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Some Ado About a Nothing: Final F Reorganization Regulations

By Michael Kliegman and Nancy Chen[1]

I. INTRODUCTION AND BACKGROUND

F Reorganizations

Corporate reorganizations under §368(a)(1)(F)[2] are reorganizations that involve a ''mere change in identity, form, or place of organization of one corporation, however effected.''[3] Similar to ''Type E reorganizations,'' F reorganizations are considered ''single-entity'' reorganizations. F reorganizations apply only to a ''mere change'' in corporate structure of one corporation and do not involve the amalgamation of two separate corporations.[4] An F reorganization has been described in judicial guidance as follows:

> [The F reorganization] encompass[es] only the simplest and least significant of corporate changes. The (F)-type reorganization presumes that the surviving corporation is the same corporation as the predecessor in every respect, except for minor or technical differences. For instance, the (F) reorganization typically has been understood to comprehend only such insignificant modifications as the reincorporation of the same corporate business with the same assets and the same stockholders surviving under a new charter either in the same or in a different State, the renewal of a corporate charter having a limited life, or the conversion of a U.S.-chartered savings and loan association to a State-chartered institution.[5]

Single Entity Model Tax Treatment of Tax Attributes

Similar to other non-recognition §368(a)(1) asset reorganization transactions, a deemed transfer pursuant to a §368(a)(1)(F) reorganization receives non-recognition treatment,[6] and tax attributes of the ''old corporation'' carry over to the ''new corporation.''[7] However, what makes an F reorganization unique

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[2] Unless otherwise indicated, all ''§'' references are to the Internal Revenue Code of 1986, as amended, and the proposed regulations, promulgated thereunder (the ''regulations''), as in effect as of the date of this article. All ''IRS'' references are to the Internal Revenue Service.

[3] §368(a)(1)(F).

[4] The Tax Equity and Fiscal Responsibility Act of 1982 (Pub. L. No. 97-248) amended the definition of a §368(a)(1)(F) reorganization by adding the three words ''of one corporation'' effective for transactions occurring after August 31, 1982. The 1982 amendment limits a ''Type F reorganization'' to transactions involving mere changes in the structure of a single corporate enterprise, and reverses prior judicial expansions of the ''Type F reorganization'' which encompassed amalgamation of active affiliated corporations if there was identity of relative shareholder proprietary interest and uninterrupted business continuity. *See generally* Boris I. Bittker and James S. Eustice, *Federal Income Taxation of Corporations and Shareholders*, ¶12.28 (7th ed. 2008); Kliegman, 774 T.M., *Single Entity Reorganizations: Recapitalizations and F Reorganizations*. The conference report noted, however, that the new limitation ''does not preclude the use of more than one entity to consummate the transaction provided only one operating company is involved: H.R. Rep. No. 760, 97th Cong., 2d Sess. 541 (1982), 1982-2 C.B. 600, 634-635.

[5] *Berghash v. Commissioner*, 43 T.C. 743, 752 (1965), *aff'd*, 361 F.2d 257 (2d Cir. 1966).

[6] Additional federal income tax implications under §367 may arise with respect to inbound and outbound F reorganizations, which are generally beyond the scope of this paper. In general, *see* Robert Willens, *Outbound F Reorganization Triggers Intangible Property Gain*, Tax Notes, July 1, 2013, p. 83; Rev. Rul. 88-25, 1988-1 C.B. 116; and Rev. Rul. 87-27, 1987-1 C.B. 134.

[7] §381(a)(2). *See also* Rev. Rul. 57-276, 1957-1 C.B. 126.

from other non-recognition §368(a)(1) asset reorganization transactions is that for federal tax purposes, consistent with the single entity model of an F reorganization, the "new corporation" (or resulting corporation) is treated for federal tax purposes as an absolute continuation and alter ego of the "old corporation" (or "transferor corporation").[8] Thus, in an F reorganization, the taxable year of the "old corporation" does not close, and the "new corporation" may carryback net operating losses to a carryback tax year of the "old corporation."[9] Note, however, the general rules described above regarding the continuation of the "old" corporation's taxable year and carryback of the "old" corporation's net operating losses are not applicable to cross-border F reorganizations, which are beyond the scope of this paper. Section 367(a) temporary regulations from 1990 (T.D. 8280) were finalized in September 2015 (T.D. 9739), which apply to outbound F reorganizations of a domestic transferor corporation into a foreign transferee corporation, and provide for closing of the taxable year of the transferor corporation at the close of the date of the outbound transfer.[10]

A purported F reorganization transaction may potentially overlap with other asset reorganization characterizations under §368(a)(1). The federal income tax treatment of distribution transactions that are effected as part of the same overall plan may differ depending on the federal income tax characterization of the asset reorganization.[11] Whether a §368(a)(1) asset reorganization transaction qualifies as an F reorganization may have federal income tax implications beyond Subchapter C. For example, transfer of a partnership interest pursuant to a reorganization of a corporate partner is treated as an "exchange" for purposes of determining whether the reorganization results in a partnership termination under §708(b)(1)(B), except where the reorganization qualifies as an F reorganization.[12] Thus, an F reorganization of a corporate partner would not result in a partnership termination event. The federal income tax characterization of a reorganization transaction may also affect a corporation's assigned employer identification number (EIN).[13] Pursuant to Rev. Rul. 73-526,[14] the previously assigned EIN should be used by the surviving corporation in a statutory merger and in a reincorporation qualifying as an F reorganization.[15] On the other hand, a new EIN should be requested by the new corporation in a consolidation and in any reincorporation transaction not qualifying as an F reorganization.[16]

Certain Common Contexts in which F Reorganizations Arise

In practice, F reorganizations arise in a number of contexts, including a corporation's name change, a change in the form of a corporation, a change in a corporation's state of incorporation, reorganization of an S corporation to facilitate a disposition of some or all of an S corporation's assets or legal entity conversions, and in cross-border transaction planning with check-the-box elections. *See figure 1.*

[8] The regular rules on taxable year and carryback of losses under §381(b) are explicitly inapplicable to F reorganizations. Under Reg. §1.381(b)-1(a)(2), the new entity in an F reorganization is treated "just as the [old] corporation would have been treated if there had been no reorganization."

[9] Section 381(b) applies to all acquisitive asset reorganizations other than the "Type F reorganization." Section 381(b) provides that the taxable year of the transferor corporation shall end of the date of the transfer and the transferee corporation may not carryback a post-acquisition net operating loss or net capital loss to a taxable year of the transferor corporation.

[10] *See* Reg. §1.367(a)-1(e) and Reg. §1.381(b)-1 for rules on closing of the taxable year and carryover of tax attributes applicable to outbound F reorganizations. *See also* Reg. §1.367(b)-3(e) for rules on carryover of net operating losses and capital losses applicable to inbound F reorganizations. Additional federal income tax implications under §367 with respect to inbound and outbound F reorganizations are generally beyond the scope of this paper.

[11] In a cash D reorganization, boot in a reorganization is taxable only to the extent of the shareholder's gain recognized in the exchange. §356(a)(1). As discussed later in this paper, distributions or redemptions connected with an F reorganization are treated as functionally separate from the F reorganization and not treated as "boot," rather, the federal income tax treatment of such related distribution or redemption transactions is to be analyzed under §301 or §302 as applicable. Cash D reorganizations also may have basis, earnings and profits ("E&P") and international tax (e.g., foreign tax credits) federal income tax implications which are well beyond the scope of this paper.

[12] *See* Rev. Rul. 87-110, 1987-2 C.B. 159, GCM 39673 (Oct. 23, 1987).

[13] *See generally* Sarah Remski and Kevin Curran, *Questions on EINs in F Reorganizations Involving Disregarded Entities*, The Tax Adviser (July 1, 2013).

[14] 1973-2 C.B. 404. The principles of Rev. Rul. 73-526 were applied to an F reorganization involving a "drop and check" transaction in PLR 201236014, whereby the IRS ruled that New HoldCo (the resulting corporation) will continue to use the taxpayer identification number previously assigned to Parent (the transferor corporation, that converted to a limited liability company under state law and became a disregarded entity of New HoldCo).

[15] The preamble to the final regulations provides Treasury and the IRS are studying how to assign (or reassign) EINs to taxpayers following an F reorganization, including in cases in which the transferor corporation remains in existence as a disregarded entity.

[16] Rev. Rul. 73-526.

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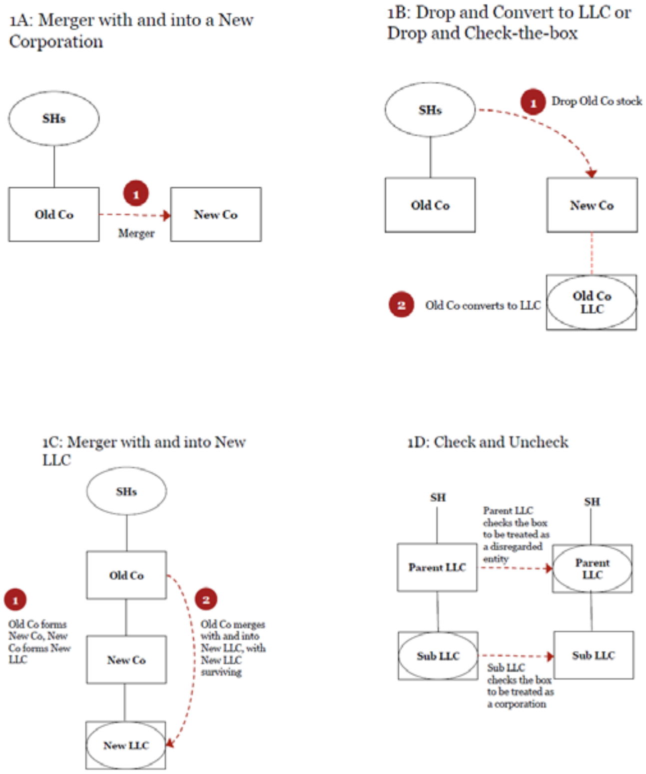
Figure 1: Certain Common F Reorganization Structures



These examples illustrate the common application of the "step-transaction doctrine" to F reorganizations involving a series of formally separate steps undertaken pursuant to a plan to effect an F reorganization. The step-transaction doctrine is a judicially developed tax law principle that treats a series of formally separate steps as a single transaction for federal tax purposes if such steps are in substance integrated, interdependent, and focused towards a particular end result.[17] For example, in *figure 1A* the formation of New Co and subsequent merger of Old Co into New Co pursuant to a plan are stepped together and treated as an F reorganization in Rev. Rul. 57-276.[18] In *figure 1B*, the drop and conversion of Old Co to an LLC, or alternatively, the drop and subsequent check-the-box election of Old Co to be classified for federal income tax purposes as a disregarded entity, are also stepped together and treated as an F reorganization applying the principles of Rev. Rul. 67-274,[19] Rev. Rul. 2004-83 (New Co's transitory ownership of Old Co is disregarded in the step-transaction analysis),[20] and Rev. Rul. 2015-10.[21] Similar step-transaction analysis applies to the series of steps undertaken pursuant to an integrated plan to effect an F reorganization in *figure 1C* (merger of Old Co with and into New LLC subsidiary of New Co) and *figure 1D* (check and uncheck federal income tax entity classification elections of Parent LLC and Sub LLC to be treated for federal tax purposes respectively as a disregarded entity and regarded corporation). These changes in identity, form, or place of organization are often undertaken to facilitate other transactions which are difficult to effect in the corporation's current form or place of organization, and may be composed of a series of steps occurring over a period of time. Thus, while the step-transaction doctrine is commonly applied to step together formally separate steps which effect F reorganizations, questions have arisen as to what other changes (if any) may occur, either before, during, or after the purported "mere change" F reorganization, without affecting the status of the "mere change" F reorganization, and the effect of the step-transaction doctrine on the analysis. Similarly, questions may arise as to whether an F reorganization may be found to occur in the midst of a series of steps, and interrupt those steps so as to interfere with an otherwise expected step-transaction analysis.

Overview of this Paper

Although F reorganizations frequently arise in connection with corporate structural changes or transactions, prior to 2004, apart from the statutory definition of an F reorganization and sparse accompanying legislative history,[22] there was ultimately relatively little precise regulatory, judicial or IRS administrative guidance on the requirements of an F reorganization. This paper traces key developments relating to guidance on F reorganizations, leading up to the issuance of the Final Regulations (T.D. 9739) that provide

[17] Step-transaction doctrine principles are also incorporated in Reg. §1.368-1(a).

[18] 1957-1 C.B. 126.

[19] 1967-2 C.B. 141. Triangular merger into a newly formed subsidiary and the subsequent planned liquidation of the subsidiary into parent are treated as a direct §368(a)(1)(C) reorganization under step-transaction analysis. Rev. Rul. 67-274 amplified in Rev. Rul. 2001-46, 2001-2 C.B. 321. In Rev. Rul. 2001-46, pursuant to an integrated plan, newly formed sub of acquiring co merges into target co, followed by merger of target co into acquiring co; transaction ruled to be treated as a single statutory merger of target co into acquiring co.

[20] 2004-2 C.B. 157. Pursuant to an integrated plan, a parent corporation sells the stock of a wholly owned subsidiary for cash to another wholly owned subsidiary, and the acquired subsidiary completely liquidates into the acquiring subsidiary, the transaction is treated as a §368(a)(1)(D) reorganization.

[21] 2015-21 I.R.B. 972. S2's transfer of LLC to S3, a wholly owned subsidiary in step (c) and LLC's entity classification election to be treated as a disregarded entity in step (d) are stepped together and characterized as a §368(a)(1)(D) reorganization applying step-transaction principles.

[22] *See generally* Kliegman, 774 T.M., *Single Entity Reorganizations: Recapitalizations and F Reorganizations*, Jasper L. Cummings, Jr., *A General Theory of F Reorganizations*, Tax Notes 1193 (Dec. 10, 2012).

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guidance on the qualification of a transaction (or series of transactions) as a reorganization under §368(a)(1)(F).[23] The Final Regulations are effective from September 21, 2015. Part II of this paper contains an overview of IRS administrative guidance on F reorganizations prior to the 2004 Proposed Regulations and the unique application of the step-transaction doctrine to F reorganizations in analyzing whether related transactions are considered to be compatible with the ''mere change'' aspect of the statutory definition. Part III of this paper discusses guidance on F reorganization requirements provided in the Proposed Regulations issued in 2004 (partially adopted as final regulations in 2005), and related comments on and issues arising from the 2004 Proposed Regulations.[24] Part IV of this paper describes the Final Regulations (T.D. 9739) issued in September 2015, and Part V offers some observations on the Final Regulations.

II. PRE-2004 IRS GUIDANCE ON F REORGANIZATIONS AND RELATED STEP-TRANSACTION ISSUES

Step-Transaction Doctrine and Reorganization Transactions

In determining whether a transaction qualifies as a reorganization under §368(a), the transaction must be evaluated under relevant provisions of law, including the step-transaction doctrine.[25] The ''step-transaction doctrine'' is a judicially developed approach based on the principle that transactions should be analyzed in accordance with their substance, and may treat a series of formally separate steps as a single transaction if such steps are in substance integrated, interdependent, and focused towards a particular result.[26] While beyond the scope of this paper, we note that it is commonplace to recite three alternative tests that have been formulated in judicial opinions as to the proper application of the step-transaction doctrine: the ''binding commitment'' test, the ''mutual interdependence'' test, and the ''end result'' test.[27] At least until the publication of Rev. Rul. 96-29, discussed below, F reorganizations provided a source of broader confusion in this area, because IRS rulings reached answers that were in practice unique to F reorganizations while purportedly relying on the same set of criteria as were applied to other fact patterns under subchapter C.[28]

Published Rulings

As indicated above, a number of rulings over the years addressed the question of whether, or how, to apply step-transaction principles to a putative F reorganization occurring in conjunction with a larger corporate restructuring transaction.[29] In each instance, the rulings concluded that the F reorganization would

[23] The Final Regulations also provide guidance on the tax treatment of outbound F reorganization, which are generally beyond the scope of this paper.

