

Comments Regarding Transfers of Assets Following Putative Reorganizations

These comments represent the individual views of members of the Section of Taxation who prepared them and do not represent the position of the American Bar Association or the Section of Taxation. These comments were prepared by individual members of the Committee on Corporate Tax of the Section of Taxation. Principal responsibility for drafting the report was exercised by Philip J. Levine, Dana L. Trier, Rachel Kleinberg, and Darin A. Zywan. Substantive contributions were made by John Barrie, Reginald Clark, Jasper L. Cummings, Julie Divola, Milton Hyman, Stuart Offer, William Richardson, Roger Ritt, Michael Schultz, Mark J. Silverman, Thomas F. Wessel, Rose L. Williams, and Philip B. Wright. The comments were reviewed by Robert Wellen of the Section's Committee on Government Submissions and by Mark Yecies, Incoming Council Director for the Committee on Corporate Tax.

Although many of the members of the Section of Taxation who participated in preparing these comments have clients who would be affected by the federal tax principles addressed by these comments or have advised clients on the application of such principles, no such member (or the firm or organization to which such member belongs) has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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I. Executive Summary

A. Overview

The 2003-2004 Priority Guidance Plan published by the Treasury Department (“Treasury”) and Internal Revenue Service (“Service”) includes, under the caption “Corporations and their shareholders,” the following item:

Guidance regarding transfers of assets after putative reorganizations.

We understand that a portion of the project may deal with the transfer of assets of a target corporation from either an acquiring subsidiary corporation or an acquired corporation to its parent after an acquisition (a “push-up”). The joint statement accompanying the Business Plan invites the public to provide comments on projects as guidance is developed throughout the year. We respectfully submit for your consideration our comments and suggestions regarding the U.S. federal income tax treatment of “push-ups.”

These comments focus on whether a “push-up” causes an acquisition otherwise qualifying as one type of triangular reorganization under Section 368¹ no longer to satisfy the applicable requirements or to be recharacterized as a transaction with potentially different tax results, such as an acquisition by the parent of the acquiring subsidiary or parent of the acquired

¹ Unless otherwise noted, all citations to sections of the Internal Revenue Code (“Code”) are to the Code of 1986, and to sections of the Regulations to the Treasury Regulations thereunder.

subsidiary after its acquisition.² In particular, these comments offer suggestions as to how Treasury and the Service might interpret, preferably through regulations, existing provisions of the Code and regulations to provide greater flexibility for such transfers of assets of acquired companies within a corporate group, consistent with the current statutory and regulatory framework.

The discussion will be divided into six parts: (1) an overview of push-ups through several core illustrative transactions described below and the questions raised by such transactions; (2) an overview of the statutory and regulatory background and relevant rulings and similar authorities; (3) a discussion of the appropriate limits of general step transaction principles in this context; (4) an analysis of the application of the statutory “substantially all” test and nonstatutory rules under the continuity of interest and continuity of business enterprise doctrines with respect to the core illustrative transactions; (5) a treatment of certain other major collateral issues raised by push-ups, including liability assumption transfers; and (6) a discussion of the appropriate form of guidance on this issue.

B. Summary of Recommendations

We believe that a “push-up” only should cause a triangular reorganization to be recast as a direct acquisition by the acquiring parent in a limited category of cases. We would follow the long-standing Service position that a pre-planned push-up by actual liquidation of the acquiring

² The “triangular” transactions that are the focus of this report include both statutory mergers potentially subject to Sections 368(a)(2)(D) and 368(a)(2)(E) and subsidiary C reorganizations under Section 368(a)(1)(C). As a practical matter, however, similar issues may be raised by other acquisitive transactions. For example, a putative C reorganization by an acquiring corporation for stock of the acquiring corporation followed by a distribution of assets to the acquiring corporation’s shareholders may raise similar issues. Although the tax treatment of such transactions is not the focus of this report, we will discuss issues relating to such transactions in Part VI.

or acquired subsidiary should not be analyzed as a subsidiary acquisition for Section 368 purposes. In that case, qualification of the transaction as a tax-free reorganization would depend upon qualification of the transaction treating the acquiring parent as the acquiror. We were unable to reach a consensus with respect to a case in which all of the principal operating assets of the target were distributed by the acquiring or acquired subsidiary to its parent, but the subsidiary remained in existence. Some of us would treat the parent as the acquiror if “substantially all” of the assets are distributed; others only would treat the parent as the acquiror if the distribution constituted a “de facto liquidation” of the subsidiary. We agreed that, in all other cases involving a push-up, the form of the transaction should be respected.

We believe that our recommendation is consistent with applicable statutory and nonstatutory requirements for a tax-free reorganization. Our comments propose that the recommended approach be included in Treas. Reg. § 1.368-2(k).

II. Issues Relating to Push-Ups

The issues relating to push-ups that are the subject of this report are of considerable practical significance. It is now quite common after consummation of a triangular reorganization for the acquiring group to consider moving a portion of the assets of the target corporation (for example, intellectual property) up to the acquiring parent or to other parts of the group. In a significant number of cases, these post-acquisition transactions will not constitute “drop-downs” covered by the now extensive guidance relating to such transactions, and important step transaction and technical questions are thus raised.

