Corporate Tax

Spring 2021

Problem Set 8: Reorganizations

1. Very broadly, what are the two ways to combine two corporate businesses?
   1. **Stock**
   2. **Assets**
   3. **Taxable v. non-taxable**
2. Very, very broadly, if a transaction qualifies as a reorganization, what the tax consequences to the parties? If it doesn’t?
   1. **Slide 4**
   2. No G/L on asset
   3. No G/L T SHs
   4. COB
   5. **G boot**
3. What are some of the underlying policy rationales for the reorganization exception? Compare the majority and dissenting opinions in *Marr* and Reg. §1.368-1(b) (first 2 sentences).
   1. **Substance v Form but what if same securities but different businesses**
   2. **Nothing left corporate solution—no change in TP’s investment**
4. Acquirer acquires Target’s assets for Acquirer stock/boot. What Code sections will apply to:
   1. Determine if the transaction qualifies as a reorganization?**368**
   2. Exchange of Target shares for Acquiring shares? **354**
   3. Exchange of Target shares for Acquiring shares and boot? **354 & 356**
   4. Basis of Acquiring shares in the hands of Target shareholders? **358**
   5. Recognition of G/L by Target on exchange of its assets for Acquiring stock? **361**
   6. Basis of Target assets in the hands of Acquirer? **362**
   7. Recognition of G/L by Target on distribution of Acquiring stock to T shareholders? **361(c)**
   8. Status of Target’s tax attributes? **381**
5. In addition to the statutory requirements of §368, what are the other requirements for an acquisition to be treated as a reorganization? Reg. §1.368-1(b)
   1. **COPI**
   2. **COBE**
   3. **Bus Purposes**
6. *Gregory v. Helvering.*
   1. Did the transactions satisfy the statutory definition of a reorganization?

*(i) Definition of Reorganization. As used in this section…(1) The term “reorganization” means…(B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its shareholders or both are in control of the corporation to which the assets are transferred.…*

* 1. What were the tax consequences to Mrs. Gregory if the transaction were treated as a reorganization? **None taxable receipt; split basis and CG/L on sale of shares**
  2. What would be the tax results if United Mtg. had instead:
     1. Distributed the shares to her as a dividend, and she subsequently sold them? **Dividend—no basis recovery; no G/L on sale**
     2. Sold the shares and distributed the AT proceeds to Mrs. Gregory? **G/L plus dividend**

1. What is the purpose of the continuity of proprietary interest (COI) requirement? Reg. §1.368-1(e)(1)(i).
   1. **Distinguish sales from exchanges; proprietary interest**
2. In a reorganization, how low can the equity consideration go and still satisfy COI? Reg. §1.368-1(e)(2)(v), Ex. 1 and Rev. Proc. 77-37, Sec. 3.02
   1. **50% ruling; 40% Regs**
3. A owns all the shares of T and receives P shares in exchange for his T shares. Immediately after the merger closes, A sells all his shares to B for $ pursuant to a binding contract. Is COI satisfied? Reg. §1.368-1(e)(8), Ex. 1.
   1. **Yes, post merger sales disregarded**
4. A and B own all the shares of T. T redeems A’s shares for $ (none of the funds come from P), and P acquires all B’s shares for P shares. Is COI satisfied? Reg. §1.368-1(e)(8), Ex. 9.
   1. **Not received from P—not treated as other property (boot)**
5. A owns all the shares of T. T merges into P, and A receives P shares. After the merger, P redeems A’s P shares. Is COI satisfied? Reg. §1.368-1(e)(8), Ex. 4(i).
   1. **No, received from P**
6. Same as previous question, except S, a P subsidiary, purchases A’s P stock.
   1. **Reg. §1.368-1(e)(8), Ex. 4(iii).**
7. What is the purpose of the continuity of business enterprise (COBE) requirement? Reg. §1.368-1(d)(1)-(3).
   1. **Substance v. form; no sub change in underlying business activities**
8. T conducts 3 lines of business, each about worth about the same. T sells 2 lines business, and P acquires the remaining business in exchange for P voting stock. Is COBE satisfied? Reg. §1.368-1(d)(5), Ex. 1.
   1. **Yes (1/3)**
9. T invests (1/3 each) in growth stocks, dividend stocks, and corporate bonds (1/3 each). T sells all of its stock and bond investments and purchases municipal bonds. P acquires T’s assets in exchange for P voting stock. Is COBE satisfied? Rev. Rul. 87-76 and Reg. §1.368-1(d)(5), Ex. 3.
   1. **No, not historic business**
10. P acquires T’s diversified agricultural business in exchange for P voting stock. P transfers various parts of the business to separate subsidiaries, but no subsidiary uses a significant portion of the T’s assets. Is COBE satisfied? Reg. §1.368-1(d)(5), Ex. 6.