[24] REG-106889-04, 69 Fed. Reg. 49,836 (Aug. 12, 2004).

[25] Reg. §1.368-1(a).

[26] See selected thoughtful discussions of the step-transaction doctrine: Boris I. Bittker and James S. Eustice, *Federal Income Taxation of Corporations and Shareholders*, ¶12.61 (7th ed. 2008); William W. Chip and Yoram Keinan, *The Economic Substance Doctrine*, NA Portfolio 508-2nd, Chapter III, Section D on Step-Transaction; Martin D. Ginsburg, Jack S. Levin, and Donald E. Rocap, *Mergers, Acquisitions, and Buyouts*, at 6-170, ¶608.3 (Mar. 2015); Bowen, *The End Results Test*, 72 TAXES 722 (Dec. 1994); Philip J. Levine and Britt M. Haxton, *''The End Result Test'' Revisited, Part 1*, Tax Notes 1259 (Dec. 7, 2015), and *''The End Result Test'' Revisited, Part 2*, Tax Notes 1383 (Dec. 4, 2015).

[27] The binding commitment test is generally considered to present the most restrictive application of the step-transaction doctrine. Under the binding commitment test, two or more related transactions will not be stepped together unless, at the time one is consummated, there is a legally binding commitment to take the later steps: *see, e.g., Commissioner v. Gordon*, 391 U.S. 83, 96 (1968). Under the mutual interdependence test, the criterion is whether the steps are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the second: *see, e.g., Redding v. Commissioner*, 630 F.2d 1169, 1177 (7th Cir. 1980), *cert. denied*, 450 U.S. 913 (1981). Lastly, under the end result test, purportedly separate transactions will be stepped together and integrated into a single transaction when it appears that they were really component parts of a single transaction intended from the outset to be undertaken for the purpose of reaching the ultimate result: *see, e.g., King Enterprises, Inc. v. United States*, 418 F.2d 511, 516 (Ct. Cl. 1969). *See generally* Philip J. Levine and Britt M. Haxton, *''The End Result Test'' Revisited, Part 1*, Tax Notes 1259 (Dec. 7, 2015), and *''The End Result Test'' Revisited, Part 2*, Tax Notes 1383 (Dec. 14, 2015).

[28] *See, e.g.,* Rev. Rul. 79-250, 1979-2 C.B. 156, involving facts and issue subsequently addressed in Situation 2 of Rev. Rul. 96-29, 1996-1 C.B. 50, seeming to articulate a broad test for treating two transactions separately where they have ''independent economic significance.'' The later ruling stepped back from this, and articulated a more specific approach unique to F reorganizations.

[29] *See, e.g.,* Rev. Rul. 61-156, 1961-2 C.B. 62 (concerning a liquidation-reincorporation type transaction fact pattern: a sale of all assets by a ''selling'' corporation pursuant to a plan of liquidation to a newly formed corporation (in which shareholders of the selling corporation will own 45% of the outstanding stock of the newly formed corporation, and 55% of the outstanding stock of the newly formed corporation will be issued pursuant to a public offering via underwriters) and a subsequent liquidation of the ''selling'' corporation pursuant to an integrated plan is treated as a §368(a)(1)(E) and §368(a)(1)(F) reorganization); Rev. Rul. 66-284, 1966-2 C.B. 115, *amplified in* Rev. Rul. 78-441, 1978-2 C.B. 152 (concluding that a merger transaction effecting a change of place of organization of a corporation could qualify as an F reorganization even though there was less than a one percent change in the publicly held corporation's shareholders as a result of stock

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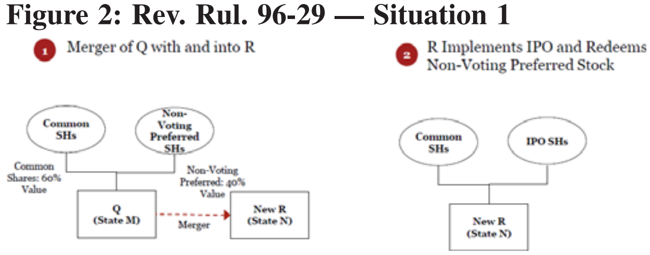
stand alone, neither interfering with nor infected by the federal income tax characterization of the larger related transactions. The rulings did not explicitly articulate the rationale for not integrating the F reorganization with related transactions under the step-transaction analysis which would otherwise generally apply to fact patterns under subchapter C. It was not until Rev. Rul. 96-29,[30] however, that the IRS articulated a rationale for these earlier conclusions that explicitly recognized the special status of the F reorganization. While the phrase had not yet been coined, and was only given semi-official status in the preamble to the Final Regulations that are the central focus of this paper, we may somewhat anachronistically describe the approach taken in Rev. Rul. 96-29 as the ''F in a bubble'' approach. Although the ''F in the bubble'' concept was not articulated, the concept was applied in practice by the IRS. The ''F in a bubble'' concept is premised on the principle that an F reorganization is, by its very nature, essentially incapable of being ''stepped'' together with other transactions, because it is ''merely'' a change in identity, form, or place of organization of a single corporation. Thus, other transactions that may occur in conjunction with the F reorganization will be tested apart from the F reorganization, and vice versa.[31] Thus, the step-transaction doctrine is generally turned off when testing a series of related steps for qualification as an F reorganization — if a series of steps constitute an F reorganization, the ''F in the bubble'' will be respected, and related events will not be stepped together to cause the ''F in the bubble'' to fail to qualify for F reorganization treatment.

Rev. Rul. 96-29 Fact Patterns

The ruling considered two fact patterns. In Situation 1,[32] all of the common stock of Q, a State M corporation, was owned by 12 individuals, and Q's sole class of nonvoting preferred stock, representing 40% of its value, was held by various corporate and noncorporate shareholders. Pursuant to a plan to raise immediate capital and enhance its ability to raise capital in the future, Q changed its state of incorporation to State N by merging with and into R, a newly organized State N corporation. Immediately after the reincorporation, R (reorganized Q) sold additional shares of stock to the public and redeemed all the outstanding nonvoting preferred shares. But for the desire to implement the public offering, Q would not have changed its state of incorporation. *See figure 2.*

Figure 2: Rev. Rul. 96-29 — Situation 1



In Situation 2,[33] W decided to acquire the business of Z, an unrelated corporation, to combine Z's business with the business of Y (a subsidiary of W), and to change W's state of incorporation. As part of the overall plan, Z merged into Y, with the former Z shareholders receiving shares of W preferred stock in exchange for their Z stock. Immediately following the acquisition of Z, W changed its place of incorporation by merging into a corporation newly formed in a different state. *See figure 3.*

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held by dissenting shareholders being redeemed in the transaction); Rev. Rul. 69-516, 1969-2 C.B. 56 (the merger of a corporation with one created in another state is treated as a §368(a)(1)(F) reorganization even though it is a part of an overall plan for a third corporation to acquire the assets of the new corporation pursuant to a reorganization under §368(a)(1)(C)); Rev. Rul. 75-456, 1975-2 C.B. 128 (F reorganization via a reincorporation transaction of the acquiring corporation in a stock reorganization under §368(a)(1)(B) did not prevent that provision's ''solely for voting stock'' requirement from being satisfied); Rev. Rul. 79-250, 1979-2 C.B. 156 (pursuant to an overall plan implemented for valid business reasons, Parent merged an unrelated corporation into its Subsidiary solely in exchange for stock of Parent, and Parent reincorporated by merging into a newly formed corporation organized in another state; ruled that acquisition of the unrelated corporation and the reincorporation of Parent are treated as two separate transactions qualifying as reorganizations); Rev. Rul. 96-29, 1996-1 C.B. 50 (discussed below). These rulings address fact patterns whereby a purported F reorganization occurs in conjunction with a larger corporate restructuring transaction as part of an overall plan (i.e., an F reorganization alongside a recapitalization, sale of assets, acquisitive reorganization). Seemingly, without an explicit rationale (until the publication of Rev. Rul. 96-29), the IRS ruled that an F reorganization would stand alone and the federal tax characterization of an F reorganization would not be affected by related corporate restructuring transactions pursuant to the same plan. Prior to the issuance of Rev. Rul. 96-29, these rulings provided a source of broader confusion on F reorganizations and application of step-transaction analysis in Subchapter C transactions.

[30] 1996-1 C.B. 50.

[31] *See* Jasper L. Cummings, Jr., *A General Theory of F Reorganizations*, Tax Notes 1193 (Dec. 10, 2012); Philip J. Levine and Britt M. Haxton, *''The End Result Test'' Revisited, Part 1*, Tax Notes 1259 (Dec. 7, 2015); Michael J. Kliegman, 774 T.M., *Single Entity Reorganizations: Recapitalizations and F Reorganizations*.

[32] Situation 1 of Rev. Rul. 96-69 involved similar facts to Rev. Rul. 61-156, involving a reincorporation in connection with a public offering of 60% of its stock.

[33] Situation 2 of Rev. Rul. 96-29 involved similar facts to Rev. Rul. 79-250.

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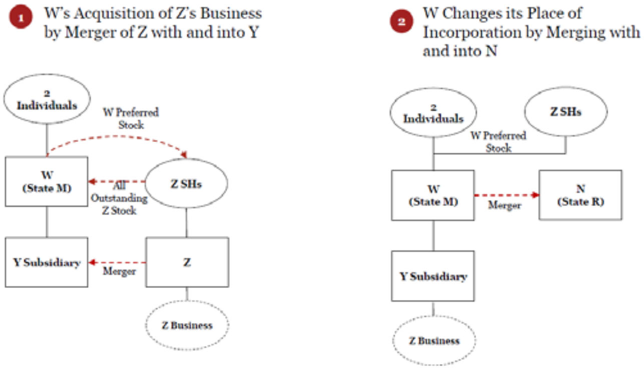
Figure 3: Rev. Rul. 96-29 — Situation 2



The IRS affirmed the general requirements that "a transaction does not qualify as a reorganization under §368(a)(1)(F) unless there is no change in the existing shareholders or in the assets of the corporation."[34] In Situation 1, the IRS ruled that the reincorporation of Q qualified as an F reorganization "even though it was a step in the transaction in which Q was issuing common stock in a public offering and redeeming stock having a value of 40 percent of the aggregate value of its outstanding stock prior to the offering." In Situation 2, the IRS ruled that the reincorporation of W qualified as an F reorganization, "even though it was a step in the transaction in which W acquired Z." The IRS cited Rev. Rul. 69-516[35] as support for the position that a reincorporation of a corporation is respected as an F reorganization even though the reincorporation was a step in a larger transaction in which the corporation either issued stock or acquired another business, and if viewed together as a single integrated transaction, would not have qualified as an F reorganization. The IRS observed that the rulings in Rev. Rul. 96-29 were based on "the unique characteristics of reorganizations qualifying under Section 368(a)(1)(F)":

> The rules applicable to corporate reorganizations as well as other provisions recognize the unique characteristics of reorganizations qualifying under Section 368(a)(1)(F). In contrast to other types of reorganizations, which can involve two or more operating corporations, a reorganization of a corporation under Section 368(a)(1)(F) is treated for most purposes of the Code as if there had been no change in the corporation and, thus, as if the reorganized corporation is the same entity as the corporation that was in existence prior to the reorganization.

The ruling affirmed the unique manner in which the step-transaction doctrine is applied to F reorganizations, in that an F reorganization "in a bubble" would not be stepped together with other related transactions — whatever else may be occurring in conjunction with the F will be tested apart from the F. This point was made clear in the ruling by the inclusion of the following comments: "although the holding of Rev. Rul. 79-250 is correct on the facts presented therein, in order to emphasize that central to the holding in Rev. Rul. 79-250 is the unique status of reorganizations under §368(a)(1)(F), and that Rev. Rul. 79-250 is not intended to reflect the application of the step-transaction doctrine in other contexts."

III. 2004 PROPOSED REGULATIONS (PARTIALLY ADOPTED AS FINAL REGULATIONS IN 2005)

In 2004, Treasury issued proposed regulations (herein, the Proposed Regulations), providing regulatory guidance regarding the characteristics of an F reorganization.[36]

Mere Change

The Proposed Regulations in general provide that in order to qualify as a reorganization under §368(a)(1)(F), a transaction must result in a mere change in identity, form, or place of organization of one corporation ("mere change"). Mere change is defined as a transaction involving an actual or deemed transfer by a transferring corporation to a resulting corporation meeting each of the following requirements:[37]

A. All the stock of the resulting corporation, including stock issued before the transfer, is *issued* in respect of stock of the transferring corporation.[38]

B. There is *no change in the ownership* of the corporation in the transaction, except a change that

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[34] However, a transaction will not fail to qualify as a reorganization under §368(a)(1)(F) if dissenters owning fewer than 1% of the outstanding shares of the corporation fail to participate in the transaction: Rev. Rul. 66-284, 1966-2 C.B. 115.

[35] 1969-2 C.B. 56. The IRS treated as two separate transactions a reorganization under §368(a)(1)(F) and a reorganization under §368(a)(1)(C) undertaken as part of the same plan. In the ruling, a corporation changed its place of organization by merging into a corporation formed under the laws of another state and, immediately thereafter, it transferred substantially all of its assets in exchange for stock of an unrelated corporation.

[36] REG-106889-04, 69 Fed. Reg. 49,836 (Aug. 12, 2004). See selected thoughtful discussions of the Proposed Regulations: Rizzi, *Mere Transactions: Are 'F' Reorganizations Really Reorganizations?* 31 Corp. Tax'n 18 (Nov. 2004); Cummings, *Three New Sets of Prop. Regs. Should Make Planning for Reorganizations Much Easier*, 101 J. Tax'n 271, at 283 (Nov. 2004); Willens, *Can Post-Squeeze Out Merger Net Operating Losses Be Carried Back to Pre-Merger Years?* 103 J. Tax'n 231 (Nov. 2005).

[37] Prop. Reg. §1.368-2(m)(1)(i).

[38] The Supreme Court noted in *Helvering v. Southwest Consoli-*

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has no effect other than that of a redemption of less than all the shares of the corporation.[39]

C. The transferring corporation completely liquidates in the transaction.[40]

D. The resulting corporation does not hold any property or have any tax attributes immediately before the transfer.[41]

Related Transactions

Treasury believes that the inclusion of the words ''however effected'' in the statutory definition of an F reorganization reflects a Congressional intent to treat as an F reorganization a series of transactions that together result in a mere change.[42] The Proposed Regulations reflect this view by providing that a series of related transactions that together result in a mere change may qualify as an F reorganization.[43]

''F in a Bubble'' — Related Events

The Proposed Regulations generally adopt the F in a bubble concept affirmed in Rev. Rul. 96-29, that an F reorganization may be a step in a larger transaction that effects more than a mere change. In the preamble to the Proposed Regulations, the IRS reiterated its position in published rulings (discussed above), that the step-transaction doctrine basically does not apply to F reorganizations, and expressly recognized that an F reorganization may be a step in a larger transaction that effects more than a mere change, without jeopardizing qualification as an F reorganization.[44] The Proposed Regulations provide a related events rule, that related events preceding or following the transaction or series of transactions that constitute a mere change do not cause that transaction or series of transactions to fail to qualify as an F reorganization. Qualification of the mere change as a reorganization under §368(a)(1)(F) will not alter the treatment of the larger transaction.[45]

Example 7[46] (*see figure 4*, below) illustrates the application of the related events rule and the F in a bubble concept. A owns all the stock of T. Unrelated P owns all the stock of S. T and S are State M corporations engaged in manufacturing businesses. Under a plan, the following transactions take place in the following order: (1) T merges into S, with A receiving solely stock of P; (2) P changes its state of incorporation by merging into New P; and (3) New P redeems A's P stock (issued in respect of his T stock) for cash. Applying the ''related events'' rule, the merger of P into New P qualifies as an F reorganization (related events preceding or following the ''mere change'' do not cause such mere change to fail to qualify as an F reorganization). The qualification of the merger of P into New P as an F reorganization does not alter the tax treatment of the merger of T into S. Because P

dated Corp., 325 U.S. 194 (1942), that ''a transaction which shifts the ownership of the proprietary interest in a corporation is hardly a 'mere change in identity, form, or place of incorporation' within the meaning of the F reorganization.'' The first two requirements for an F reorganization in the Proposed Regulations reflect this principle by providing that an F reorganization could not be used as a vehicle to introduce new owners or new equity capital into the corporate enterprise. However, issuance of a nominal amount of stock other than in respect of stock of the transferring corporation to facilitate the organization of the resulting corporation would not cause the transfer to fail to be a mere change. *See* Prop. Reg. §1.368-2(m)(1)(ii)(B). *See* Prop. Reg. §1.368-2(m)(5) *Ex.* 3, issuance of one percent of stock of the resulting corporation to facilitate its organization under foreign law are considered nominal and used to facilitate the organization of the resulting corporation.

