T assets to S-2 and from S-2 to S-3 because the transfers are not distributions described in paragraph (k)(1)(i) of this section, the transfers consist of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence in connection with the transfers, and the transaction satisfies the requirements of §1.368-1(d).

Example 2. Distribution of acquired assets to a member of the qualified group after a reorganization under section 368(a)(1)(C). (i) Facts. Pursuant to a plan of reorganization, T transfers all of its assets to S-1 solely in exchange for P stock, which T distributes to its shareholders, and S-1's assumption of T's liabilities. In addition, pursuant to the plan, S-1 distributes half of the T assets to P, and P assumes half of the T liabilities.

(ii) Analysis. Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the distribution of half of the T assets from S-1 to P, or P's assumption of half of the T liabilities from S-1, because the distribution consists of assets of the acquiring corporation, the distribution does not consist of an amount of S-1's assets that would result in a liquidation of S-1 for Federal income tax purposes (disregarding S-1's assets held prior to the acquisition of T), and the transaction satisfies the requirements of §1.368-1(d).

Example 3. Indirect distribution of acquired assets to a member of the qualified group after a reorganization under section 368(a)(1)(C). (i) Facts. The facts are the same as Example 2, except that, pursuant to the plan, S-1 contributes half of the T assets to newly formed S-6, S-6 assumes half of the T liabilities, and S-1 distributes all of the S-6 stock to P.

(ii) Analysis. Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the transfer of half of the T assets to S-6 and the distribution of the S-6 stock to P because the transfer of half of the T assets to S-6 is described in paragraph (k)(1)(iii) of

this section, the distribution of the S-6 stock to P is an indirect distribution of assets of the acquiring corporation, the distribution does not consist of an amount of S-1's assets that would result in a liquidation of S-1 for Federal income tax purposes (disregarding S-1's assets held prior to the acquisition of T), and the transaction satisfies the requirements of §1.368-1(d).

Example 4. Distribution of acquired stock to a controlled partnership after a reorganization under section 368(a)(1)(B). (i) Facts. P owns 80 percent of the stock of S-1, and an 80-percent interest in PRS, a partnership. S-4 owns the remaining 20-percent interest in PRS. PRS owns the remaining 20 percent of the stock of S-1. Pursuant to a plan of reorganization, the T shareholders transfer all of their T stock to S-1 solely in exchange for P stock. In addition, pursuant to the plan, S-1 distributes 90 percent of the T stock to PRS in redemption of 5 percent of the stock of S-1 owned by PRS.

(ii) Analysis. Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(B), is not disqualified by the distribution of 90 percent of the T stock from S-1 to PRS because the distribution consists of less than all of the stock of the acquired corporation that was acquired in the transaction, the distribution does not cause T to cease to be a member of the qualified group (as defined in §1.368-1(d)(4)(ii)), and the transaction satisfies the requirements of §1.368-1(d).

Example 5. Transfer of acquired stock to a non-controlled partnership. (i) Facts. Pursuant to a plan, the T shareholders transfer all of their T stock to S-1 solely in exchange for P stock. In addition, as part of the plan, T distributes half of its assets to S-1, S-1 assumes half of the T liabilities, and S-1 transfers the T stock to S-2. S-2 and U, an unrelated corporation, form a new partnership, PRS. Immediately thereafter, S-2 transfers all of the T stock to PRS in exchange for a 50 percent interest in PRS, and U transfers cash to PRS in exchange for a 50 percent interest in PRS.

(ii) Analysis. Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(B), is not disqualified by the distribution of half of the T assets from T to S-1, or S-1's assumption of half of the T liabilities from T, because the distribution consists of assets of the acquired corporation, the distribution does not consist of an amount of T's assets that would result in a liquidation of T for Federal income tax purposes, and the transaction satisfies the requirements of §1.368-1(d). Further, this paragraph (k) describes the transfer of the acquired stock from S-1 to S-2, but does not describe the transfer of the acquired stock from S-2 to PRS because such transfer causes T to cease to be a member of the qualified group (as defined in §1.368-1(d)(4)(ii)). Therefore, the characterization of this transaction must be determined under the relevant provisions of law, including the step transaction doctrine. See §1.368-1(a). The transaction fails to meet the control requirement of a reorganization described in section 368(a)(1)(B) because immediately after the acquisition of the T stock, the acquiring corporation does not have control of T.