    1. **Yes, part of same qualified group**
11. Same as previous question, except that P transfers all of the business to S1, a subsidiary, which in turn, transfers it to a partnership in exchange for a 20% interest in the partnership. S1 performs management functions, including making significant business decisions. Is COBE satisfied? Reg. §1.368-1(d)(5), Ex. 8.
    1. **Surprisingly yes, even though only 20% interest.**
12. What is an “A” reorganization? §368(a)(1)(A); Reg. §1.368-2(b)(1)(ii).
    1. **Merger under some statute to effectuate a merger or consolidation.**
13. Under Texas state law, T can merge into P with T shareholders receiving P voting stock and T surviving and continuing to hold a portion of its assets. T shareholders retain their T stock and P stock. Is this a good A reorg? Rev. Rul. 2000-5; Reg. §1.368-2(b)(1)(iii), Ex. 1.
    1. **No, divisive transaction.**
14. Under Del. Law, T merges into DRE, an LLC treated as a DRE owned by X Corp. T shareholders receive X voting stock. All of T’s assets become the assets of DRE and T’s legal existence ceases. Is this a good A reorg? Reg. §1.368-2(b)(1)(iii), Ex. 2.
    1. **Yes**
15. Under Del. Law, DRE, an LLC treated as a DRE owned by X Corp, merges into T, and T shareholders receive X voting stock. All of DRE’s assets become the assets of T and DRE’s legal existence ceases. Is this a good A reorg? Reg. §1.368-2(b)(1)(iii), Ex. 6.
    1. **Not DRE combining entity; no combing unit**
16. T merges into P pursuant to Spanish law and T shareholders receive P voting stock. Is this a good A reorg? Reg. §1.368-2(b)(1)(iii), Ex. 13
    1. **Good Reorg**.
17. T merges into P pursuant to Delaware law, and T shareholders receive P voting stock. P drops down ½ of T’s assets into S1, a wholly owned subsidiary. Is this a good A reorg? Reg. §1.368-2(k)(1), 1(ii), -2(k)(2), Ex. 1. Would it make a difference if P dropped down 100% of T’s assets?
    1. **Yes, same qualified group.**
18. T merges into S1, a wholly owned subsidiary of P pursuant to Delaware law, and T shareholders receive P voting stock. S1 distributes ½ of T’s assets to P. Is this a good A reorg? Reg. §1.368-2(k)(1), 1(ii), -2(k)(2), Ex. 2. Would it make a difference if S1 distributed 100% of T’s assets?
    1. **Yes, liquidation is problematic.**
    2. **100% ding**
19. T merges into P pursuant to DGCL. 50% of T shareholders want to receive $ and 50% want to receive P stock. Is that permissible under §368(a)(1)(A)? Rev. Proc. 77-37, §3.02.
    1. **Yes, COPI looks at the aggregate consideration**
20. T merges pursuant to DGCL into S, a 100% subsidiary of P, in exchange for P voting stock. Is this good reorganization? What kind of transaction is this called?
    1. **Forward triangular merger**
21. What are some of the non-tax reasons for structuring a merger as a forward triangular merger instead of a direct merger of T into P?
    1. **Avoid P assuming T liabilities**
    2. **Merger vote**
22. T merges pursuant to DGCL into S, a 100% subsidiary of P, in exchange for the following consideration:
    1. NV P preferred **OK**
    2. 30-yr P debt **OK but counts against COI**
    3. $ paid by P and/or S **OK but counts against COI**
    4. Assumption of T liabilities by P and/or S. Rev. Rul. 73-257. **OK, compare C reorg; 1.368-2(b)(2) (6th 7th sentence)**
    5. NV common stock or V preferred of S—**BAD; enough P stock is A merger, stock of**
    6. 20-year S debt or 1-year S note **OK but counts against COI**
    7. S debt that is convertible into **S** or **P** stock. Rev. Rul. 79-155. **OK**
23. T merges pursuant to DGCL into S, a 100% subsidiary of P, in exchange for P voting stock. Immediately thereafter, S liquidates. Is this a good reorg under §368(a)(2)(D)? Rev. Rul. 72-405.
    1. **No, disregard S; treated as asset acquisition (C) reorg**
24. What issue does “substantially all of the properties” raise in §368(a)(2)(D)?
    1. **Step transaction**
25. What is a “C” reorganization and what are the basic requirements? §§368(a)(1)(C), (a)(2)(B), (a)(2)(C), and (a)(2)(G).