[39] *See Reef Corp. v. United States*, 368 F.2d 125 (5th Cir. 1966), holding that a redemption of 48% of the stock of a corporation that occurred during a change in place of incorporation did not cause the transaction to fail to qualify as an F reorganization, because the redemption was functionally separate from the F reorganization even if concurrent in time. There does not appear to be any limitation on the amount of stock that can, preceding or after the reincorporation, be actually or effectively redeemed. Prop. Reg. §1.368-2(m)(5) *Ex.* 2 involves an F reorganization in a situation in which some 75% of the transferring corporation's stock is retired in the transaction. *See* Willens, *Can Post-Squeeze Out Merger Net Operating Losses Be Carried Back to Pre-Merger Years?* 103 J. Tax'n 231 (Nov. 2005).

[40] The third and fourth requirements of the Proposed Regulations implemented the statutory requirement that an F reorganization involve only one corporation. Legal dissolution of the transferring corporation is not required, and the mere retention of a nominal amount of assets for the sole purpose of preserving the corporation's legal existence will not disqualify the transaction as a mere change. *See* Prop. Reg. §1.368-2(m)(1)(ii)(A).

[41] At the time of or before the transfer, the resulting corporation may hold or have held a nominal amount of assets to facilitate its organization or preserve its corporate existence, and may have tax attributes related to holding such assets. The resulting corporation may hold the proceeds of borrowings undertaken in connection with the transaction. *See* Prop. Reg. §1.368-2(m)(1)(ii)(B).

[42] REG-106889-04, 69 Fed. Reg. 49,836 (Aug. 12, 2004).

[43] Prop. Reg. §1.368-2(m)(3)(i). *See* Prop. Reg. §1.368-2(m)(5) *Ex.* 5, the contribution of S1 stock to S2 and the merger of S1 into S2 pursuant to an integrated plan together constitute a mere change of S1. *See also Ex.* 8, the conversion of S from a State A corporation to a State A limited partnership, together with an entity classification election to treat S as a corporation for federal tax purposes, constitutes a mere change and is an F reorganization of S.

[44] REG-106889-04, 69 Fed. Reg. 49,836 (Aug. 12, 2004).

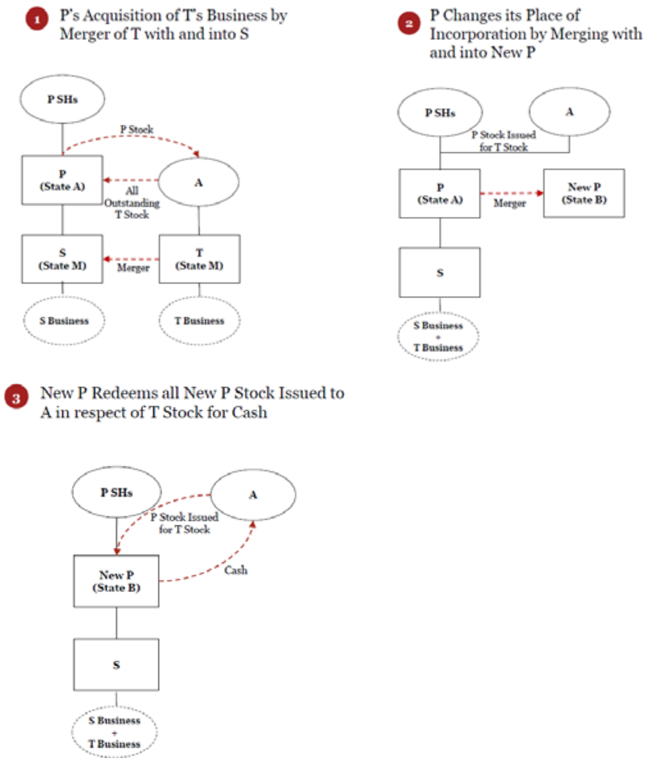
[45] Prop. Reg. §1.368-2(m)(3)(ii). *See* Prop. Reg. §1.368-2(m)(5) *Ex.* 6, as part of the same plan, S is merged into New S to change its place of incorporation to facilitate a sale of New S (successor to S) stock to an unrelated party. The sale of the New S stock is disregarded in determining whether the merger of S into New S is a mere change.

[46] Prop. Reg. §1.368-2(m)(3)(ii).

ISSN 0148-8295

shares received by A with respect to the T shares are redeemed for cash pursuant to the plan, the merger of T into S does not satisfy the continuity of interest requirement and does not qualify as a reorganization under §368(a)(1)(A) by reason of §368(a)(2)(D).

Figure 4: Example 7 from Reg. §1.368-2(m)(4) and Prop. Reg. §1.368(m)(5)



Treatment of Distributions

Section 356 by its terms governs the treatment of boot distributed in connection with any reorganization under §368(a). It has been a longstanding question how this interacts with Reg. §1.301-1(l), which provides that §301 will apply to a distribution occurring at the same time as another transaction, including certain reorganizations, such as recapitalizations and reincorporations. The Proposed Regulations provide that money or other property received by a shareholder from the transferring or resulting corporation in an F reorganization is treated as distributed by the transferring corporation *immediately before* the transaction, and §356(a) does not apply to such distribution.[47] The tax treatment of such distributions is governed by §301 and §302.[48] The Final Regulations embrace this approach, and treat distributions as unrelated and separate transactions from F reorganizations even if distributions occur during and concurrently with a Potential F Reorganization.[49]

Elimination of Continuity of Interest and Continuity of Enterprise Requirements

The Proposed Regulations also provide that the continuity of interest (COI) and continuity of enterprise (COE) requirements are not required for a transaction to qualify as an F reorganization.[50] The accompanying preamble explains that because F reorganizations involve only the slightest change in a corporation and do not resemble sales, the COI and COE requirements are not necessary to protect the policies underlying the reorganization provisions.[51] Final regulations were issued in 2005 amending Reg. §1.368-1(b) to eliminate COI and COE requirements for single entity reorganizations under §368(a)(1)(E) and §368(a)(1)(F).[52] The elimination of COI and COE requirements is preserved in the Final Regulations issued in 2015.

Comments on and Issues Arising from the Proposed Regulations

Overlap Problems with a Larger §368(a) Reorganization Transaction

Commentators have observed that the Proposed Regulations result in ambiguity regarding the federal tax characterization of a transaction where a purported ''mere change'' F reorganization transaction or a step thereof may also qualify as a reorganization or part of a reorganization under another provision of §368(a)(1), including where a corporation in control of the resulting corporation is a party to such other re-

[47] Prop. Reg. §1.368-2(m)(4).

[48] REG-106889-04, 69 Fed. Reg. 49,836 (Aug. 12, 2004). *See* Jasper L. Cummings, Jr., *A General Theory of F Reorganizations*, Tax Notes 1193 (Dec. 10, 2012): the author comments the proposed abandonment of §356 boot characterization of distributions in an F reorganization seems to be premised on (1) if all related steps are ignored under the F in a bubble concept, leaving boot coming out of a corporation with no new shareholders or assets added, there is no reason not to tax it as a regular §301 and §302 distribution and (2) potential application of the peculiar dividend within gain rule of §356. *See generally* Bailine, *Section 368(a)(1)(F) — A Poke in the Eye of the Hurricane*, 33 Corp. Tax'n 6 (Nov./Dec. 2006).

[49] *See* Reg. §1.368-2(m)(3)(iii) and discussions under Part IV of this paper.

[50] Prop. Reg. §1.368-2(m)(2).

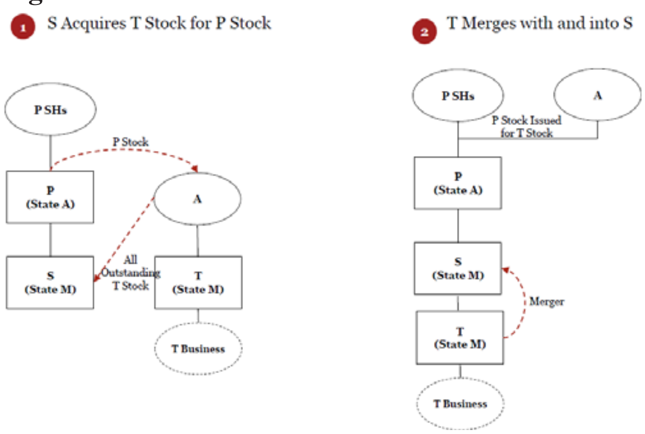
[51] REG-106889-04, 69 Fed. Reg. 49,836 (Aug. 12, 2004).

[52] T.D. 9182, 70 Fed. Reg. 9219 (Feb. 25, 2005). *See* Jasper L. Cummings, Jr., *A General Theory of F Reorganizations*, Tax Notes 1193 (Dec. 10, 2012), where the author notes the most likely explanation for the 2005 amendment is that Treasury eliminated COI and COE requirements as the most straight-forward way to apply the F in a bubble concept to ignore subsequent asset changes inside the corporation and changes of shareholders that might occur in related transactions.

ISSN 0148-8295

organization.[53] Using a variation of the facts of Example 7 in the Proposed Regulations, assume (1) P forms S, a newly formed corporation, (2) S acquires the stock of T for P Stock (P Stock issued to A is not redeemed in this alternative scenario), and (3) T merges into S. *See figure 5.*

Figure 5:



Under the step-transaction doctrine principles and analysis applied in *J.E. Seagram Corp.*,[54] and Rev. Rul. 2001-26[55] (citing *Seagram*), such two-step stock acquisition-merger transactions would ordinarily be stepped together and characterized for federal tax purposes as a §368(a)(1)(A) asset reorganization by reason of §368(a)(2)(D), with P as the acquirer and T as the target. In *J.E. Seagram Corp.*, involving a two-step stock acquisition-merger transaction in which DuPont acquired Conoco by means of a tender offer of cash and DuPont stock in exchange for Conoco stock, followed by a statutory merger of Conoco into DT (a subsidiary of DuPont) pursuant to a plan of reorganization, the merger of Conoco into DT was held to have qualified as a reorganization under §368(a)(1)(A) and §368(a)(2)(D). Similar step-transaction principles were applied in Situation 1 in Rev. Rul. 2001-26 (citing *Seagram*), in which a two-step integrated acquisition of more than 80% of target stock for voting stock of acquirer qualified as a valid reverse merger under §368(a)(2)(E). Similarly, in Situation 2 in Rev. Rul. 2001-46,[56] the momentary ownership of acquired T (via a reverse merger transaction that if viewed independent of a subsequent merger of T would qualify as a §368(a)(1)(A) reorganization by reason of §368(a)(2)(E)) is disregarded. Reg. §1.368-2(k)[57] supplements §368(a)(2)(C) and generally allows for one or more post-reorganization push-ups (distributions) as well as drop-downs of acquired stock or assets within a qualified group (as defined in Reg. §1.368-1(d)(4)(ii), generally a chain of corporations connected to the issuing corporation through §368(c) control stock ownership at each tier) provided that the continuity of business enterprise (COBE) requirement is satisfied. Reg. §1.368-2(k) expanded the scope of §368(a)(2)(C) by permitting successive transfers of the acquired assets or stock to one or more corporations, provided the transferee corporation is a member of the qualified group (controlled in each transfer by the transferor corporation).[58]

Would the transaction (and deemed transfer from T to S) in the example in *figure 5*, above, be recharacterized as a triangular asset reorganization under §368(a)(1)(A) by reason of §368(a)(2)(D) consistent with prior step-transaction analysis in *Seagram* and Rev. Rul. 2001-26, discussed above — with the potential F in a bubble of T into S ignored? Alternatively, would the reincorporation of T be respected as

[53] For comments on the Proposed Regulations, *see* John N. Geracimos and Richard W. Bailine, Comments Regarding Proposed Regulations on Recapitalization and Change-in-Form Reorganizations (REG-106889-04), Mar. 3, 2005 (supplemented on Mar. 8, 2005); Philip J. Levine and Britt M. Haxton, *"The End Result Test" Revisited, Part 1*, Tax Notes 1259 (Dec. 7, 2015). *See also* Amy S. Elliott, *Overlap Transaction Debate Affecting IRS Thoughts on Regs for F Reorgs*, 2011 TNT 99-2 (May 23, 2011). *See generally* NYSBA Tax Section Report Focuses on Characterizing Overlap Transactions in Subchapter C (Jan. 6, 2011), Doc 2011-402, or 2011 TNT-5-13.

[54] 104 T.C. 75 (1995).

[55] 2001-1 C.B. 1297.

[56] 2001-2 C.B. 321.

[57] IRS's abandonment of the *Groman* and *Bashford* limitations on remote continuity became complete with the adoption of new (and further liberalized) final regulations under Reg. §1.368-2(k) issued on October 15, 2007 (T.D. 9361), further revised on May 9, 2008 (T.D. 9396). In *Groman v. Commissioner*, 302 U.S. 82 (1937), the Supreme Court held that continuity of interest did not exist to the extent that the transferors received stock of the transferee corporation's parent in exchange for the transferors' property (although the transaction at issue in that case did constitute a reorganization with 41.4% qualifying equity continuity under the then applicable statute). The refusal to find a continuity of interest in such a triangular transaction merely because a second corporate shell was interposed between the transferred property and the transferors reflected a surprisingly restrictive and formalistic view of the continuity doctrine's function. A companion case, *Helvering v. Bashford*, 302 U.S. 454 (1938), also involved a triangular acquisition, except that the acquired properties were received by the parent itself and were then transferred by it to a subsidiary as part of a single plan. The Court held that *Groman* was applicable despite these variations in the facts.

[58] Administratively, the IRS and Treasury Department have since interpreted §368(a)(2)(C) and Reg. §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 C.B. 1290, permitting the transfer of acquiring subsidiary stock to a controlled subsidiary following a reorganization described in §368(a)(1)(A) by reason of §368(a)(2)(D), and Rev. Rul. 2002-85, 2002-2 C.B. 986, permitting the transfer of acquired assets to a controlled subsidiary following a reorganization described in §368(a)(1)(D).