Example 6. Transfers of acquired assets to members of the qualified group after a reorganization under section 368(a)(1)(D). (i) Facts. P owns all of the stock of T. Pursuant to a plan of reorganization, T transfers all of its assets to S-1 solely in exchange for S-1 stock,

which T distributes to P, and S-1's assumption of T's liabilities. In addition, pursuant to the plan, S-1 transfers all of the T assets to S-2, and S-2 transfers all of the T assets to S-3.

(ii) Analysis. Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(D), is not disqualified by the successive transfers of all the T assets from S-1 to S-2 and from S-2 to S-3 because the transfers are not distributions described in paragraph (k)(1)(i) of this section, the transfers consist of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence in connection with the transfers, and the transaction satisfies the requirements of §1.368-1(d).

Example 7. Transfer of stock of the acquiring corporation to a member of the qualified group after a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D). (i) Facts. Pursuant to a plan of reorganization, S-1 acquires all of the T assets in the merger of T into S-1. In the merger, the T shareholders receive solely P stock. Also, pursuant to the plan, P transfers all of the S-1 stock to S-4.

(ii) Analysis. Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D), is not disqualified by the transfer of all of the S-1 stock to S-4 because the transfer is not a distribution described in paragraph (k)(1)(i) of this section, the transfer consists of part or all of the stock of the acquiring corporation, the transfer does not cause S-1 to cease to be a member of the qualified group (as defined in §1.368-1(d)(4)(ii)), the acquiring corporation does not terminate its corporate existence in connection with the transfer, and the transaction satisfies the requirements of §1.368-1(d).

Example 8. Transfer of acquired assets to a partnership after a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D). (i) Facts. Pursuant to a plan of reorganization, S-1 acquires all of the T assets in the merger of T into S-1. In the merger, the T shareholders receive solely P stock. In addition, pursuant to the plan, S-1 transfers all of the T assets to PRS, a partnership in which S-1 owns a 33 1/3-percent interest. PRS continues T's historic business. S-1 does not perform active and substantial management functions as a partner with respect to PRS' business.

(ii) Analysis. Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D), is not disqualified by the transfer of T assets from S-1 to PRS because the transfer is not a distribution described in paragraph (k)(1)(i) of this section, the transfer consists of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence in connection with the transfers, and the transaction satisfies the requirements of §1.368-1(d).

Example 9. Sale of acquired assets to a member of the qualified group after a reorganization under section 368(a)(1)(C). (i) Facts. Pursuant to a plan of reorganization, T transfers all of its assets to S-1 in exchange for P stock, which T distributes to its shareholders, and S-1's assumption of T's liabilities. In addition,

pursuant to the plan, S-1 sells all of the T assets to S-5 for cash equal to the fair market value of those assets.

(ii) Analysis. Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by the sale of all of the T assets from S-1 to S-5 because the transfer is not a distribution described in paragraph (k)(1)(i) of this section, the transfer consists of part or all of the assets of the acquiring corporation, the acquiring corporation does not terminate its corporate existence in connection with the transfers, and the transaction satisfies the requirements of §1.368-1(d).

(3) Effective/applicability date. This paragraph (k) applies to transactions occurring on or after October 25, 2007, except that it does not apply to any transaction occurring pursuant to a written agreement which is binding before October 25, 2007, and at all times after that.

Kevin M. Brown,

Deputy Commissioner for Services and Enforcement.

Approved: October 16, 2007.

Eric Solomon,

Assistant Secretary of the Treasury (Tax Policy).

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