A. Illustrative Transactions

The central issues that are our focus can be usefully analyzed from the perspective of four variations of pre-planned transactions immediately after a putative tax-free reorganization under Sections 368(a)(1)(A) and 368(a)(2)(D). Assume, for illustration purposes, that an unrelated target (“T”) is acquired by the forward merger of T into the newly formed wholly-owned acquisition subsidiary (“S”) of a parent acquiror (“P”) in which the T shareholders receive P voting stock. P and S then enter into one of four alternative preplanned transactions:

- (1) The outright liquidation of S into P (“Case 1”);
- (2) The distribution of a portion of T’s assets to P in a transaction in which S does not liquidate and after which S retains assets of T constituting all of T’s principal operating assets (i.e., substantially all of T’s assets) (“Case 2”);
- (3) The distribution by S of all of the principal operating assets of one of the acquired businesses (i.e., less than substantially all of T’s assets) to P (40-60 percent of the gross assets) in a transaction in which S does not liquidate and after which S retains all of the principal operating assets of the other acquired business (“Case 3”); and
- (4) The distribution by S to P of all of T’s principal operating assets (i.e., substantially all of T’s assets) in a transaction in which S does not liquidate and retains some of T’s assets (“Case 4”).

B. Questions Raised By the Illustrative Transactions

The questions posed by these basic transactions can be divided into two broad categories. The first set of questions is whether the transactions can, consistently with the structure of the statute and the existing framework of established step transaction authorities under Subchapter C, be viewed as a transaction with S as the “acquiror” and analyzed on that basis under Section 368(a)(2)(D). As to this question, we propose, for the reasons discussed below, that Case 2 and Case 3 above should be analyzed as a transaction with S as the acquiror. In addition, we propose

that a pre-planned push-up by actual liquidation of the acquiring or acquired subsidiary (Case 1) should not be analyzed as a subsidiary acquisition for Section 368 purposes. Accordingly, in that case, qualification of the transaction as a tax-free reorganization would depend upon qualification of the transaction as if P were the acquiror and would depend upon whether, for example, the requirements of Section 368(a)(1)(C) were met viewing P as the acquiror. As to Case 4, which involves a push-up of substantially all of the T assets but no liquidation of S, we did not reach a consensus. As discussed below, some of us would not treat S as the acquiror if “substantially all” of the assets are distributed to P; others would treat S as the acquiror unless the distribution constituted a “de facto liquidation” of S. In any case in which the transaction was recast to treat P as the acquiror and in which S retains some of the T assets, we propose that the transaction be treated as an acquisition by P with a drop to S of the assets that S in form retains.

The second set of questions raised by these transactions is whether both the technical statutory requirements of the “substantially all” test and the broad nonstatutory concepts relating to the tax-free reorganization rules such as the continuity of interest and continuity of business enterprise rules can be reconciled with Case 2 and Case 3. We conclude for the reasons discussed below that the tax-free treatment of these transactions is not inconsistent with the application of these requirements and concepts.

III. Background

A. Statutory and Regulatory Framework

Section 368 identifies several types of corporate stock and asset transactions as qualifying reorganizations subject to nonrecognition treatment. The Code originally limited the definition

of reorganization to two-party transactions.³ The Supreme Court, in *Groman v. Comm'r*, 302 U.S. 82 (1937), and *Helvering v. Bashford*, 302 U.S. 454 (1938), held that the reorganization provisions did not permit a direct transfer of target assets to an acquiring subsidiary in exchange for its parent's stock or a transfer of target assets to an acquiring parent followed by a drop to its subsidiary.⁴ Starting in 1954, in response to these decisions, Congress repeatedly has expanded the reorganization definition to permit drops of acquired assets or stock following a reorganization and to permit direct transfers to a subsidiary in exchange for parent stock.⁵ With the issuance of Treas. Reg. § 1.368-2(k), the government has, in effect, expanded Section

³ The Code first incorporated the concepts of triangular reorganizations and drops of acquired assets in 1954. See Sections 368(a)(1)(C) and 368(a)(2)(C) of the 1954 Code, Pub. L. No. 591, Ch. 736, 83d Cong., 2d Sess., H.R. 8300.

⁴ *Groman* involved the acquisition of all the stock of target by a newly formed subsidiary of a parent corporation followed by the liquidation of target into the subsidiary for consideration consisting of stock of both the parent and acquiring subsidiary. The Supreme Court determined that the parent corporation was not "a party to a reorganization" and would not look through the parent to measure the target shareholders' continuity of interest in the acquired assets. The Supreme Court emphasized that the stock in the parent was an interest in parent's assets, only part of which was the stock of the acquiring subsidiary. *Bashford* involved the acquisition and consolidation in one subsidiary of the acquirer of the stock and assets of three target corporations, with the target shareholders again getting stock in both the acquiring parent and its subsidiary as consideration. The Supreme Court held that the parent stock did not represent stock with the requisite continuity of interest.

⁵ Congress enacted Section 368(a)(2)(C) as part of the 1954 Code in an attempt to limit the application of the *Groman-Bashford* doctrine, which, as noted above, would cause a reorganization to be disqualified on remote asset continuity grounds if the acquired assets or stock of a target were ultimately lodged in a subsidiary of an acquirer. Section 368(a)(2)(C) explicitly provides that a transaction otherwise qualifying under Sections 368(a)(1)(A), (1)(B), (1)(C) and certain transactions under 368(a)(1)(G) shall not be disqualified by reason of the fact that part or all of the assets or stock which were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets or stock.