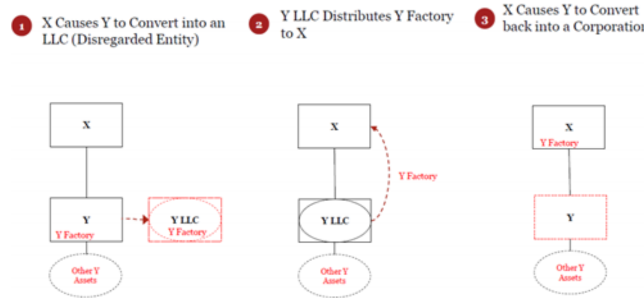
ISSN 0148-8295

an F in a bubble, preventing the application of the step-transaction doctrine to recast the acquisition as an asset reorganization (instead characterized as a stock acquisition transaction)?[59]

Overlap Problems with Redemptions and "Up-down" Transaction Recasts

The second requirement of the Proposed Regulations allows a change of ownership that has no effect other than a redemption of less than all of the shares of the corporation.[60] Permitting a mere change transaction to qualify as an F reorganization despite a redemption of most of the stock of the corporation can also result in overlap transactions.[61] Should shrinkage be tolerated and if so, how much shrinkage of the target corporation may be tolerated in an F reorganization? Consider the following example. Parent (X) owns a subsidiary (Y) that owns several assets including a factory. X wants to own the factory directly. If Y just distributes the factory to X, Y would trigger corporate level gain under §311(b). Pursuant to an integrated plan, Parent (X) causes Y to convert to an LLC (a disregarded entity for federal tax purposes), and transfer the factory to X before converting Y back into a corporation. Following the transaction, X directly owns the factory and Y stock.[62] *See figure 6.*

Figure 6:



In PLR 200952032, the IRS ruled that a transaction like this was an upstream C reorganization of the subsidiary into the parent, followed by a section 368(a)(2)(C) drop of the assets remaining in the LLC to a new corporation, avoiding section 311(b) gain.[63]

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[59] The Final Regulations provide a new priority rule to resolve this ambiguity. Treasury also takes affirmative steps to preserve the application of the step-transaction doctrine to related transactions, and affirms that taxpayers may not assert an F in a bubble to block the application of the step-transaction doctrine to related transactions. *See* Reg. §1.368-2(m)(3)(iv)(A), §1.368-2(m)(3)(iv)(B) and §1.368-2(m)(4) *Ex.* 13, and related discussions in the following part of this paper.

[60] Prop. Reg. §1.3681.368-2(m)(1)(i)(B). There does not appear to be any limitation on the amount of stock that can, preceding or after the reincorporation, be actually or effectively redeemed. Prop. Reg. §1.3681.368-2(m)(5) *Ex.* 2 involves an F reorganization in a situation in which some 75% of the transferring corporation's stock is retired in the transaction.

[61] *See* Prop. Reg. §1.368-2(m)(5) *Ex.* 2. *See generally* Amy S. Elliott, *Overlap Transaction Debate Affecting IRS Thoughts on Regs for F Reorgs*, 2011 TNT 99-2 (May 23, 2011); Amy S. Elliott, *Alexander Defends Continued Application of Unstream Reorg Revenue Ruling*, 2011 TNT 83-1 (Apr. 29, 2011); NYSBA Tax Section Report Focuses on Characterizing Overlap Transactions in Subchapter C (Jan. 6, 2011), Doc 2011-402, or 2011 TNT-5-13.

[62] Based on the facts of Rev. Rul. 58-93, 1958-1 C.B. 188. Other variations to the transaction structure are possible, for example, X may instead cause Y to convert to an LLC (a disregarded entity for federal tax purposes) and transfer the factory to X before making an entity classification election to convert Y back into a regarded corporation for federal tax purposes.

[63] *See* Rev. Rul. 58-93, 1958-1 C.B. 188. In Rev. Rul. 58-93, Y, a state C corporation, was owned 79% by X, also a state C corporation, and 21% by various individuals. X wanted to operate the business of Y through a wholly owned state B subsidiary. Pursuant to an integrated plan, Y transferred all of its assets, subject to its liabilities, to newly formed Z, a state B corporation, in exchange for all of Z's stock. Immediately thereafter, Y merged into X, with the minority shareholders of Y exchanging their Y stock for X stock. The ruling indicates Y assets were transferred to Z prior to the statutory merger of Y into X because X was not legally licensed to hold certain Y assets directly. Rev. Rul. 58-93 resequenced the drop of Y assets followed by an upstream merger of Y ("down-up" transaction) as an upstream §368(a)(1)(A) merger followed by a drop down of assets under §368(a)(2)(C) ("up-down" transaction), disregarding the form of the transaction. Commentators queried whether Rev. Rul. 58-93 might be interpreted as suggesting that for purposes of federal tax characterization, an upstream A reorganization predominates over a downstream D reorganization in an overlap transaction. In recent private letter rulings involving "down-up" transactions, the IRS respected the form of the transactions and did not apply the resequencing aspect of Rev. Rul. 58-93 to recast the steps as an "up-down" transaction. *See* PLR 201026010 and PLR 200733002. The characterization of the transaction may impact the location of transferor corporation's tax attributes post-transaction. In November 2014, Treasury and the IRS issued final regulations under §381 (T.D. 9700), providing for the following amendments to the definition of an "acquiring corporation" (the successor corporation to inherit certain tax attributes of the transferor corporation) under Reg. §1.381(a)-1(b): general rule relating to carryover of tax attributes in certain corporate reorganizations. Generally, in an acquisitive asset reorganization, the acquiring corporation is that corporation which pursuant to a plan of reorganization, acquires directly or indirectly, all of the assets transferred by the transferor corporation. Final regulations issued in November 2014 added that in an acquisitive asset reorganization, if no one corporation ultimately acquires all of the assets transferred by the transferor corporation, the "acquiring corporation" shall be the corporation that directly acquires the assets transferred by the transferor corporation, regardless of whether that corporation ultimately retains none of the assets transferred. Reg. §1.381(a)-1(b)(2). Conforming companion regulations were also issued under §312 relating to earnings & profits allocation. For additional discussions on overlap problems, see thoughtful discussions in

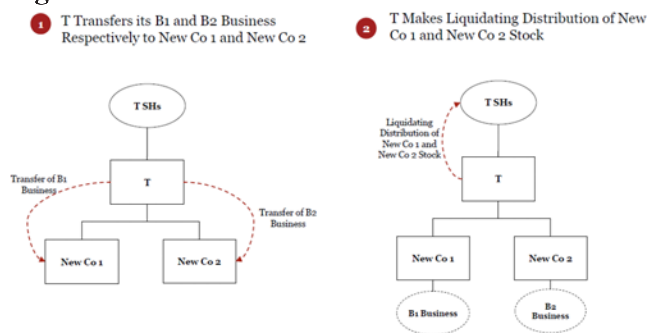
ISSN 0148-8295

A 2011 NYSBA Report on Characterizing Overlap Transactions in Subchapter C and other commentators[64] have pointed out that there is an argument that this type of transaction could also be characterized as an F reorganization of the subsidiary (Y in this example), preceded by a §302 redemption distribution by Y (of the factory to X) under the Proposed Regulations.[65] See discussions in part IV of this paper under ''F Reorganization Requirements — V. Resulting corporation is the only acquiring corporation'' for clarification on this issue in the Final Regulations (accompanying discussions to *figure 13*, below).

Multiple Fs from a Single Entity: Divisive Transactions

One firm observed in a comment letter to the IRS on the Proposed Regulations that the mechanics of the Proposed Regulations appear to facilitate tax-free divisive transactions that do not satisfy the requirements of §355, and such result would be inconsistent with the mere change of ''one corporation'' language of §368(a)(1)(F).[66] Assume that T owns two businesses of equal value, B1 and B2 (each conducted for less than a five-year period or was purchased for cash within the five-year period). Under the Proposed Regulations, T could transfer B1 and B2 respectively to Newco 1 and Newco 2 in exchange for their stock, and T could liquidate, distributing Newco 1 and Newco 2 stock to T stockholders, and satisfy the requirements of ''mere change.'' *See figure 7.* Commentators recommended that the Final Regulations clarify that only one §368(a)(1)(F) reorganization can flow from a mere change involving a single target corporation.[67]

Figure 7:



Combination of Several Corporations into a Newco

Other problematic examples arising under the mechanics of the Proposed Regulations discussed in the comment letters to the IRS relate to the treatment of a combination of several corporations into a single newly created entity.[68] Note, such combination transactions seem to be inconsistent with the ''one corporation'' statutory requirement of an F reorganization. For example, pursuant to an integrated plan, T1 transfers all of its assets to Newco and immediately thereafter, unrelated T2 transfers all of its assets to Newco. *See figure 8.* The issue becomes more problematic if T1 and T2 transfer their assets to Newco simultaneously.[69]

Amy S. Elliott, *Overlap Transaction Debate Affecting IRS Thoughts on Regs for F Reorgs*, 2011 TNT 99-2 (May 23, 2011); Amy S. Elliott, *Alexander Defends Continued Application of Upstream Reorg Revenue Ruling*, 2011 TNT 83-1 (Apr. 29, 2011); NYSBA Tax Section Report Focuses on Characterizing Overlap Transactions in Subchapter C (Jan. 6, 2011), Doc 2011-402, or 2011 TNT-5-13.

[64] See NYSBA Tax Section Report, Characterizing Overlap Transactions in Subchapter C, Section II.G. (Jan. 6, 2011), Doc 2011-402, or 2011 TNT-5-13; and Amy S. Elliott, *Overlap Transaction Debate Affecting IRS Thoughts on Regs for F Reorgs*, 2011 TNT 99-2 (May 23, 2011).

[65] The Proposed Regulations provide that a change in ownership of the target corporation that arise from a redemption of less than all the target corporation stock is permitted.

[66] *See* John N. Geracimos and Richard W. Bailine, Comments Regarding Proposed Regulations on Recapitalization and Change-in-Form Reorganizations (REG-106889-04), Mar. 3, 2005 (supplemented on Mar. 8, 2005); Stephen Joyce, *KPMG Advisors Submits Comments, Aim to Improve Section 368 Rules*, Daily Tax Rep. G-9 (Mar. 4, 2005).

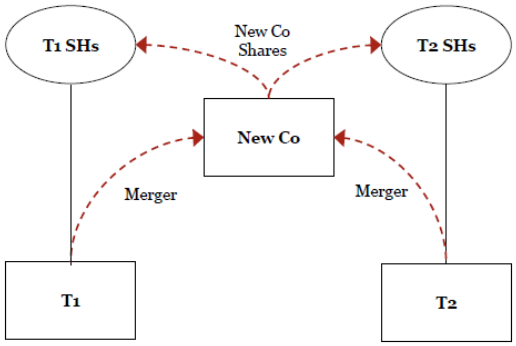
[67] The final F regulations provide a new requirement that the resulting corporation is the only acquiring corporation — immediately after the Potential F Reorganization, no corporation other than the resulting corporation may hold property that was held by the transferor corporation prior to the Potential F Reorganization. Reg. §1.368-2(m)(1)(v). The preamble accompanying the final F regulations reiterates that a transaction that divides the property or tax attributes of a transferor corporation between or among acquiring corporations, or that leads to potential competing claims to such tax attributes, will not qualify as a mere change. T.D. 9739, 80 Fed. Reg. 56,904 (Sept. 21, 2015).

[68] The authors recommended the Proposed Regulations be clarified to allow taxpayers to elect which combination will be treated as an F reorganization. *See* John N. Geracimos and Richard W. Bailine, Comments Regarding Proposed Regulations on Recapitalization and Change-in-Form Reorganizations (REG-106889-04), Mar. 3, 2005 (supplemented on Mar. 8, 2005); Stephen Joyce, *KPMG Advisors Submits Comments, Aim to Improve Section 368 Rules*, Daily Tax Rep. G-9 (Mar. 4, 2005).

[69] The final F regulations provide a new requirement that the transferor corporation is the only acquired corporation — Reg. §1.368-2(m)(1)(vi). The preamble accompanying the final F regulations reiterates that a transaction that involves simultaneous acquisitions of property and tax attributes from multiple transferor corporations (such as the transaction described in Rev. Rul. 58-422, 1958-2 C.B. 145) will not qualify as a mere change. T.D. 9739, 80 Fed. Reg. 56,904 (Sept. 21, 2015).

ISSN 0148-8295

Figure 8:
T1 and T2 Merges with and into New Co
(Either Sequentially or Simultaneously)



cause the corporation's taxable year to close. Unlike a partnership that might terminate for federal income tax purposes upon the transfer of a given percentage of the partnership interests, a corporation that continues to inhabit a single corporate shell continues to exist for federal tax purposes, independent of the identity of its shareholders or the composition of its assets.

The underlying premise of the Proposed Regulations was that, if a corporate enterprise changes its corporate shell while adhering to four proposed requirements for a Mere Change, the resulting corporation should be treated as the functional equivalent of the transferor corporation.

IV. THE 2015 FINAL REGULATIONS

Highlights

Treasury and IRS issued final regulations (T.D. 9739) in September 2015 that provide guidance with respect to the qualification of a transaction as a corporate reorganization under §368(a)(1)(F) (herein the "Final Regulations").[70] The Final Regulations are effective from and applicable to transactions occurring on or after September 21, 2015.[71] The preamble to the Final Regulations includes an excellent articulation of the underlying philosophy of the Proposed Regulations, perpetuated in the Final Regulations:

> A corporation that continues to inhabit its corporate shell can change in many respects. Although these changes may have federal income tax consequences, they do not result in the corporation being treated for federal income tax purposes as a new corporation or as transferring assets. Nor do these changes

The Final Regulations provide six requirements for a "mere change" transaction to qualify as an F reorganization. The first four requirements generally retain the four requirements set forth in the Proposed Regulations. Two additional requirements are intended to address overlap situations discussed above. The rules establish when a transaction or series of related transactions begins and ends for purposes of testing against the six requirements. The Final Regulations also embrace the "F in a bubble" concept initially outlined in Rev. Rul. 96-29 and reflected in the Proposed Regulations: that the step-transaction doctrine applies to events within an F reorganization "in a bubble," however events motivated by business reasons that either precede or occur subsequent to a potential F reorganization generally will not be integrated under the step-transaction doctrine to prevent the transaction from qualifying as an F reorganization, or vice versa. Note, however, that the step-transaction doctrine may still apply to related transactions that precede or follow the F reorganization. The Final Regulations take affirmative steps to preserve the principle that an "F in a bubble" cannot be asserted to turn off the application of the step-transaction doctrine to related transactions. See related discussions below under "Series of Related Transactions" in part IV of this paper.

"Potential F Reorganization" for Testing

The Final Regulations added the concept of a "potential F reorganization" (herein, Potential F Reorganization) to aid in determining which steps in a multi-step transaction should be considered steps "in the bubble" when applying the six requirements to a potential mere change transaction — the "bubble" begins when the transferor corporation begins transferring (or is deemed to begin transferring) its assets to

[70] See generally selected thoughtful discussions of the Final Regulations on F reorganization requirements: T.D. 9739, 80 Fed. Reg. 56,904 (Sept. 21, 2015); Willens, *"Mere Change" a Reorganization under Section 368(a)(1)(F)*, Daily Tax Rep. J-1 (Sept. 30, 2015); Davison, *F Reorganization Rules Highlight Importance of Form*, Daily Tax Rep. G-1 (Nov. 6, 2015); Amy S. Elliott and Marie Sapirie, *Treasury Preserves the Bubble in Final Change-in-Form Regs*, 2015 TNT 182-3 (Sept. 21, 2015); Nathan J. Richman and Amy S. Elliott, *De Minimis for Change-in-Form Regs Depends on Purpose*, 2015 TNT 215-2 (Nov. 6, 2015); and Laurence M. Bambino, Michael B. Shulman, Laurence E. Crouch and Ethan D. Harris, *IRS Issues Final Regulations on F Reorganizations*, Shearman & Sterling LLP (Oct. 14, 2015), http://www.shearman.com.

[71] The Final Regulations also include rules regarding outbound F reorganizations by adopting, without substantive change, the provisions of the 1990 proposed regulations relating to §367(a) and making conforming changes to other regulations.

ISSN 0148-8295

the resulting corporation,[72] and ends when the transferor corporation has distributed (or is deemed to have distributed) the consideration it receives from the resulting corporation to its shareholders and has completely liquidated for federal income tax purposes.[73]

F Reorganization Requirements

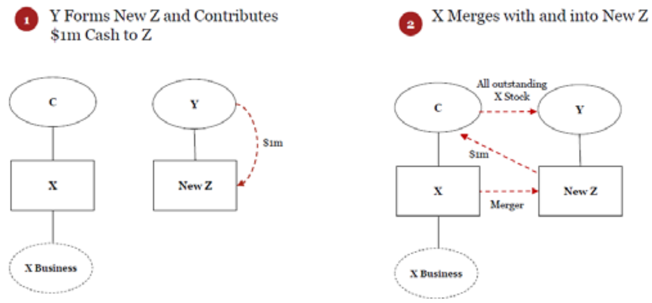
The following six requirements for an F reorganization ensure that an F reorganization involves only one continuing corporation and is neither an acquisition transaction nor a divisive transaction.