    1. **Sub All Assets solely for VS of acquiring or P (triangular or parenthetical C)**
    2. **Boot relaxation—20%, but then liabilities count as money paid**
    3. **Liquidation requirement**
26. For ruling purposes, what is “substantially all”? Rev. Proc. 77-37, §3.01.
    1. **90 net; 70 gross**
27. T has 1,100x of gross assets and 1,000x of liabilities. P wants to acquire T for P voting common stock in a C reorg. Which of the following proposed structures raise an issue:
    1. T transfers 100x assets to P for P VS, and T uses its remaining 1,000x of assets to pay off creditors. Rev. Proc. 77-37, §3.01 and Rev. Rul. 57-518.
       1. **100 of Net Ass but only 9% of GA. RR says no. Taxable asset transfer and taxable to T creditors.**
    2. T transfers all of its assets to P in exchange for 100x of P VS and P’s assumption of liabilities. Read last 2 sentences of Reg. §1.368-2(d)(1).
       1. **Technically fine, but maybe liabilities too big.**
    3. T pays off its creditors and transfers 100x of its assets to P for P VS.
       1. **Step transaction issue; SA?; contrast 88-48**
    4. T transfers 1,100 P for 100x of P VS and 1,000x of cash, which T uses to pay off creditors.
       1. **Violates solely for VS**
    5. T transfers 1,100x assets to P for P VS, and T uses the 1,000x of the P VS to pay off creditors. §§368(a)(2)(G)(i), 361(c)(1) and (3).
       1. **Maybe best alternative; problem: creditors agree?**
    6. T transfers 1,100x assets to P for P VS, and T sells the P stock and uses the cash to pay off creditors.
       1. **Sale of P stock by T be integrate with issuance of P stock and violate solely for VS, but post acq sale OK**
       2. **Violated distribution requirement b/c assets being distributed aren’t those that were received**
       3. **T may recog gain; P stock has CO basis but 361c1 doesn’t apply b/c sale not a distribution**
28. T Corporation has 650x operating assets, 250x investment assets, 100x cash, and liabilities of 350x. Which of the following are good reorgs? GP owns 100% of P, and assume in each case that the “distribution” requirement is met.
    1. P acquires T’s operating assets for P VS of 650x.
       1. **SA? 65% of GA but 100% of operating assets.; RR 57-518 (70% of GA ok if reminder used to pay liab); no ruling**
    2. P acquires T’s operating assets for P VS of 50x and GP VS of 600x.
       1. **Can’t mix consideration. 1.368-2d1 (5th sentence)**
    3. P acquires T’s ~~operating~~ assets for P VS of 600x, P NVS of 50x, and P’s assumption of T’s liabilities.
       1. **P NVS is boot, so total book is 50+350 or 400.**
    4. P acquires T’s ~~operating~~ assets for P VS of 650x and P’s assumption of T’s liabilities.
       1. **Good C**
    5. P acquires T’s ~~operating~~ assets for GP VS of 650x and P’s and GP’s assumption of T’s liabilities.
       1. **GP is NOT acquiring so assumption of liabilities is boot. RR 70-107. Also boot relaxation rule doesn’t apply b/c GP not acquiring. Solution: GP acquire and drop down; or P acquire and distribute, or GP guarantee**
29. T Corporation has two business, A and B, each worth 1,000x. P wants to acquire Business A but not B. P transfers Business B to a subsidiary and distributes the stock to its shareholders. Immediately thereafter, P acquires Business A for 1,000x of P VS. *See Helvering v. Elkhorn Coal Co.*  on slides.
    1. **Bad, didn’t acquire SA of T assets**
30. Same as previous Q, except that T spins off Business A via a distribution of the stock of subsidiary and P acquires all of the assets of subsidiary (Business A) from subsidiary. Rev. Rul. 2003-79. Skip the discussion of section 355.
    1. **OK, acquired SA of spun off subsidiary**
31. P owned 79.9% of S, with the other 20.1% owned by unrelated parties. P exchanged 100k of its VS for all the assets of S, and S liquidated. P therefore received back 79.9k of its shares, with the other 20.1k going to unrelated parties.
    1. In essence, what did P exchange for the S assets? Does that violate the “solely for voting stock” requirement? These are roughly the facts of *Bausch & Lomb,* 267 F.2d 75 (2nd Cir. 1959).
       1. **B&L: P (B&L) exchanged its S shares (Riggs shares) and 20.1K of its shares for the S assets. The Riggs shares are boot. Too much Could do triangular C (use NewcoSub to acquire Riggs assets). If owned 80%, liquidate. TF to B&L; taxable to 3rd party SHs**
    2. How does Reg. §1.368-2(d)(4)(i) change the result?
       1. **If holding is “old and cold”, good if bott distributed to other SH PLUS any liabilities assumed by P don’t exceed 20% of target assets. See Example 1.**
32. P acquires 90% of T VS in exchange for P VS worth $100MM. T only has VS outstanding. Is this a good “B” reorg?
    1. **Yes, control is acquired “solely in exchange for P VS”.**
33. Same as previous Q, except P also acquires 10 T shares in exchange for $500.
    1. **Rule #1: No boot in a B**
34. P owns 100% of S1 and transfers P VS to S1, which S1 uses the P VS to acquire 90% of T VS. T only has VS outstanding.