In 1954, Congress also amended Section 368(a)(1)(C) to permit the use of a parent corporation's stock in a transaction in which the assets of the target corporation are acquired by a subsidiary which is directly controlled by the parent corporation. In 1964, Congress expanded the scope of Section 368(a)(1)(B), permitting the use of a parent corporation's stock in a transaction in which the stock of the target corporation is acquired by a subsidiary which is directly controlled by the parent corporation. In 1968, Congress added Section 368(a)(2)(D), which permits the target corporation to merge directly into a subsidiary of the parent corporation with the target shareholders exchanging their target stock for stock of the parent corporation (a "forward triangular" merger). In 1971, Congress added Section 368(a)(2)(E), which permits a subsidiary corporation to merge directly into the target corporation with the target corporation surviving and the target shareholders receiving stock of the subsidiary's parent corporation (a "reverse triangular" merger). These provisions were added or amended to accommodate transactions that had the effect of a merger, when for some reason a direct statutory merger or consolidation into the parent corporation was not feasible.

368(a)(2)(C) by permitting successive transfers of acquired assets or stock to one or more corporations controlled in each transfer by the transferor corporation.⁶ In addition, in two recent revenue rulings, the Service announced its view that the language of Section 368(a)(2)(C) permitting drops of acquired assets or stock is permissive, rather than exclusive or restrictive.⁷ Finally, most recently, the Service issued proposed regulations, which would further confirm the liberal treatment of drop-downs evidenced in these pronouncements.⁸ Thus, taxpayers now are afforded considerable flexibility in dropping acquired assets or stock following an acquisitive reorganization.

By contrast, the tax law governing “push-ups” is much less developed. In fact, it is striking how little guidance exists regarding the effect of push-ups on reorganization qualification. There are no cases addressing reorganization transactions in which some or all of the acquired assets were transferred to the shareholder of the acquiring corporation following the initial acquisition other than by liquidation or merger; and perhaps in part for that reason, there is no statutory analogue to Section 368(a)(2)(C) in which Congress has explicitly addressed such a transaction. As summarized below, although there are several revenue rulings that could be viewed as generally relevant to the treatment of push-ups under step transaction principles, the

⁶ For this purpose, control is defined under Section 368(c) as ownership of stock possessing at least 80 percent of the total combined voting power of all classes of voting stock plus at least 80 percent of the number of outstanding shares of each class of nonvoting stock of the corporation. Rev. Rul. 59-259, 1959-2 C.B. 115.

⁷ Rev. Rul. 2002-85, 2002-2 C.B. 986; Rev. Rul. 2001-24, 2001-1 C.B. 1290.

⁸ See Prop. Treas. Reg. §§ 1.368-1(d)(4)(i) and 1(d)(4)(ii).

most thorough discussion of the issues still relevant today is contained in several General Counsel Memoranda (“GCMs”)⁹ issued in the 1970’s and 1980’s.

B. Revenue Rulings

In two of the classic revenue rulings under Subchapter C, Rev. Rul. 67-274, 1967-2 C.B. 141, and Rev. Rul. 72-405, 1972-2 C.B. 217, the Service considered the tax treatment of a pre-arranged liquidation of the target or acquiring subsidiary on the overall characterization of an acquisitive transaction. While the application of the step transaction doctrine to acquisition transactions has been the subject of several important pronouncements in recent years as a result of statutory changes, the basic concepts applied in these two rulings have remained intact.

In Rev. Rul. 67-274, the acquiring corporation acquired all of the outstanding stock of the target corporation in exchange solely for voting stock of the acquiring corporation. As part of the plan to acquire the target corporation, the target corporation distributed all of its assets to the acquiring corporation in liquidation. The Service concluded that “the two steps may not be considered independently of each other for Federal income tax purposes. . . . The substance of the transaction is an acquisition of assets” Accordingly, the Service ruled that the transaction qualified as a reorganization described in Section 368(a)(1)(C), rather than Section 368(a)(1)(B).¹⁰

⁹ GCMs are not considered “authority” for certain purposes. Treas. Reg. § 1.6662-3(b)(2) does not list GCMs as “authority” that can be considered in determining whether there is “substantial authority” for the tax treatment of an item.

¹⁰ As a consequence of its holding, the Service stated that the rules under Section 382(b) (relating changes of ownership resulting from reorganizations), as then in effect, would apply. The treatment under Section 382, as then in effect, would have been different had the transaction been treated as a reorganization under Section 368(a)(1)(B).