Resulting Corporation Stock Distributed in Exchange for Transferor Corporation Stock

Immediately after the Potential F Reorganization, all the stock of the resulting corporation must have been distributed[74] or deemed distributed in exchange for stock of the transferor corporation (a *de minimis* amount of stock issued by the resulting corporation other than in respect of transferor corporation stock to facilitate the organization of the resulting corporation or maintain its legal existence is disregarded).[75]

The requirement that resulting corporation stock is distributed in exchange for transferor corporation stock is illustrated in Reg. §1.368-2(m)(4) *Ex.* 1. C owns all the stock of X. Y seeks to acquire the assets of X for cash. To effect the transaction, Y contributes $1M to a newly formed corporation, Z, in exchange for Z stock, and X merges into Z. In the merger, C surrenders X stock and receives $1M. *See figure 9.* The merger of X into Z is not a mere change because Z stock is not distributed to X's shareholder in exchange for X stock. Rather, C exchanges X stock for cash.

Figure 9: Example 1 from Reg. §1.368-2(m)(4)



Identity of Stock Ownership

The same person or persons own all the stock of the transferor corporation at the beginning of the Potential F Reorganization and all of the stock of the resulting corporation at the end of the Potential F Reorganization, in identical proportions. However, this requirement is not violated if one or more holders of stock in the transferor corporation exchange stock in the transferor corporation for stock of equivalent value in the resulting corporation, but having different terms from those of the stock in the transferor corporation, or receive a distribution of money or other property from either the transferor corporation or the resulting corporation, whether or not in exchange for stock in the transferor corporation or the resulting corporation.[76]

The identity of stock ownership requirement is illustrated in example 1 of the Final Regulations (discussed above). Also, in example 2 of the Final Regulations, in connection with a reincorporation of corporation X for state law purposes, A, the 75% shareholder of X surrenders his X stock for a redemption distribution. Corporation X's change in ownership caused by A's surrender of X stock results from a permitted distribution and exchange described above. Therefore, the merger of X into Y is a mere change of X and qualifies as an F reorganization. A's surrender of X stock for cash is treated as a transaction, separate from the F reorganization, to which §302(a) applies.

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[72] In the context of determining whether a Potential F Reorganization qualifies as a mere change, deemed asset transfers include transfers treated as occurring as a result of an entity classification election under Reg. §301.7701-3(c)(1)(i), as well as transfers resulting from the application of step-transaction principles. For example, a "liquidation-reincorporation" transaction or a "drop-and-check" transaction (a newly formed resulting corporation acquires the stock of a transferor corporation from its shareholders and, as part of the plan, the transferor corporation liquidates into the resulting corporation).

[73] Reg. §1.368-2(m)(1).

[74] This first requirement in the Final Regulations reflects a slight modification to the Proposed Regulations. The preamble to the Final Regulations notes that the first requirement of the 2004 Proposed Regulations focused on the "issuance" of the stock of the resulting corporation in respect of the stock of the transferor corporation. Treasury and the IRS believe, however, that a focus on the "distribution" of the stock of the resulting corporation better matches the transactions that occur (or are deemed to occur) in reorganizations.

[75] Reg. §1.368-2(m)(1)(i). A *de minimis* exception applies to the first four requirements provided in §1.368-2(m)(1)(i) through §1.368-2(m)(1)(iv). *See* Reg. §1.368-2(m)(4) *Ex.* 3, issuance of 1% of stock of the resulting corporation to facilitate its organization under foreign law are considered nominal and used to facilitate the organization of the resulting corporation. Treasury officials have commented that the interpretation of the *de minimis* exceptions is "really purpose driven," and "*de minimis* requirements are restricted to a particular purpose — namely to preserve the resulting corporation's organization or preserve its existence." *See* Nathan J. Richman and Amy S. Elliott, *De Minimis for Change-in-Form Regs Depends on Purpose*, 2015 TNT 215-2 (Nov. 6, 2015). Note that under Rev. Rul. 66-384, 1966-2 C.B. 115, the IRS permitted a *de minimis* amount — 1% — of corporate shrinkage (either by way of changing shareholders or distributing assets) in connection with an F reorganization.

[76] Reg. §1.368-2(m)(1)(ii).

ISSN 0148-8295

Prior Assets or Attributes of Resulting Corporation

The resulting corporation may not hold any property or have any tax attributes immediately before the Potential F Reorganization. A treasury official weighed in on what constitutes a tax attribute for purposes of this third F reorganization requirement, and clarified that "we intended for this to refer to federal tax attributes, not state or foreign."[77] Holding a *de minimis* amount of assets to facilitate the organization of the resulting corporation or maintain its legal existence, and having tax attributes related to holding those assets are permitted and do not violate this third requirement.[78] Holding the proceeds of borrowings undertaken in connection with the Potential F Reorganization is also permitted.

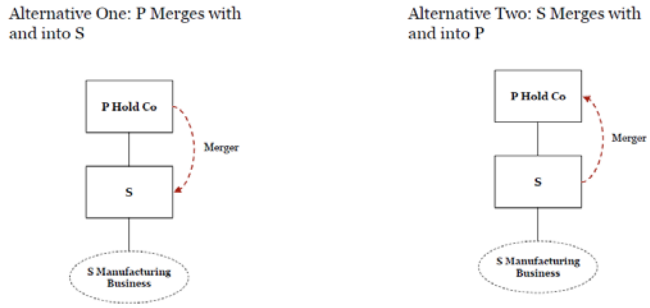
The prohibition of pre-transaction assets and tax attributes of the resulting corporation is illustrated in Reg. §1.368-2(m)(4) *Ex.* 4. P is a holding company that owns all outstanding stock of S, engaged in a manufacturing business. P owns no assets other than stock of S. P's shareholder decides to eliminate the holding company structure by merging P into S. *See figure 10.* The merger of P into S is not a mere change under Reg. §1.368-2(m)(1)(iii) because S holds property and has tax attributes immediately before the Potential F Reorganization. Similarly, if S were to merge into P, the same result would occur because P, the potential resulting corporation, holds S stock and tax attributes related to holding S stock.[79]

[77] *See* Amy S. Elliot, *ABA Meeting: Only Federal Attributes Count for Third F Reorg Requirement*, 2016 TNT 21-8 (Feb. 2, 2016); and Laura Davison, *Attributes in F Reorganization Rules Refer to Federal Losses*, 21 Daily Tax Rep. G-5 (Feb. 1, 2016).

[78] Reg. §1.368-2(m)(1)(iii).

[79] Section 332 or §368(a)(1)(A) reorganization characterization may apply instead.

Figure 10: Example 4 from Reg. §1.368-2(m)(4)



Liquidation of Transferor Corporation

The transferor corporation must completely liquidate for federal income tax purposes.[80]

Resulting Corporation Is the Only Acquiring Corporation

Immediately after the Potential F Reorganization, no corporation other than the resulting corporation may hold property that was held by the transferor immediately before the Potential F Reorganization if the resulting corporation would, as a result, succeed to and take into account the items of the transferor described under §381(c).[81] This single resulting/acquiring corporation requirement and the overlap

[80] Reg. §1.368-2(m)(1)(iv). The transferor corporation is not required to dissolve under applicable law and may retain a *de minimis* amount of assets for the sole purpose of preserving its legal existence.

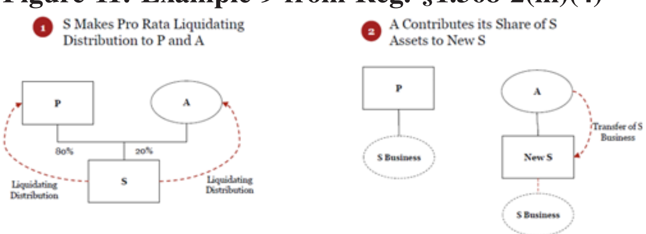
[81] Reg. §1.368-2(m)(1)(v). The fifth requirement was added to address overlap concerns with "Up-down" transaction recasts, and reflects the view that an F reorganization does not include transactions that divide the property or tax attributes of the transferor corporation. *See* Rev. Rul. 58-93, 1958-1 C.B. 188, and discussion above in part III. For example, if a transferor corporation merges upstream into its parent corporation and a portion of the transferor corporation's assets are contributed to a potential resulting corporation, under the Final Regulations, neither the upstream merger to parent or the transfer to the resulting corporation would qualify as an F reorganization. Under the Proposed Regulations, it was unclear whether such transaction qualifies as an upstream §368(a)(1)(A) reorganization followed by a deemed §368(a)(2)(C) drop of assets of the transferor corporation, or alternatively, a sideways F reorganization preceded or followed by a distribution. Since there are two potential entities that could claim to be a successor to the transferor corporation for purposes of F reorganizations (the parent or the resulting corporation), Treasury and the IRS decided none of them would be a successor under the F reor-

ISSN 0148-8295

rule in Reg. §1.368-2(m)(3)(iv)(A) (preventing F reorganization overlaps with triangular asset reorganizations involving a controlling corporation as a party to the reorganization, discussed below), both new rules added to the Final Regulations, are designed to ensure that divisive transactions will not qualify as an F reorganization. The application of this requirement is illustrated in the following examples of Reg. §1.368-2(m)(4).

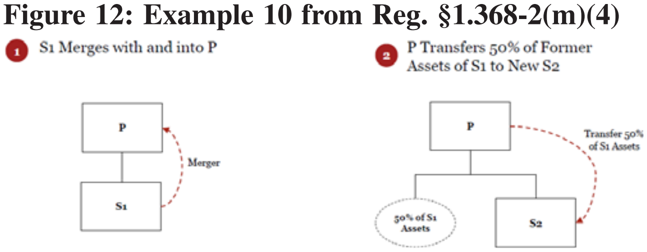
In example 9 of the Final Regulations, P owns 80% and A owns 20% stock of S. P and A desire to completely liquidate S while A continues to operate part of the business of S in corporate form. Thus, S dissolves and distributes its assets pro rata among P and A. *See figure 11.* S's liquidation distribution to P meets the requirements of §332 and §381(a) applies to P's acquisition of S property. A contributes the assets it receives from S to newly incorporated New S for New S stock. Under Reg. §1.368-2(m)(1)(v), the Potential F Reorganization in which 20% of the property previously held by S is transferred to New S cannot be a mere change of S.

Figure 11: Example 9 from Reg. §1.368-2(m)(4)



In example 10, P owns all of S1. Pursuant to a plan, S1 merges into P, and immediately afterward, P contributes 50% of the former assets of S1 to a newly incorporated S2 in exchange for S2 stock.

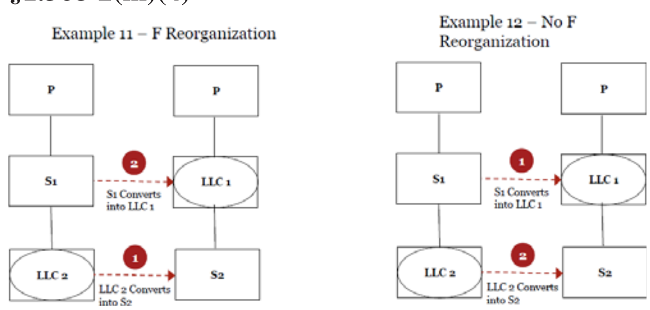
Figure 12: Example 10 from Reg. §1.368-2(m)(4)



The transaction qualifies as an upstream §368(a)(1)(A) merger of S into P by reason of §368(a)(2)(C) and Reg. §1.368-2(k). The indirect transfer of property from S1 to S2 does not qualify as an F reorganization because §381(a) applies to P's acquisition of S1 property and under Reg. §1.368-2(m)(3)(iv)(A), P (the corporation with §368(c) control of S2) is a party to the reorganization. Note, if instead, S1 first merges with and into newly incorporated S2 with S2 as the surviving corporation, and S2 subsequently distributes property to P, the merger of S1 with and into S2 would qualify as an F reorganization and the distribution from S2 to P treated as a §301 distribution. This illustrates that altering the form and sequence of transaction steps may impact the F reorganization analysis under the Final Regulations.

In example 11, P owns S1, and S1's only asset is all of the equity interest in LLC2, a domestic limited liability company. Pursuant to an integrated plan, LLC2 converts to S2, a corporation, followed by the conversion of S1 into LLC1, a domestic limited liability company. *See figure 13.* As a result, S1 is deemed to transfer its assets to S2 in exchange for all of the stock in S2 and then distribute the S2 stock to P in complete liquidation of S1. The two conversions are treated as steps in the Potential F Reorganization and qualify as an F reorganization of S1.

Figure 13: Examples 11 and 12 from Reg. §1.368-2(m)(4)



Example 12 assumes the same facts as example 11, except that S1 converts into LLC1 prior to the conversion of LLC into S2. *See figure 13.* S1 is deemed to distribute all of its assets to P in exchange for all of P's S1 stock, and P is deemed to transfer all of those assets to S2 in exchange for all of the stock of S2.[82] Applying step-transaction analysis, the transaction does not qualify as a complete liquidation of S1 under §332 (because of the reincorporation of S1's assets). The transaction in example 12 of the Final Regulations is characterized under step-transaction principles

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ganization rules. *See* Amy S. Elliott and Marie Sapirie, *Treasury Preserves the Bubble in Final Change-in-Form Regs*, 2015 TNT 182-3 (Sept. 21, 2015).

[82] With respect to conversions from C corporations to disregarded entities, the check-the-box regulations provide specific rules concerning elective changes in entity classification. Under these rules, if a corporation becomes a disregarded entity, then the ''association'' is deemed to have distributed in complete liquidation all of its assets and liabilities to its single owner in liquidation. Reg. §301.7701-3(g)(1)(iii). The regulations concerning elective changes in the tax classification of an entity helpfully provide that if any tax classification (check-the-box) election is made, the tax treatment of a change in the classification of an entity for federal tax purposes is determined ''under all relevant provisions'' of federal tax law and ''general principles of tax law,'' including the step-transaction doctrine. Reg. §301.7701-3(g)(2).