    1. **Triangular B**
35. P acquires 30% of T for cash in 2020. 15 years later, it acquires another 60% in a series of exchanges over 6 months of P VS for T voting stock. This is referred to as a creeping (note, not “creeper”) acquisition. Reg. §1.368-2(c).
    1. **Can have acquisition in a series of transaction (12 month in regs); separation for longer events (1939-1955); both going over and after 80% is owned**
36. P acquires 90% of T VS in exchange for P VS worth $100MM. T only has VS outstanding. P also acquires for cash all of the T’s outstanding convertible debt for $20MM. Rev. Rul. 69-91.
    1. **Good; convertible debt not stock, so acquisition of stock was only for VS**
37. P acquires 90% of T VS in exchange for P VS worth $100MM. T only has VS outstanding. T has some complaining SHs who don’t want P VS. They are paid cash by T. Rev. Rul. 68-285.
    1. **Good as long as source of funds don’t come from issuing/acquiring.**
38. P owns 100% of S1, and S1 merges into T and T survives. All T SH receive P VS. Is this a good reorg? What kind of transaction is this called? §368(a)(2)(E).
    1. **Reverse triangular; less restrictive than B (stock acquisition) b/c of flexibility of consideration: former T shareholders must receive P VS in exchange for stock representing control in surviving.**
    2. **“Substantially all”**
    3. **Why? Keep licenses etc.**
    4. **Passage and existence of control**
39. P owns 100% of S1 and wishes to acquire all 1,000 shares of T stock, but 30% of the SHs don’t want P stock. T redeems 10% of its shares (100) for cash, and S1 merges into T with T SHs receiving consideration consisting of 20% cash (for 180 shares) and 80% P VS (for 720 shares). Does this qualify under §368(a)(2)(E)? Reg. §1.368-2(j)(6), Exs. 2 and 3.
    1. **Yes, but counts against SA**
40. Memories of the Delaware two-step from corporations. P wants to acquire T via a stock acquisition. P initiates a tender offer for 51% of the T stock, which if it is successful, will be followed by a merger of S1, a wholly owned subsidiary of P, into T solely for P VS. Does this qualify under §368(a)(2)(E)? Rev. Rul. 2001-26.
    1. **Generally old & cold is a problem. If P owns 21% O&C, in the transaction, can’t acquire control. Ex. 4.; maybe good B is S is transitory**
    2. **RR 2001-26: If TO combine w/ RSM, ok; step transaction**
41. Individual A owns all of the stock of T corp. T transfers all of its assets to a newly formed P corp in exchange for all of P’s CS. T distributes the P stock to A in liquidation. Is this a good reorg under §§368(a)(1)(D)? §354(b)(1)(A) and (B).
    1. **Yes**
    2. **Liquid/reincorporation doctrine; remember could get assets out of corp in liquid w/out tax**
    3. **Nondivisive D; divisive D in the context of 355**
    4. **Used a lot in international—the 100 is a dividend for US PURPOSES**
42. Corp A owns all of the stock of T and P. T transfers all of its assets to P in exchange for 100x, the value of T’s assets. T liquidates and distributes the 100x to A. Is this a good D reorg? What else is deemed to have happened? Reg. §1.368-2(l)(2) and (l)(3), Ex. 1.
    1. **All cash D reorg**
    2. **Issuance of nominal share—needed for basis as we’ll see Thursday.**
43. Which of the following are good “E” reorgs? Reg. §1.368-2(e).
    1. Corp A exchanges its bonds for its CS **Yes**
    2. Corp A exchanges its preferred stock for its CS **Yes**
    3. Corp A exchanges its CS for its preferred stock **Yes**
    4. Corp A exchanges its CS for its bonds. *Bazley v. CIR*, 331 US 737 (1947). **NO**
44. Corp A is a NJ corp, and because of the very high NJ taxes, it becomes a Delaware corporation via a re-domiciliation statute. Is this a good “F” reorg?
    1. **Yes**
    2. **Can be transfer of prop from one corp to another, provided that require are met**
45. That was pretty easy. Now, A owns 75% of X corp, a NY corp, and B owns 25%. X forms Y, a Del. Corp, and X merges into Y. A receives $, B receives Y shares for his X shares. Is this a good F reorg? Reg. §1.368-2(m)(4), Ex. 2.
46. Why corporate tax is hard: read Rev. Rul. 2008-25
    1. See slide
       1. No K safe harbor b/c of liquidation
       2. Not C b/c of 10 cash and liabilities
       3. Not A b/c no merger of T into P, even acquire all assets & liabilities
       4. No 351 b/c T doesn’t have control
       5. COB