The concept underlying Rev. Rul. 67-274 was extended in Rev. Rul. 72-405 to a liquidation of an acquiring subsidiary rather than the acquired corporation. In that ruling, the target corporation merged into a newly-formed subsidiary of a parent corporation with the target shareholders receiving stock of the parent corporation. As part of a plan that included the reorganization, the newly-formed subsidiary distributed all of its assets in complete liquidation to the parent. After discussing the principles of Rev. Rul. 67-274, the Service determined that the transitory passage of the assets and liabilities of the target corporation through the newly-formed subsidiary would not be accorded independent significance for tax purposes. Accordingly, the Service ruled that the transaction qualified as a reorganization described in Section 368(a)(1)(C), rather than as a reorganization within the meaning of Sections 368(a)(1)(A) and 368(a)(2)(D) followed by a liquidation of the newly-formed subsidiary. These rulings can be viewed as key authorities at the core of a broader line of authority applying step transaction principles to two-step acquisitions of all of a target's assets.¹¹

There appears, however, to be only one published ruling dealing with the narrower question of the effect of push-ups of a portion of the target assets after the first step of an acquisitive transaction. In Rev. Rul. 74-35, 1974-1 C.B. 85, the acquiring corporation acquired all of the outstanding stock of the target corporation solely in exchange for shares of voting common stock of the acquiring corporation. As part of the plan that included the reorganization, the target corporation made a distribution to the acquiring corporation of appreciated investment

¹¹ See *King Enterprises, Inc. v United States*, 418 F.2d 511 (Ct. Cl. 1969); *Seagram Corp. v. Comm'r*, 104 T.C. 95 (1995); Rev. Rul. 2001-46, 2001-2 C.B. 321; Rev. Rul. 2001-26, 2001-1 C.B.1297. If the acquiring subsidiary immediately merges up into P, it is not clear whether the integrated transaction is analyzed under Section 368(a)(1)(A) or 368(a)(1)(C) because T, the target, did not merge directly with P under state law. See PLRs 9644046 (Nov. 1, 1996); 8701028 (Oct., 7, 1986) and 8453046 (Sept. 28, 1984). See generally Ginsburg and Levin, *Mergers, Acquisitions and Buyouts*, Vol. 2, 8-35 (2003).

assets that represented 30 percent of the target corporation's total assets. The Service considered whether the transaction should be recast as (1) a constructive sale by the target to the acquiring corporation of the assets "distributed" in exchange for an amount of acquiring corporation stock received of equivalent value, followed by a constructive taxable distribution of such stock by the target corporation to its shareholders, and (2) a concurrent exchange by the target corporation shareholders of their target stock solely for acquiring corporation stock qualifying as a reorganization under Section 368(a)(1)(B). The ruling notes that:

The *Kimbell-Diamond* principle, as illustrated by Rev. Rul. 67-274, does not support a recast of a portion of a transaction, such as in the instant case, because [the acquiring corporation] does not acquire substantially all the property of [the target corporation]. [The acquiring corporation] continues its stock interest in [the target corporation], which retains all of its operating assets and 70 percent in value of all the assets it owned prior to the transaction.¹²

Accordingly, the Service ruled that the acquisition qualified as a reorganization within the meaning of Section 368(a)(1)(B) and the subsequent distribution of assets was a distribution of property under Section 301.¹³

¹² In *Kimbell-Diamond Milling Co. v. Comm'r*, 14 T.C. 74 (1950), *aff'd per curiam*, 187 F.2d 718 (5th Cir. 1951), one corporation acquired all of the stock of another corporation pursuant to a prearranged plan in which the target corporation then distributed all of its assets to the acquiring corporation in complete liquidation. The court gave effect to the intent, purpose, and result "of this plan such that the acquiring corporation was treated as if it had actually acquired assets rather than stock." In Rev. Rul. 74-35, the Service viewed Rev. Rul. 67-274 as an application of "the *Kimbell-Diamond* principle."

¹³ *Cf.* Rev. Rul. 75-521, 1975-2 C.B. 120 (*Kimbell-Diamond* principles not applied to recast transaction in which parent owned 50 percent of the stock of a subsidiary that was not recently purchased and acquired the remaining 50 percent and immediately liquidated the subsidiary).

C. General Counsel Memoranda

Several GCMs issued during a relatively brief period of time generally contemporaneously with Rev. Rul. 74-35 provide a more detailed analysis by the Service of the issues that must be addressed in determining the tax treatment of a “push-up.” In revealing how the views of the Chief Counsel’s office kept changing over a relatively short time period, these GCMs reflect the difficulty of the issues raised by push-ups. The same issues considered in these GCMs during this period ultimately must be resolved for meaningful guidance on push-ups to be issued today.

The Service’s initial reference to push-ups appears in GCM 35267 (Mar. 14, 1973), in which it was noted that the qualification of a triangular reorganization under Section 368(a)(1)(C) “might be voided on the ground that the acquiring company (the controlled subsidiary) failed to acquire ‘substantially all’ the assets of the acquired company” due to a planned distribution of part of the acquired assets by a controlled subsidiary to its parent in an otherwise qualifying triangular C reorganization. However, this was not the primary focus of the GCM, and the Service acknowledged that the issue had not been considered in depth.¹⁴

In GCM 36111 (Dec. 18, 1974), the Service considered whether, as part of a plan of reorganization described in Sections 368(a)(1)(A) and 368(a)(2)(D), the surviving corporation in the merger could transfer a large portion of the acquired assets (80 to 85 percent by value) to its sole corporate shareholder. Respecting the form of the transaction, the GCM determined that the

¹⁴ The facts of GCM 35267 did not involve a push-up after an asset reorganization. The GCM did, however, consider whether a stock for stock transaction otherwise described in Section 368(a)(1)(B) that was followed by a planned intercorporate distribution of assets should be recast for tax purposes. The other portions of the analysis are not relevant to the discussion of push-ups.

push-up was not incompatible with the statutory requirements of Section 368(a)(2)(D) and did not violate the continuity of interest requirement. The GCM noted that the enactment of Section 368(a)(2)(C) was required by reason of the *Groman* and *Bashford* decisions in order to permit drop-downs to a controlled corporation following a reorganization. According to the GCM, no similar special statutory provision was required to permit a push-up to the controlling corporation. Changing its initial view as expressed in GCM 35267, the Service concluded that the “substantially all” requirement of Section 368(a)(2)(D) was not affected by post-acquisition dispositions of the acquired assets.