ISSN 0148-8295

as an upstream reorganization of S1 into P under §368(a)(1)(C) by reason of §368(a)(2)(C) and Reg. §1.368-2(k).[83] Reg. §1.368-2(k) supplementing §368(a)(2)(C) generally allows for one or more post-reorganization transfers via push-ups (distributions) as well as drop-downs of stock or assets acquired in a reorganization under §368(a)(1) within a qualified group (as defined in Reg. §1.368-1(d)(4)(ii), generally a chain of corporations connected to the issuing corporation through §368(c) control stock ownership at each tier) provided that the Continuity of Business Enterprise (COBE) requirement is satisfied. Thus, one or more subsequent transfers (distributions or drop-downs) of stock or assets acquired in a §368(a)(1) reorganization permitted within the ambit of Reg. §1.368-2(k) will not cause the transaction to fail to qualify as a §368(a)(1) reorganization. The Potential F Reorganization in which the former assets of S1 are deemed transferred first to P then dropped down to S2 is not a mere change of S1 because §368(a) applies to P's acquisition of property held by S1. Furthermore, P is a controlling corporation of S2 and is a party to the reorganization under Reg. §1.368-2(m)(3)(iv)(A). The issue of whether similar transactions to this example 12 should be characterized for federal tax purposes as an upstream §368(a)(1)(C) (or §368(a)(1)(A) in the case of a statutory merger, if applicable) asset reorganization followed by a §368(a)(2)(C) drop-down of acquired assets to a controlled subsidiary of acquiring in accordance with the form of the transaction, or alternatively characterized as a side-way brother-sister §368(a)(1)(D) reorganization is not unique to an F reorganization analysis.[84]

Transferor Corporation Is the Only Acquired Corporation

Immediately after the F reorganization, the resulting corporation may not hold property acquired from a corporation other than the transferor corporation if the resulting corporation would, as a result, succeed to and take into account the items of that other corporation described in §381(c).[85] A transaction that involves simultaneous acquisitions of property and tax attributes from multiple transferor corporations will not qualify as a mere change.[86] This new requirement in the Final Regulations is designed to ensure that ac-

[83] This application of the step-transaction analysis appears consistent with the IRS's prior ruling position in similar ''up-down'' transactions. In Rev. Rul. 69-617, 1969-2 C.B. 57, the IRS ruled the merger of one corporation into another owning more than 80% of its stock and immediate transfer of the acquired corporation's assets and liabilities to a new wholly owned subsidiary is a reorganization under §368(a)(1)(A) and §368(a)(2)(C). The drop down transfer of acquired assets by the acquiring corporation to a controlled subsidiary is permitted by §368(a)(2)(C) without invalidating the tax-free merger eligibility. The IRS viewed the merger of a controlled subsidiary with and into its parent as a §368(a)(1)(A) merger reorganization rather than a controlled subsidiary liquidation. The reincorporation of assets is apparently regarded by the IRS as inconsistent with its concept of a ''liquidation.'' In Rev. Rul. 69-617, P owned more than 80% of the outstanding stock of corporation S. The balance of the outstanding stock of S was publicly held. For valid business reasons, P wanted to have the business of S conducted by a wholly owned subsidiary. In order to accomplish this result, S was merged into P pursuant to the laws of the states in which they were incorporated. The stock of S owned by P was cancelled and the minority shareholders of S received shares of common stock of P in exchange for their S stock. P then transferred all of the assets received from S, subject to all the liabilities of S, to its new subsidiary, corporation X Also, for example, in PLR 200952032, the IRS ruled that a similar ''up-down'' transaction was an upstream C reorganization of the subsidiary into the parent, followed by a §368(a)(2)(C) drop of the acquired assets of the subsidiary to a §368(c) controlled subsidiary corporation of the parent. In PLR 200952032, parent owns all of S1 and S2. The assets comprising the State Y operations are held as tenancy in common (TIC) by S1 and S2. For administrative and regulatory purposes, parent converts S1 into a single member limited liability company (''S1 LLC'') under applicable state law that will be treated as disregarded entity, S1 LLC transfers its interest in the TIC to S2, and S1 LLC subsequently converts back to a corporation under state law. S1's transfer of substantially all of its assets to parent solely in exchange for parent voting stock and assumption of liabilities of S1, followed by distribution by S1 of parent voting stock to parent in complete liquidation qualifies as an upstream §368(a)(1)(C) reorganization, which would not be disqualified or recharacterized by reason of the deemed §368(a)(2)(C) drop down S1's interest in the TIC to S2 or the reincorporation of S1.

[84] Note prior to the issuance of Reg. §1.368-2(k), similar transactions would likely have been integrated and characterized as a brother-sister reorganization of S1 into S2 under §368(a)(1)(D). Under the new overlap rule in Reg. §1.368-2(m)(3)(iv)(B) of the Final Regulations, if a Potential F Reorganization qualifies as an F reorganization and may also qualify as a reorganization under §368(a)(1)(A), §368(a)(1)(C) or §368(a)(1)(D), the F reorganization characterization prevails and the transaction shall qualify only as an F reorganization. Following the finalization of Reg. §1.368-2(k) supplementing §368(a)(2)(C), the form of the transaction is respected and the ''up-down'' tax characterization applies.

[85] Reg. §1.368-2(m)(1)(vi)(B). The sixth requirement, together with the overlap rule in Reg. §1.368-2(m)(3)(iv)(B) discussed below, has the effect of removing overlap in cases when a transaction could be considered an acquisitive reorganization under either §368(a)(1)(A), §368(a)(1)(C), §368(a)(1)(D) or §368(a)(1)(F). *See* Amy S. Elliott and Marie Sapirie, *Treasury Preserves the Bubble in Final Change-in-Form Regs*, 2015 TNT 182-3 (Sept. 21, 2015).

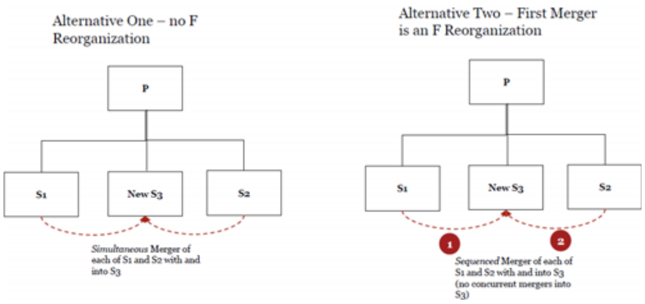
[86] Rev. Rul. 58-422, 1958-2 C.B. 145, and Rev. Rul. 57-276, 1957-1 C.B. 126, now obsoleted by the Final Regulations. In Rev. Rul. 58-422, a corporation (''parent'') desired, for valid business purposes, to reincorporate in a state other than its state of incorporation and to acquire directly the assets and businesses of its two wholly-owned subsidiaries. To carry out this plan, the parent organized a new corporation under the laws of the desired other state, and the new corporation, the parent, and the two subsidiaries entered into an agreement of statutory merger under which the new corporation was to be the surviving corporation. The IRS ruled the two subsidiaries are treated as liquidating into parent under §332 pursuant to the merger agreement, and the merger of parent with and into the new corporation was treated as an F reorganization. Under the Final Regulations, this transaction would violate the single transferor/acquired corporation requirement in Reg.

ISSN 0148-8295

quisitive or consolidation transactions will not qualify as an F reorganization.

Example 14 of Reg. §1.368-2(m)(4) illustrates the application of the single transferor corporation requirement. P owns all stock of S1 and S2, and desires to operate S1 and S2 as a single corporation. Pursuant to a plan, P forms S3 and simultaneously merges S1 and S2 into S3. *See figure 14.*

Figure 14: Example 14 from Reg. §1.368-2(m)(4)



Immediately after the simultaneous mergers, S3 holds property acquired from a corporation other than the transferor corporation and related tax attributes. Therefore, neither Potential F Reorganization of S1 and S2 is a mere change qualifying as an F reorganization. The example notes the result would be different if the mergers were not simultaneous. If S1 completed its merger into S3 before S2 began its merger into S3, the merger of S1 into S3 would qualify as an F reorganization, but the merger of S2 into S3 would not so qualify (but would qualify as a reorganization under §368(a)(1)(A) and §368(a)(1)(D)).

Series of Related Transactions

The Final Regulations provide that a Potential F Reorganization consisting of a series of related transactions that together result in a mere change may qualify as an F reorganization (regardless of whether certain steps in the series, viewed in isolation, may be treated as a §304(a) redemption, complete liquidation under §331 or §332, or a transfer of property under §351). The Final Regulations clarify that an F reorganization involving a ''drop-and-check'' type transaction is allowed.[87] Note, however, that an upstream merger followed by a deemed drop down of assets of the target corporation will not be recharacterized as a mere change, but will instead be characterized in accordance with its form as an upstream ''A'' reorganization followed by a drop-down of assets permitted under §368(a)(2)(C).[88] The Final Regulations address the potential overlap ambiguity raised by commentators with respect to transactions involving an upstream §368(a)(1)(A) reorganization or upstream §368(a)(1)(C) reorganization, followed by a deemed §368(a)(2)(C) drop down of assets of the transferor corporation (or ''down-up'' transactions deemed cast as ''up-down'' transactions). Under the Proposed Regulations, it was unclear whether such transaction also qualifies as an F reorganization to the resulting corporation preceded or followed by a distribution to parent. The Final Regulations clarify neither the upstream merger followed by drop down of assets or sideways reorganization followed by distribution of assets will be treated as a mere change F reorganization. Also note that Reg. §1.368-2(m)(1)(v) requires the resulting corporation to be the only acquiring corporation (divisive type transactions are not allowed) in mere change transactions.

Example 13 of Reg. §1.368-2(m)(4) (new example added to the Final Regulations) provides an interesting illustration of the application of the step-transaction doctrine, and affirms that the ''F in a bubble'' concept should not block the application of the step-transaction doctrine.[89] In example 13, X owns all of the stock of T. P acquires all of the stock of T in exchange for consideration consisting of $50

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§1.368-2(m)(1)(vi), and would not be treated as an F reorganization of parent.

[87] Reg. §1.368-2(m)(3)(i). The application of the series of transactions rule is illustrated in Reg. §1.368-2(m)(4) *Ex.* 5. P owns S1. To facilitate a change of S1's place of organization, P forms S2, contributes the stock of S1 to S2, followed by a merger of S1 into S2. The contribution of S1 and the merger of S1 into S2 together constitute a mere change of S1. The Potential F Reorganization qualifies as an F reorganization (not a §368(a)(1)(D) reorganization applying the overlap priority rule of Reg. §1.368-2(m)(3)(iv)(B)). The result would be the same if instead S1 completely liquidates or is deemed to completely liquidate for federal income tax purposes. *See also* Reg. §1.368-2(m)(4) *Ex.* 8. P owns all stock of S, and converts its legal form from a corporation under state law to a limited partnership under state law. Upon conversion to a limited partnership under state law, S also elects to be classified as a corporation for federal tax purposes. Applying Reg. §1.368-2(m)(3)(i), the conversion of S to a limited partnership together with entity classification election to be classified as a corporation for federal tax purposes results in a mere change of S and qualifies as an F reorganization.

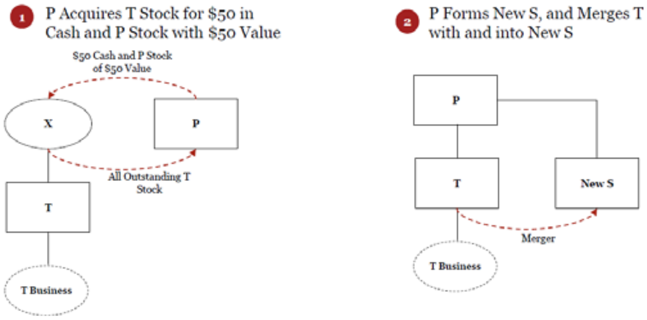
[88] Reg. §1.368-2(m)(3)(i) cross references Reg. §1.368-2(k) for (a)(2)(C) drop-down asset reorganizations that will not be recharacterized as a mere change transaction. *See also* 80 Fed. Reg. 56,904 (Sept. 21, 2015). See thoughtful discussions in Amy S. Elliott, *Overlap Transaction Debate Affecting IRS Thoughts on Regs for F Reorgs*, 2011 TNT 99-2 (May 23, 2011); Amy S. Elliott, *Alexander Defends Continued Application of Upstream Reorg Revenue Ruling*, 2011 TNT 83-1 (Apr. 29, 2011); NYSBA Tax Section Report Focuses on Characterizing Overlap Transactions in Subchapter C (Jan. 6, 2011), Doc 2011-402, or 2011 TNT-5-13.

[89] Reg. §1.368-2(m)(3)(ii) provides ''Qualification of a potential F reorganization as a reorganization under Section 368(a)(1)(F) will not alter the character of other transactions for federal income tax purposes, and step-transaction principles may be applied to other transactions without regard to whether certain steps qualify as a reorganization or part of a reorganization under Section 368(a)(1)(F).'' *See also ''The End Result Test'' Revisited*, Part 2, Tax Notes 1383 (Dec. 14, 2015).

ISSN 0148-8295

cash and P voting stock with $50 value. Immediately thereafter and as part of the same plan, P forms S as a wholly owned subsidiary and T is merged into S. *See figure 15.*

Figure 15: Example 13 from Reg. §1.368-2(m)(4)



Viewed in isolation as a Potential F Reorganization, the merger of T into S appears to constitute a mere change of T. Nevertheless, the step-transaction doctrine is applied to characterize the overall transaction as a statutory merger of T into New S in exchange for $50 cash and $50 of P's voting stock (and S's assumption of T's liabilities). For federal income tax purposes, the merger transaction is treated as a §368(a)(1)(A) merger by reason of §368(a)(2)(D), with New S as the acquiring corporation and P as the controlling corporation. P's momentary ownership of T stock is disregarded under the step-transaction analysis. Applying the overlap rule of Reg. §1.368-2(m)(3)(iv)(A), P is a controlling corporation of New S and is a party to the reorganization within §368(b). Thus, the transfer of property from T to New S does not qualify under §368(a)(1)(F).

Note there is strong support for the application of the step-transaction analysis in this manner to disregard P's transitory ownership of T stock, and to integrate the steps and characterize the overall transaction in this example 13 as a §368(a)(1)(A) merger of T with and into New S by reason of §368(a)(2)(D). For example, in *King Enterprises, Inc. v. United States,*[90] an acquiring corporation acquired all of the stock of acquired corporation for shares of acquiring corporation stock, notes and cash. Following the acquisition, the acquiring corporation merged the acquired corporation into itself. The two transactions were considered parts of a single plan. Applying the step-transaction doctrine, the two-step stock acquisition-merger transaction in *King Enterprises* was held to have qualified as a reorganization under §368(a)(1)(A). Also in *J.E. Seagram Corp.,*[91] involving a two-step stock acquisition-merger transaction in which DuPont acquired Conoco by means of a tender offer of cash and DuPont stock in exchange for Conoco stock, followed by a statutory merger of Conoco into DT (a subsidiary of DuPont) pursuant to a plan of reorganization, the merger of Conoco into DT was held to have qualified as a reorganization under §368(a)(1)(A) and §368(a)(2)(D). Similar step-transaction principles were applied in Rev. Rul. 2001-26[92] (citing *Seagram*). In Situation 1, a two-step integrated acquisition of more than 80% of target stock for voting stock of acquirer qualified as a valid reverse merger under §368(a)(2)(E).[93]

This appears to be an exception to the "F in the bubble" approach. Where steps that consist of a Potential F Reorganization are part of a series of steps pursuant to a plan that qualify as a reorganization under §368, the steps in the "bubble" should not be treated as an F reorganization and should not affect the step-transaction analysis under existing law. It appears that the IRS would prefer not to insert F reorganization characterization to do harm to well established, largely favorable reorganization analysis using step-transaction principles, applied in for example, *King Enterprises, Inc. v. United States,*[94] *J.E. Seagram Corp.,*[95] and Rev. Rul. 2001-26[96] (citing *Seagram*) discussed above. Additionally, there is arguably a strong preference to preserve the §368(a)(1) tax-free reorganization treatment over the deemed taxable as-

[90] 418 F.2d 511 (Ct. Cl. 1969).

[91] 104 T.C. 75 (1995).

[92] 2001-1 C.B. 1297.

[93] In Situation 1 under Rev. Rul. 2001-26, Corporation P and Corporation T are widely held, manufacturing corporations organized under the laws of state A. T has only voting common stock outstanding, none of which is owned by P. P seeks to acquire all of the outstanding stock of T. For valid business reasons, the acquisition will be effected by a tender offer for at least 51% of the stock of T, to be acquired solely for P voting stock, followed by a merger of a subsidiary of P into T. P initiates a tender offer for T stock conditioned on the tender of at least 51% of the T shares. Pursuant to the tender offer, P acquires 51% of the T stock from T's shareholders for P voting stock. P forms S and S merges into T under the merger laws of state A. In the statutory merger, P's S stock is converted into T stock and each of the T shareholders holding the remaining 49% of the outstanding T stock exchanges its shares of T stock for a combination of consideration, two-thirds of which is P voting stock and one-third of which is cash. It is assumed that under general principles of tax law, including the step-transaction doctrine, the tender offer and the statutory merger are treated as an integrated acquisition by P of all of the T stock. *See also* Rev. Rul. 2001-46, 2001-2 C.B. 321. In Situation 2 in Rev. Rul. 2001-46, the momentary ownership of acquired T (via a reverse merger transaction that if viewed independent of subsequent merger of T would qualify under §368(a)(1)(A) reorganization by reason of §368(a)(2)(E)) is disregarded.