In our opinion . . . the “substantially all” requirement . . . , at least where the assets are retained by the acquiring corporation, its controlled corporation, or a corporation controlling it, refers only to the respective value of the assets transferred by [the target corporation] pursuant to the plan of reorganization and those disposed of by it prior to but as a part of the reorganization transaction. . . . We therefore believe that the “substantially all” requirement as it exists in [Section] 368(a)(2)(D) again, at least in the context of this case, concerns only preacquisition dispositions.

The Service stated that its “categorical conclusion” in GCM 35267, in which the Service said that a push-up might void a triangular reorganization under Section 368(a)(1)(C), was incorrect.

Ultimately the Service concluded that:

the “substantially all” language . . . expresses a requirement that substantially all of the acquired corporation’s assets be acquired in the reorganization. This requirement, in our opinion, does not mandate that such quantum of assets be retained by the surviving subsidiary corporation assuming that the basic requisites of a reorganization are satisfied

However, the Service acknowledged that a push-up:

raises questions as to whether such transaction should be considered to qualify under [Section] 368(a)(1)(A) and (a)(2)(D) because of the large

portion of the acquired corporation's assets transferred by the acquiring subsidiary to its parent corporation. . . . At this juncture, we simply wish to emphasize that there is some doubt that [Section] 368(a)(2)(D) was intended to facilitate mergers whereby the parent corporation, via a "push-up" arrangement, acquires direct possession of the assets of the target corporation.

Presumably if the transaction were recast as an acquisition by the parent, the requirements of Section 368(a)(1)(C) would have to be satisfied.

In GCM 37905 (Mar. 29, 1979), the Service reconsidered whether the form of a purported triangular reorganization should be respected when approximately 90 percent by value of the acquired assets were transferred to the parent corporation in a push-up. The Service determined that use of the substance-over-form doctrine was appropriate in identifying which entity was the "acquiring" corporation in purported triangular reorganizations under Section 368(a)(2)(D) and parenthetical Section 368(a)(1)(C) that involved a push-up. Because the push-up involved approximately 90 percent of the value of the target corporation's assets, the Service concluded that the parent was in substance the "acquiring" corporation. Furthermore, citing Rev. Rul. 70-107, 1970-1 C.B. 78, the Service concluded the transaction did not satisfy the "solely for voting stock" requirement of Section 368(a)(1)(C), because the liabilities of the target were assumed by the subsidiary corporation, rather than the parent corporation.¹⁵

Later, in GCM 39102 (Dec. 21, 1983), the Service applied a substance-over-form analysis similar to that used in GCM 37905. However, GCM 39102 took the position that Rev. Rul. 70-107 was incorrect and that all parties to a reorganization exchange should be permitted to

¹⁵ In Rev. Rul. 70-107, 1970-1 C.B. 78, the Service concluded that "solely for voting stock" requirement of Section 368(a)(1)(C) required that only the "acquiring corporation" assume liabilities of the target corporation in the reorganization. See discussion below.

assume the liabilities of the target corporation, reasoning among other things that the failure to provide relief for the assumption of liabilities by the parent of acquirer was a legislative oversight when Congress extended “C” reorganization treatment to triangular C reorganizations and that Rev. Rul. 70-107 imposes an “artificial distinction” between triangular mergers subject to Section 368(a)(2)(D) and “practical” triangular mergers subject to Section 368(a)(1)(C). Accordingly, under GCM 39102 the transaction would qualify as a reorganization under Section 368(a)(1)(C), even though a party other than the acquiring corporation assumed liabilities of the target corporation. The revocation of Rev. Rul. 70-107 was, however, never implemented.

IV. Determination of the Acquiring Corporation; Application of Step Transaction Principles and Consistency with Statutory Framework

The threshold question relating to push-ups, as reflected in the GCMs discussed above, is how to reconcile the application of step transaction principles with treatment of the acquiring subsidiary as the “acquiring” corporation for purposes of technical statutory analysis. In this regard, we believe it important to apply to push-ups an analytical framework generally consistent with otherwise established core step transaction authorities. We believe that these objectives are best satisfied in this context by applying step transaction and substance over form principles to recast the transaction if and only if the putative acquiring corporation (S in our four core illustrative cases) either actually liquidates (or merges) in a pre-planned transaction into its parent (P in our illustrative cases) or distributes virtually all of its assets to P. In the case of a transaction in which S remains in existence, the transaction would be recast as a direct transfer to P followed by a drop of assets to S. In addition, we would apply our analysis equally to a transaction in which S merged with and into T, with T surviving (i.e., a reverse triangular merger), and T’s assets were pushed up to P.

This approach appears to be entirely consistent with the relevant published revenue rulings described above. Rev. Rul. 67-274 and Rev. Rul. 72-405, of course, involved the termination of the existence of S, and we believe that, at this stage of the development of Subchapter C principles, it is appropriate to leave these rulings intact and applicable for purposes of analyzing push-ups.¹⁶ Moreover, as discussed above, Rev. Rul. 74-35 explicitly did not recast a transaction in which less than substantially all of the assets were moved in a preplanned transaction.

We were unable to reach a consensus on which test should be applied to determine whether a transaction should be recast if assets are distributed to P, but S is not liquidated. There was general agreement, however, that the test applied should limit recasts to cases in which virtually all of T's operating assets had been pushed-up to P.

Some of us favor drawing a line for application of step transaction principles between transfers of assets not constituting substantially all of the assets and those constituting substantially all. It is argued that use of a substantially all test in this context appears consistent with a statutory scheme in which the acquisition of substantially all of the assets by P would be analyzed under Section 368(a)(1)(C) and in which Congress applied a substantially all test in defining a "practical merger."¹⁷ In this connection, we would not recommend that the Service's

¹⁶ Several members of the Committee question whether Rev. Rul. 67-274 should continue to govern the application of step transaction doctrine, noting among other things that the issues at stake at the time the revenue ruling was issued (i.e., treatment of the transaction under Section 382) are no longer relevant. These members suggest that the step transaction rules should not be applied to convert a transaction that in form is tax-free into a taxable transaction. (Neither Rev. Rul. 67-274 nor Rev. Rul. 72-405 caused the transactions analyzed to be taxable.) Concerns were also expressed that unilateral actions by the acquiring group should not affect the tax treatment of the target shareholders.

¹⁷ The substantially all test is discussed in more detail below.

90/70 ruling safe harbor¹⁸ should create an absolute standard for applying the step transaction doctrine.¹⁹ For example, if the acquiring subsidiary retains an active business, we do not believe the transaction should be recast even if the assets transferred up to parent would satisfy the ruling safe harbor.

Others of us are concerned that a substantially all test is potentially overbroad, and argue that use of substantially all as the standard has the disadvantage of importing a test that has been the subject of considerable uncertainty and litigation over the years.²⁰ It is recommend that transactions in which S stays in existence should only be recast in the event that S has made a distribution that constitutes a “de facto liquidation.”²¹ Under this approach, recasts would be limited to cases in which S actually liquidated or liquidated in substance and retained only immaterial assets.

We explicitly considered and rejected an approach that would turn off step transaction principles completely and disregard all push-ups. We note in this regard that there appears to be no reason based in legislative history to “turn off” the core historic Subchapter C recast authorities that continue in effect today. Unlike the case with respect to the legislative history of

¹⁸ The Service has stated that a transfer of assets representing at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by the transferor corporation immediately prior to the transfer will be considered substantially all of the assets for advance ruling purposes. See Rev. Proc. 77-37, 1977-2 C.B. 568.

¹⁹ If the substantially all approach is adopted, we believe that a safe harbor would be appropriate.

²⁰ See footnote 31 *supra*. Because of the uncertainty in this area, whether or not substantially all is the standard adopted here, it would be helpful for the Service to issue guidance on the meaning of that test.

²¹ For examples of cases addressing de facto liquidation, *see Owens v. Comm’r*, 568 F.2d 1233 (6th Cir. 1977), *aff’g*, 64 T.C. 1 (1975); *United States v. Jackson Oldsmobile, Inc.*, 371 F.2d 808 (5th Cir. 1967); *Anbaco-Emig Corp. v. Comm’r*, 49 T.C. 100 (1967)(acq.); *Lowndes v. United States*, 384 F.2d 635 (4th Cir. 1967); *Grubbs v. Comm’r*, 39 T.C. 42 (1962); Rev. Rul. 61-191, 1961-2 C.B. 251.

Section 338 relating to two-step transactions involving a qualified stock purchase²² and the legislative history of Section 355(e) relating to transactions after a spin-off,²³ for example, there is no legislative history indicating a reason to apply a strict form-based analysis in this context. Moreover, as noted above, there is no real equivalent to Section 368(a)(2)(C) with respect to push-ups. Of course, the Service has the authority to “turn off” the step transaction doctrine in appropriate cases without any specific Congressional authorization.²⁴ However, the Service already has applied the step transaction doctrine to push-ups in Rev. Rul. 67-274 and Rev. Rul. 72-405. Thus, we believe the lines we are drawing between Case 2 and Case 3, on the one hand, and Case 1 and Case 4, on the other hand, are most consistent with the existing framework of the authorities under Subchapter C.²⁵

A somewhat more difficult question is whether Case 3 should be viewed as consistent with the statutory framework. Assume, for example, a case in which exactly 50 percent of the historic assets of T are pushed up by S to P in a preplanned transaction immediately after a putative Section 368(a)(2)(D) triangular reorganization. In such a case, neither P nor S ends up with substantially all T’s assets and in that regard both arguably could be viewed as equal candidates for being viewed as the acquiring corporation for purposes of technical analysis.

²² See Rev. Rul. 90-95, 1990-2 C.B. 67; see also Rev. Rul. 2001-46, *supra*; Rev. Rul. 2001-26, *supra*.

²³ See Rev. Rul. 98-27, 1998-1 C.B. 1189; Rev. Rul. 2003-79, 2003-29 I.R.B. 80.

²⁴ See, e.g., Rev. Rul. 2003-51, 2003-21 I.R.B. 938; Rev. Rul. 84-111, 1984-2 C.B. 88.