[94] *See* n. 91, above.

[95] *See* n. 92, above.

[96] *See* n. 93, above. *See also* Rev. Rul. 2001-46, 2001-2 C.B. 321. In Situation 2 in Rev. Rul. 2001-46, the momentary ownership of acquired T (via a reverse merger transaction that if viewed independent of subsequent merger of T would qualify under §368(a)(1)(A) reorganization by reason of §368(a)(2)(E)) is disregarded.

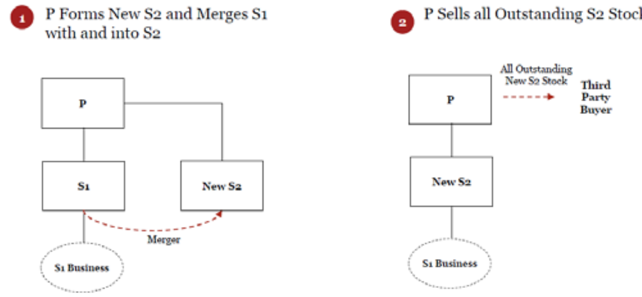
ISSN 0148-8295

set acquisition characterization (under the repealed *Kimbell-Diamond* doctrine) in such types of acquisitive asset reorganization transactions.[97]

F in a Bubble Remains Intact and Related Events

Consistent with the Proposed Regulations, the Final Regulations embrace the notion of the F reorganization being in a "bubble," and step-transaction doctrine generally will not apply to integrate events motivated by business reasons that either precede or occur subsequent to a Potential F Reorganization to prevent the transaction from qualifying as an F reorganization. The Final Regulations adopt the related events rule of the Proposed Regulations, which provided that related events preceding or following the Potential F Reorganization that constitutes a mere change generally would not cause that Potential F Reorganization to fail to qualify as an F reorganization. Step-transaction doctrine will still apply to related transactions to an F reorganization.[98] The application of the F in a bubble concept and related events rule is illustrated in Reg. §1.368-2(m)(4) *Ex.* 6, involving a post F reorganization stock sale. P owns S1. To change S1's place of incorporation, P forms S2 and merges S1 into S2. Immediately thereafter and as part of the same plan, P sells all of its S2 stock to an unrelated party. *See figure 16.*

Figure 16: Example 6 from Reg. §1.368-2(m)(4)



Applying the related events rule of Reg. §1.368-2(m)(3)(ii), P's sale of S2 stock is disregarded in determining whether the merger of S1 into S2 is a mere change of S1. The result would be the same if instead of the sale of S2 stock, S2 merges into an unrelated corporation and terminates its separate existence subsequent to completion of the merger in step 1. See also Reg. §1.368-2(m)(4) *Ex.* 7 (carried over from the Proposed Regulations) discussed above. *See figure 4.* What would be the result in example 7 if P shares issued to A in respect of T stock were not redeemed? See discussion above relating to example 13. Step-transaction doctrine would apply to characterize the merger of T into S as a §368(a)(1)(A) merger by reason of §368(a)(2)(D). Applying the overlap rule of Reg. §1.368-2(m)(3)(iv)(A), the Potential F Reorganization would not qualify as an F reorganization.

COI and COE

The Final Regulations affirm that COI and COE requirements do not apply for a Potential F Reorganization to qualify as an F reorganization.[99]

Overlap Transactions Qualifying Under Other Provisions of §368(a)(1)

The Final Regulations provide overlap and priority rules applicable to cases where a Potential F Reorganization would qualify as another reorganization or part of another reorganization under §368(a)(1). Reg. §1.368-2(m)(3)(iv)(A) provides that if the Potential F Reorganization or a step thereof qualifies as a reorganization or part of a reorganization under another provision of §368(a)(1), and if a controlling corporation (with §368(c) control) of the resulting corporation is a party to such other reorganization, the Potential F Reorganization will not qualify as an F reorganization.

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[97] Congress intended the availability of the §338 election in a taxable stock acquisition transaction to be the exclusive route to asset-acquisition treatment. Following the repeal of the *Kimbell-Diamond* doctrine, it is no longer possible to treat an 80% taxable stock purchase followed by a liquidation of target as an integrated asset purchase under the *Kimbell-Diamond* doctrine. Reg. §1.338-3(d) is based on Congressional intent that §338 replaces any non-statutory treatment of a stock purchase as an asset purchase under the *Kimbell-Diamond* doctrine. (In *Kimbell-Diamond Milling Co. v. Commissioner*, 14 T.C. 74 (1950), *aff'd per curiam*, 187 F.2d 718 (5th Cir.) *cert. denied*, 342 U.S. 827 (1951), the court held that the purchase of the stock of a target corporation for the purpose of obtaining its assets through a prompt liquidation should be treated by the purchaser as a purchase of the target corporation's assets with the purchaser receiving a cost basis in the assets.) *See also* Rev. Rul. 2008-25, 2008-1 C.B. 986.

[98] Reg. §1.368-2(m)(3)(ii).

[99] Reg. §1.368-2(m)(2).

ISSN 0148-8295

Thus, if a Potential F Reorganization or a step thereof may overlap with a qualifying reorganization (i) under §368(a)(1)(C) by reason of the parenthetical language therein (i.e., a triangular C reorganization), (ii) under §368(a)(1)(A) by reason by §368(a)(2)(D) (i.e., a forward triangular A merger), or (iii) under §368(a)(1)(A) or §368(a)(1)(C) by reason by §368(a)(2)(C) (i.e., ''up-down'' transactions[100]), the transaction will not be characterized as an F reorganization applying this overlap rule. This overlap rule (preventing F reorganization overlaps with triangular asset reorganizations involving a controlling corporation as a party to the reorganization) and the single resulting/acquiring corporation requirement (fifth requirement in Reg. §1.368-2(m)(1)(v) discussed above) are new rules designed to ensure that divisive transactions will not qualify as an F reorganization.

Additionally, Reg. §1.368-2(m)(3)(iv)(B) provides that if a Potential F Reorganization would also qualify for asset reorganization treatment under both §368(a)(1)(F) and one or more of §368(a)(1)(A), §368(a)(1)(C), or §368(a)(1)(D), then for all federal income tax purposes, the Potential F Reorganization will qualify as a reorganization only under §368(a)(1)(F).[101] This overlap rule and the single transferor/acquired corporation requirement (sixth requirement in Reg. §1.368-2(m)(1)(vi) discussed above) are new rules designed to ensure that acquisitive or consolidation transactions will not qualify as an F reorganization (consistent with the single-entity reorganization statutory requirement). This overlap rule does not apply to overlaps with §368(a)(1)(E) reorganizations[102] or §368(a)(1)(G) reorganizations.[103]

Distributions

The Final Regulations, consistent with the Proposed Regulations, treat distribution of money or other property (including a redemption distribution in exchange for shares) from the transferor corporation or the resulting corporation in a Potential F Reorganization that qualifies as an F reorganization as an unrelated, separate transaction from the F reorganization, whether or not connected in a formal sense.[104] The Treasury and the IRS have concluded that a distribution, even occurring *during and concurrently with* a Potential F Reorganization, should be treated as a transaction separate from the F reorganization.[105] The federal tax characterization of such distribution is determined under §301 and §302.[106] In example 2 of the Final Regulations, in connection with a reincorporation of corporation X for state law purposes, A, the 75% shareholder of X surrenders his X stock for a redemption distribution. A's surrender of X stock for cash is treated as a transaction, separate from the F reorganization, to which §302(a) applies.[107]

V. OBSERVATIONS ON THE FINAL REGULATIONS

Defining the Bubble: the Potential F Reorganization for Testing

The Final Regulations embrace and further articulate the ''F in a bubble'' concept that has been evidenced by longstanding ruling policy and first announced, albeit without the useful imagery, in Rev. Rul. 96-29.[108] This is a welcome step by the IRS and Treasury in moving away from the traditional ''we'll know it when we see it'' approach of the courts to step-transaction issues.

In applying the Final Regulations, identifying the steps or series of steps that fall within the ''bubble'' for testing against the six requirements of an F reorganization becomes central to the analysis. The Final Regulations provide that a Potential F Reorganization begins when the transferor corporation begins transferring (or is deemed to begin transferring) its assets (directly or indirectly) to the resulting corporation, and it ends when the transferor corporation has distributed (or is deemed to have distributed) to its shareholders the consideration it receives from the resulting corporation and has completely liquidated for fed-

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[100] *See* Rev. Rul. 58-93, 1958-1 C.B. 188, discussed above in Part III.

[101] *See* Reg. §1.368-2(m)(4) *Ex.* 3. P owns all of S stock and desires to change the place of incorporation of S to country B. P forms Y, a country B corporation. Pursuant to a plan of merger, S merges into Y, and P surrenders its S stock in exchange for Y stock. Without regard to the merger's qualification under §368(a)(1)(F), the merger would also qualify as a reorganization under §368(a)(1)(A) and §368(a)(1)(D). Applying the overlap rule in Reg. §1.368-2(m)(3)(iv)(B), the Potential F Reorganization of S qualifies only as an F reorganization.

[102] *See* Rev. Rul. 2003-19, 2003-1 C.B. 468, and Rev. Rul. 2003-48, 2003-1 C.B. 863 (providing that certain demutualization transactions may involve both E reorganizations and F reorganizations).

[103] *See* §368(a)(3)(C).

[104] Reg. §1.368-2(m)(3)(iii).

[105] *See* Reg. §1.301-1(l). *Cf.* Prop. Reg. §1.368-2(m)(4), in the Proposed Regulations, distributions are deemed to occur immediately before the F reorganization in a separate transaction.

[106] *Id.*

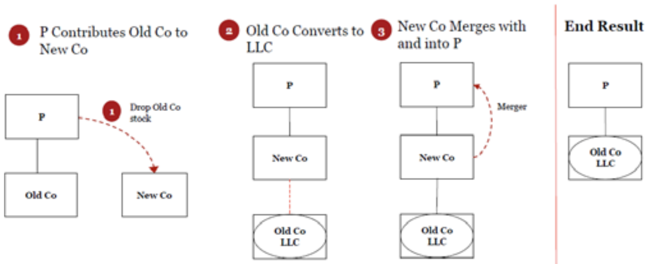
[107] *See* Reg. §1.368-2(m)(4) *Ex.* 2. Example 2 of the Final Regulations does not indicate the source of the cash for the distribution (unlike example 2 of the Proposed Regulations which indicates the redemption distribution was funded by X's cash reserves). This seems to indicate the source of cash does not impact the tax characterization of the distribution as a separate transaction from the F reorganization.

[108] Reg. §1.368-2(m)(3)(ii).

ISSN 0148-8295

eral income tax purposes. The following examples illustrate that how the bubble is defined (i.e., the answer to the question of *when* the Potential F Reorganization begins and ends) may drive the F reorganization analysis in certain circumstances.

Figure 17:



In the example in *figure 17*,[109] if the bubble consists only of steps 1 and 2, the steps would be integrated and treated as an F reorganization of Old Co into New Co applying step-transaction principles discussed above (similar to a "drop-and-check" transaction). However, if the Potential F Reorganization bubble consists of steps 1 through 3, together, the transactions may possibly be stepped together and treated as a §332 liquidation or an upstream C reorganization (with P as the acquiring corporation).

Distributions or Redemptions in the Bubble are Allowed, but not Contributions

The Final Regulations liberally allow distributions or redemptions in the bubble, but prohibit any contributions of property in the bubble (regardless of whether the contribution would introduce new owners). In particular, the first requirement of the Final Regulations requires that all stock of the resulting corporation be distributed (or deemed distributed) in exchange for stock of the transferor corporation stock (subject to permitted *de minimis* exceptions described above).[110] Thus, if resulting corporation stock is distributed in exchange for *non-de minimis* cash or other properties that are contributed "in the bubble," this requirement would be violated. Additionally, the second requirement of the Final Regulations requires the transferor corporation and the resulting corporation to have identical ownership both immediately before and immediately after the Potential F Reorganization (subject to permitted ownership shifts from redemptions and certain recapitalization transactions).[111] Ownership shifts from contributions of cash or property in the bubble are not covered by exceptions provided in the second requirement. The preamble to the Final Regulations does not provide a clear explanation of this dichotomy in treatment between contribution and redemption/distribution transactions, nor provide a clear rationale for prohibiting all contributions of cash or property in the bubble.[112]

The Final Regulations affirm that any distribution or redemption that is concurrent with the F reorganization should be treated as a transaction separate from the F reorganization.[113] It appears that corporate structure changes that are consistent with changes which may be effected by a single continuing corporation (not otherwise undergoing a mere change) are considered compatible with an F reorganization and allowed to occur in the bubble.[114] On other hand, all contributions that occur in the bubble are broadly considered to be incompatible with an F reorganization.

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[109] *See* William D. Alexander, Douglas C. Bates, Amie Colwell Breslow and Kenneth H. Heitner, *"Mere Change": The New Final Section 368(a)(1)(F) Regulations*, panel presentation, presented at the American Bar Association Tax Section Meeting on January 30, 2016.

[110] Reg. §1.368-2(m)(1)(i).

[111] Reg. §1.368-2(m)(1)(ii).

[112] The preamble to the Final Regulations cites some authorities that support the proposition that changes in ownership resulting from redemptions are compatible with an F reorganization. For example, *Reef Corp. v. United States*, 368 F.2d 125 (5th Cir. 1966) (holding that a redemption of 48% of the stock of a corporation that occurred during a change in place of incorporation did not cause the transaction to fail to qualify as an F reorganization, because the redemption was functionally separate from the F reorganization even if coincident in time). Reg. §1.301-1(l) (relating in part to the treatment of a distribution with respect to stock that is in substance separate from a reincorporation); and Rev. Rul. 66-284, 1966–2 C.B. 115, *amplified in* Rev. Rul. 78-441, 1978-2 C.B. 152 (concluding that a merger transaction effecting a change of place of organization of a corporation could qualify as an F reorganization even though there was less than a one percent change in the publicly held corporation's shareholders as a result of stock held by dissenting shareholders being redeemed in the transaction); *cf.*, *Casco Products Corp. v. Commissioner*, 49 T.C. 32 (1967) (reaching a comparable result without finding an F reorganization where a 9% shareholder was redeemed in the transaction).

[113] *See* Reg. §1.301-1(l). A distribution is within the terms of §301 although it takes place at the same time as another transaction if the distribution is in substance a separate transaction whether or not connected in a formal sense. The regulation states that this is most likely to occur in a §368(a)(1)(E) recapitalization or an F reorganization. *See also Bazley v. Commissioner*, 331 U.S. 737 (1947), a distribution in connection with a purported §368(a)(1)(E) reorganization is treated as a dividend. TAM 9743001 determined that a series of transactions included an F reorganization and a separate distribution under Reg. §1.301-1(l) because the purpose of the distribution was unrelated to the other purpose of the transaction and the distribution was not a necessary element for achieving other transactional goals. See related discussions in Philip J. Levine and Britt M. Haxton, *"The End Result Test" Revisited, Part 2*, Tax Notes 1383 (Dec. 14, 2015).