²⁵ We also believe that the result should not change if, following a push-up of assets that would be treated as a separate step under our analysis, P were to drop the T assets to a subsidiary in a different chain. Similarly, we believe that our push-up analysis should be applied to direct cross-chain transfers, whether or not consideration is received in the exchange.

The principal question here is whether the existing statutory framework reveals a strong Congressional intent that one and only one corporation be the real acquiror. Note in this regard, for example, that specific statutory provisions, such as Section 368(a)(2)(D)(ii) and the parenthetical clauses of Sections 368(a)(1)(B) and 368(a)(1)(C), seem to indicate a Congressional unwillingness to permit flexibility if and to the extent that the consideration is that of two different acquirors. In a very general way, this could indicate a Congressional unwillingness to sanction transactions as to which there are two strong candidates for being treated as the acquirors and thus successors to target's attributes. Note in this regard that the changes to the Code after *Groman* and *Bashford* did not actually sanction split consideration.²⁶

We believe, however, that legislative intent is not so clear as to preclude a division of target assets among the acquiring group so long as, in form, one party is the acquiring corporation and the target shareholders only receive stock of the parent of the acquiring corporation. Once those requirements are satisfied and one logical entity to serve as a successor to target has been established, application of existing step transaction principles is, as argued here, not inconsistent with respecting the form so long as the push-up is not of virtually all the target assets acquired. What we are proposing here is also generally consistent with the concepts underlying the drop-down rules. As stated in the preamble to the recent proposed regulations, the question should be whether “. . . in all the situations considered, the transactions in form satisfy the statutory requirements of a reorganization and, in substance, constitute readjustments

²⁶ We also note that the Section 381 regulations do not divide target attributes among members of the acquiring group. See Treas. Reg. § 1.381(a)-1(b)(2)(ii) (Example 3) and -1(b)(3)(ii).

of continuing interests in the reorganized business in modified corporate form” and “none of the transactions involve the transfer of the acquired . . . assets to a stranger.”²⁷

V. Analysis of Push-ups Under Core Statutory and Nonstatutory Requirements

Assuming that, consistent with generally applicable step transaction principles and the existing statutory and regulatory framework, the acquiring subsidiary, S, can be viewed as the acquiror in transactions similar to Case 2 and Case 3, the question remains whether the other core statutory and nonstatutory requirements applicable to triangular acquisitions specifically and tax-free reorganizations generally are satisfied if there is a preplanned push-up. There are several statutory and nonstatutory requirements for qualification as a reorganization that may be implicated by a push-up. Other than direct mergers, all acquisitive asset reorganizations include a requirement that the acquiring corporation acquire “substantially all” of the assets of the target corporation.²⁸ Reverse triangular acquisitions require that the target “holds” substantially all of

²⁷ REG-265579-02, 69 Fed. Reg. 9771, 9772 (March 2, 2004).

²⁸ Section 368(a)(1)(C) is defined as:

the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other shall be disregarded.

A transaction subject to Section 368(a)(1)(D) is described as:

a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under Section 354, 355, or 356.

For acquisitive reorganizations under Section 368(a)(1)(D), Section 354(b)(1)(A) requires that “the corporation to which the assets are transferred acquires substantially all of the assets of the transferor of such assets.” Section 368(a)(2)(D) provides that:

the acquisition by one corporation, in exchange for stock of a corporation (referred to in this subparagraph as “controlling corporation”) which is in control of the acquiring corporation, of substantially all of the properties of another corporation shall not disqualify a transaction under paragraph (1)(A) or (1)(G) if -- (i) no stock of the acquiring corporation is used in the transaction,

its properties and the properties of the merged corporation following the acquisition.²⁹ A question arises as to whether it is enough to acquire substantially all of the target corporation's assets if the acquiring corporation ceases to hold such assets pursuant to a pre-arranged plan to do a push-up. In addition, push-ups must be analyzed with respect to the continuity of interest and continuity of business enterprise requirements.

A. Substantially All

The core issue here relating to the substantially all requirement is the effect on the satisfaction of the requirement of subsequent transfers by the acquiring corporation to its shareholder for no consideration.³⁰ Analysis of this issue requires a review of the history of the reorganization provisions and the purpose of the substantially all requirement. We believe that the purpose of this requirement is met as long as substantially all of the assets of the target are acquired in the transaction, and the transaction is not "divisive" in relation to the indirect proprietary interests of the target shareholders in the target corporation (i.e., the target

and (ii) in the case of a transaction under paragraph (1)(A), such transaction would have qualified under paragraph (1)(A) had the merger been into the controlling corporation.

²⁹ Section 368(a)(2)(E) provides that:

[a] transaction otherwise qualifying under paragraph (1)(A) shall not be disqualified by reason of the fact that stock of a corporation (referred to in this subparagraph as the "controlling corporation") which before the merger was in control of the merged corporation is used in the transaction, if -- (i) after the transaction, the corporation surviving the merger holds substantially all of its properties and of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction); and (ii) in the transaction, former shareholders of the surviving corporation exchanged, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation which constitutes control of such corporation.