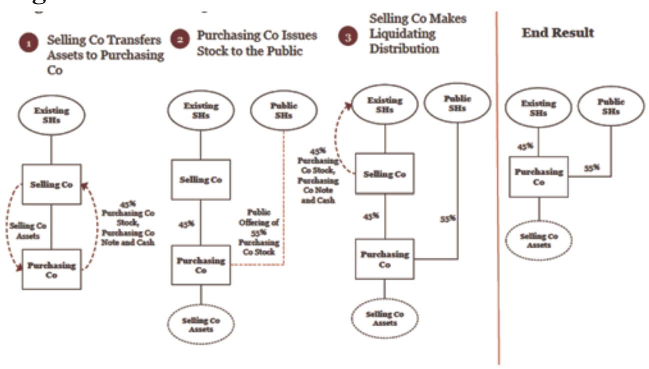
[114] The preamble to the Proposed Regulations indicate a target corporation could have purchased, sold, or exchange property, borrowed money or repaid debt, simultaneously with the transaction or series of transactions qualifying as an F reorganization in a bubble. Reg. §1.382-2(m)(1)(iii) also allows the resulting corporation to hold proceeds of borrowings undertaken in connection with the Potential F Reorganization.

ISSN 0148-8295

The preamble suggests that the prohibition of contributions is intended to ensure that an F reorganization could not be used as a vehicle to introduce new owners or new capital into the corporate enterprise, and cites *Helvering v. Southwest Consolidated Corp.*[115] as support for this position. In *Helvering v. Southwest Consolidated Corp.*,[116] pursuant to a plan of reorganization, creditors of a troubled corporation acquired substantially the entire proprietary interest of the troubled corporation and old shareholders' equity was substantially diminished following the reorganization. The Supreme Court noted that ''a transaction which shifts the ownership of the proprietary interest in a corporation is hardly a ''mere change'' in identity, form, or place of incorporation'' within the meaning of §368(a)(1)(F). This holding arguably should not extend to contributions of cash or property from existing shareholders in the bubble which do not introduce new owners. Changes in relative ownership interests among existing shareholders are not incompatible with single entity reorganizations, and it is difficult to see the relevant difference between these changes occurring in connection with capital reduction transactions and capital increasing transactions. It seems the Final Regulations failed to recognize the distinction between contributions which result in ownership shifts involving ''new'' equity versus contributions which merely result in ownership shifts among ''existing'' equity, and that *Helvering v. Southwest Consolidated Corp.* should be applied only to shifts in proprietary interests of the old corporation to new owners.

Note that the prohibition on contributions of cash or property in an F reorganization, let alone from new investors, implicitly revokes a prior IRS ruling involving a significant share offering by the new corporation in connection with the putative F reorganization. Rev. Rul. 61-156[117] presented a liquidation-reincorporation type transaction, with the following key facts. Within a 12-month period following the adoption of a plan of complete liquidation, a corporation (''Selling Co'') sold substantially all of its assets to a new corporation (''Purchasing Co'') formed by management of the Selling Co, in exchange for shares of Purchasing Co equal to 45% of all Purchasing Co shares to be issued, long-term notes issued by Purchasing Co (''Purchasing Co Notes''), and cash obtained through a mortgage borrowing on the assets acquired. Immediately thereafter, Purchasing Co sold shares to the public through underwriters equal to 55% of all Purchasing Co shares to be issued. Selling Co was subsequently liquidated after paying off its liabilities and distributing the balance of its assets (including 45% stock interest in Purchasing Co, the Purchasing Co Notes and cash) to its shareholders. *See figure 18.*

Figure 18: Rev. Rul. 61-156



The IRS ruled the sale of assets by Selling Co to Purchasing Co and the subsequent liquidation of Selling Co pursuant to an integrated plan are stepped together and treated as a §368(a)(1)(E) and §368(a)(1)(F) reorganization of Selling Co. In the ruling, the IRS noted the issuance of stock by Purchasing Co to new investors can be disregarded as being a separate transaction from the E recapitalization and F reorganization transactions, since the dominant purpose of the overall transaction (to withdraw corporate earnings while continuing the equity interest in substantial part in the same business enterprise) was not dependent on raising new capital.

Applying the Final Regulations to the facts in Rev. Rul. 61-156, the Potential F Reorganization begins when Selling Co begins transferring its assets to Purchasing Co, and ends when Selling Co has distributed to its shareholders the consideration it received from Purchasing Co and has completely liquidated for federal income tax purposes. The issuance of stock by Purchasing Co to new investors ''in the bubble'' would violate the first two requirements in the Final Regulations discussed above. The first requirement is violated since Purchasing Co stock (resulting corporation stock) is distributed not only for Selling Co stock (transferor corporation stock) but also for cash proceeds from the public offering of Purchasing Co stock. The second requirement is violated since there is no identity of stock ownership of Selling Co and Purchasing Co immediately before and immediately after the Potential F Reorganization.

[115] 315 U.S. 194 (1942).

[116] *Id. See also Berghash v. Commissioner*, 43 T.C. 743, 752 (1965), where the court noted ''. . . . the F reorganization typically has been understood to comprehend only such insignificant modifications as the reincorporation of the same corporate business with the same assets and the same stock holders surviving under a new charter . . . .''

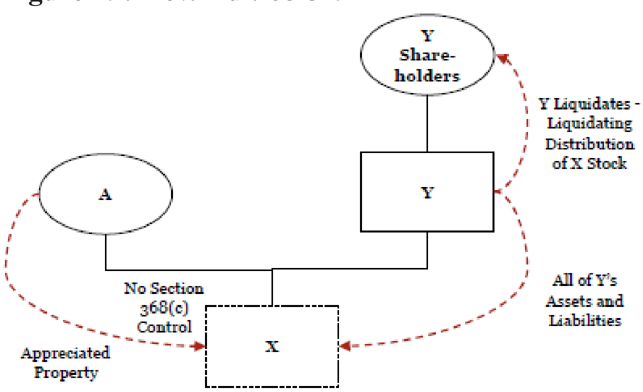
[117] 1961-2 C.B. 62. Rev. Rul. 61-156 has not been obsoleted by the Final Regulations.

ISSN 0148-8295

Final Regulations Seem to Disqualify the F Reorganization in Rev. Rul. 68-349; Does the F Reorganization Have a Doppelgänger Named Alter Ego?

In Rev. Rul. 68-349,[118] individual A owned appreciated property which Y corporation desired to acquire for use in its business. To carry out the transaction, Y transferred all of its assets subject to all of its liabilities to X, a newly organized corporation, in exchange solely for voting stock of X. At the same time, A transferred to X the appreciated property that Y desired to acquire and also received in exchange voting stock of X. A did not own X stock representing §368(c) control of X immediately after the transfers. Y distributed the X stock received to its shareholders in liquidation in exchange for their Y stock. Thereafter, X continued to operate the business formerly conducted by Y. *See figure 19.*

Figure 19: Rev. Rul. 68-349



The presumably hoped-for result of these steps is indicated by the nearly concurrent ruling, Rev. Rul. 68-357,[119] namely a §368(a)(1)(C) reorganization of Y into X in conjunction with a §351 transfer by A of the appreciated property to X in exchange for X stock. In Rev. Rul. 68-349, the IRS ruled that the transfer by Y of all of its properties to corporation X in exchange for voting stock of X and the assumption of Y's liabilities, followed by the liquidation of Y, is treated as a reorganization under §368(a)(1)(F). The concurrent transfer of appreciated property by A to X is a taxable transfer, having no impact on the F reorganization of Y into X, and also not benefitting from Y's being treated as a co-transferor with A.

[118] 1968-2 C.B. 143.
[119] 1968-2 C.B. 144.

The transaction in Rev. Rul. 68-349, involving simultaneous transfers of property from A and Y to X, would violate the first requirement in the Final Regulations that all stock of the resulting corporation be distributed (or deemed distributed) in exchange for stock of the transferor corporation stock. The second requirement of the Final Regulations that requires identity of ownership immediately before and immediately after the Potential F Reorganization would also be violated.

If the transaction between X and Y in this ruling is not an F reorganization, then what is it? Much of the time a failed F reorganization will instead qualify as one of the acquisitive reorganizations, here, presumably, a "C" reorganization. If it did, then on what basis could the IRS not provide co-transferor treatment to Y and thereby qualify A's exchange under §351? If the IRS were to assert that the Y-X transaction failed to qualify as any sort of reorganization due to a failure of business purpose, then we would have the bizarre result that the transaction would be taxable to Y and its shareholders, but possibly still tax-free to A under §351.[120]

Is the IRS's only response that somehow, without reference to an F reorganization, X is nothing more than Y by another name, its (for lack of a better term) alter ego?

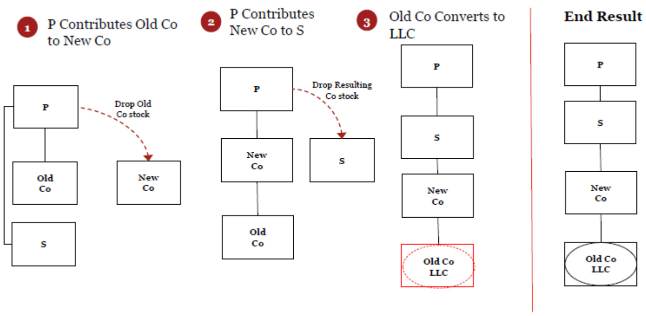
No Intervening Transactions in the Bubble

The approach taken in the Final Regulations provides a very useful model to reconcile applying common step-transaction principles to characterize a Potential F Reorganization as an F reorganization while preventing this reorganization from corrupting or being corrupted by other transactions occurring before or after it. Where this model becomes unhelpful is when we have a series of steps that involve what very much "feels" like an F reorganization occurring in conjunction with other transactions, but some of these other transactions intervene somewhere into the bubble. Consider the following examples.

[120] Putting aside the age-old question of whether §351 has a business purpose requirement, it can probably be stipulated that Y had a business purpose for acquiring A's asset, and presumably the choice of consideration does not require a business purpose.

ISSN 0148-8295

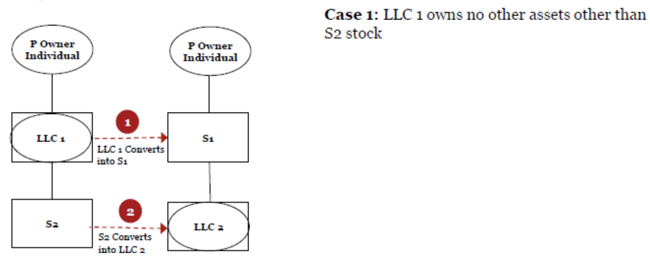
Figure 20:



The example in *figure 20*[121] illustrates that an intervening transfer of New Co (the resulting corporation) in the bubble violates the F reorganization requirements. In this example, the Potential F Reorganization (actual or deemed transfer of transferor corporation assets to the resulting corporation) may be considered to begin in step 1 and end in step 3 with the conversion of Old Co to an LLC.[122] We might have thought that these steps could be characterized as an F reorganization of Old Co to New Co in conjunction with a drop-down of the Old Co/New Co stock by P to S. However, due to the ordering of the steps, the first two requirements of an F reorganization would not be met. Immediately after the Potential F Reorganization, New Co (resulting corporation) stock is distributed to P in exchange for S stock (not Old Co stock, the transferor corporation) violating the first requirement. Secondly, there is no identity of stock ownership of Old Co (transferor corporation) and New Co (resulting corporation) immediately before and immediately after the Potential F Reorganization, violating the second requirement (P would be the shareholder immediately before and S would be the shareholder immediately after the Potential F Reorganization). However, if the sequence of steps 2 and 3 were reversed, the Potential F Reorganization would end after Old Co converts to an LLC (the new step 2), and there would be no intervening transfer of New Co stock to S (the new step 3) during the Potential F Reorganization. The "drop and conversion" of Old Co would qualify as an F reorganization.

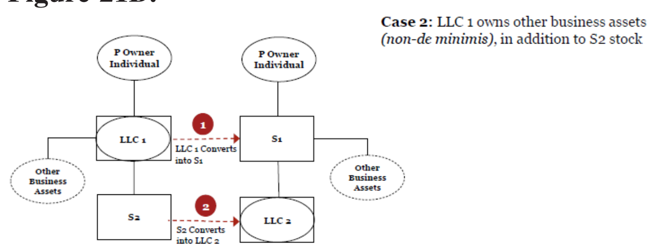
Deemed intervening transactions may also occur in the bubble in connection with certain common entity conversion or tax entity classification election changes illustrated in the following pact patterns.

Figure 21A:



In case 1 (see *figure 21A*), where LLC 1 owns no other assets other than S2 stock, P is treated as contributing S2 stock to S1, followed by a deemed liquidation of S2 for federal income tax purposes. This classic "drop and check" or "drop and convert" fact pattern would be stepped together and treated as an F reorganization.

Figure 21B:



In case 2 however (see *figure 21B*), LLC 1 owns other business assets (*non-de minimis*) in addition to S2 stock. Prior to the Final Regulations, we might have thought that this was an F reorganization of S2 to S1 in conjunction with a §351 drop of other business assets to the corporation. However, under the Final Regulations, since the contribution of property occurs in the bubble, the Potential F Reorganization would not qualify as an F reorganization. The first requirement would be violated since S1 stock (resulting corporation stock) is deemed to be distributed in exchange for LLC1's business assets in addition to S2 stock (transferor corporation stock), notwithstanding that the contribution did not shift the proprietary interests of S2 (the transferor corporation).

Form and Ordering Matters

Treasury officials have acknowledged the Final Regulations are very focused on the form of the transaction.[123] New examples 11, 12, 13 and 14[124] added to the Final Regulations and other examples discussed

[121] *See* Gordon E. Warnke, Deborah L. Paul, Karen Gilbreath Sowell, Robert H. Wellen and Thomas C. West, Jr., *Selected F Reorganization Issues*, panel presentation, presented at the New York State Bar Association Tax Section Meeting on January 26, 2016.

[122] Reg. §1.368-2(m)(1) provides deemed transfers include, for example, those provided in Reg. §301.7701-3(g)(1)(iv) (relating to a change in federal income tax entity classification of an entity) and deemed transfers resulting from the application of the step-transaction principles. Step transaction principles may also treat a contribution of all the stock of the transferor corporation, followed by a liquidation (or deemed liquidation) of the transferor corporation, as a deemed transfer of the transferor corporation's property to the resulting corporation, followed by a distribution of stock of the resulting corporation in complete liquidation of the transferor corporation.

[123] Davison, *F Reorganization Rules Highlight Importance of Form*, Daily Tax Rep. G-1 (Nov. 6, 2015); and Nathan J. Richman and Amy S. Elliott, "*De Minimis for Change-in-Form Regs*

ISSN 0148-8295

above all illustrate the importance of the form and sequence of the transaction steps may drive the F reorganization analysis and impact the tax characterization of the transaction. This arguably provides flexibility for taxpayers to structure into or bust an F reorganization electively (see example 10 of the Final Regulations).[125] Moreover, while the Final Regulations generally take positive steps to set forth objective bright line requirements for an F reorganization, the focus on form and ordering of transactions, may result in certain transactions which fall outside the requirements for an F reorganization as provided in the Final Regulations that seem like they should not (e.g., *figure 20 and figure 21B* examples discussed above).

What one wants to somehow be authorized to do on occasion is to step onto the set in the midst of the Potential F Reorganization, say ''Stop the action,'' bring in the independent transaction (such as asset contribution), and then get back to the Potential F Reorganization that is already in progress. Alternatively, it should be possible to take a transaction that occurs in the bubble and move it out so that it is a pre-reorganization Oldco transaction or a post-reorganization Newco transaction. The problem with this is it presents almost exactly the dilemma the Final Regulations are meant to address. It seems to us that a fundamental principle of the Final Regulations is that along with the protection that the Potential F Reorganization enjoys from being stepped together with other transactions, comes the inability to extract from a series of steps one or more that do not belong to the F reorganization and treat them as occurring outside of the F.

Depends on Purpose, 2015 TNT 215-2 (Nov. 6, 2015).

[124] Reg. §1.382-2(m)(4).

[125] A Potential F Reorganization that does not qualify as a mere change F reorganization may still qualify for non-recognition treatment as an asset reorganization under §368(a)(1). However, the ability to preserve (and not close) the tax year of the target corporation and carryback tax attributes would be impacted.

ISSN 0148-8295