The Service recently ruled that the use of the term "holds" in Section 368(a)(2)(E) "does not impose requirements on the surviving corporation before and after the merger that would not have applied had such corporation transferred its properties to another corporation in a reorganization under Section 368(a)(1)(C) or a reorganization under Sections 368(a)(1)(A) and 368(a)(2)(D)." Rev. Rul. 2001-25, 2001-1 C.B. 1291.

³⁰ For a thoughtful discussion of the issues related to the application of the substantially all requirement in the context of distributions both before and after an acquisitive reorganization, see Michael L. Schultz, *The Evolution of the Continuity of Interest Test, General Utilities Repeal and the Taxation of Corporate Acquisitions*, 80 Taxes 229, 257-59 (2002).

shareholders do not, after the transaction, hold proprietary direct or indirect interests in separate parts of the target business assets).³¹

The substantially all requirement arose out of the extension of tax-free reorganization treatment from statutory mergers and consolidations to other “practical” mergers. Congress addressed the effect of a reorganization for the first time in Section 202(b) of the Revenue Act of 1918, providing that no gain or loss would be recognized in connection with a “reorganization, merger, or consolidation of a corporation.” However, Congress did not define the terms “reorganization,” “merger,” or “consolidation.” In 1921, Congress defined a reorganization in Section 202(c)(2) of the Revenue Act of 1921 to include “a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation).” But, again, Congress did not define the terms “reorganization,” “merger,” or “consolidation.”

In 1934, Congress separated the definition of a reorganization into separate provisions. One provision described a “merger or consolidation” of companies, the predecessor to reorganization under the current Section 368(a)(1)(A). The word “statutory” was added to the definition of a reorganization so that the definition “will conform more closely to the general

³¹ Although there is a substantial body of case law that addresses the quantity and quality of assets that must be transferred in order to satisfy the substantially all requirement, this case law regarding the quantity and quality of assets that must be acquired is beyond the scope of this report. See, e.g., *James Armour, Inc. v. Comm’r*, 43 T.C. 295 (1965) (51 percent held substantially all where assets necessary to the conduct of an enterprise of the business are not retained); *American Mfg. Co. v. Comm’r*, 55 T.C. 204 (1970) (20 percent substantially all because all operating assets); *Smothers v. United States*, 648 F.2d 894 (5th Cir. 1981) (15 percent substantially all because all operating assets acquired). Whether a transaction satisfies the substantially all requirement generally depends on the facts and circumstances, including the amount and nature of the assets that are not transferred, and the purpose for their retention. See Rev. Rul. 57-518, 1957-2 C.B. 253; Boris I. Bittker & James S. Eustice, Federal Income Taxation of Corporations and Shareholders ¶ 12.24[2][b] (7th Ed. 2000).

requirements of [state] corporation law,”³² which generally contemplate that a merger constitutes an acquisition of all of the target corporation’s assets by the surviving corporation by operation of law. Accordingly, in this provision, Congress did not include a substantially all requirement for transactions described as a statutory merger or consolidation.

The second provision added in 1934 encompassed an “acquisition by one corporation . . . of substantially all the properties of another corporation,” the predecessor to an asset reorganization under the current Section 368(a)(1)(C). The form of such asset reorganizations is a transfer of assets by the target corporation in exchange for stock of the acquirer. Often referred to as a “practical merger,”³³ Congress imposed a substantially all requirement to ensure that a transfer of assets by a target corporation that was eligible for nonrecognition treatment (i.e., an asset reorganization) resembled a merger or combination of two corporations rather than taxable sales of a portion of the assets of a target corporation.³⁴ Consistent with this history, in *Helvering v. Elkhorn Coal Co.*, 95 F.2d 732, 735 (4th Cir.), *cert. denied*, 305 U.S. 605 (1938), the Fourth Circuit held that the substantially all requirement could not be satisfied if the acquisition was preceded by a divisive transaction such that the acquiring corporation did not receive substantially all of the target corporation’s historic assets.³⁵

³² H.R. Rep. No. 73-704, 73d Cong., 2d Sess. 14 (1934).

³³ The legislative history surrounding the Revenue Act of 1934 concluded that the “practical merger” provision was designed to permit transactions which are “equivalent to a merger.” *See* S. Rep. No. 73-558, 73d Cong., 2d Sess. 17 (1934).

³⁴ H.R. Rep. No. 73-704, at 14.

³⁵ *See also Mellon v. Comm’r*, 36 B.T.A. 977 (1937). In Rev. Rul. 2003-79, 2003-29 I.R.B. 80, the Service ruled that, after the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788, 916-17, the substantially all rule of *Elkhorn Coal* would apply with respect to acquisitions of the distributing corporation following a divisive transaction, but not to acquisitions of a newly-formed controlled corporation following a divisive transaction.

The policy underlying the substantially all test was further buttressed in 1984. Up until that time, there was no requirement in a reorganization under Section 368(a)(1)(C) that the target corporation dissolve following the transfer of its assets to the acquiring corporation. Thus, up to that point in time the substantially all test was the only requirement that would prevent a reorganization under Section 368(a)(1)(C) from being used to effect a divisive transaction without satisfying the requirements of Section 355. In 1984, Congress addressed this issue by amending Section 368 to require that the target corporation in a reorganization described in Section 368(a)(1)(C) liquidate after transferring substantially all its properties.³⁶ This amendment was enacted further to ensure that a transfer of assets by a target corporation that was eligible for nonrecognition treatment (i.e., an asset reorganization) resembled a merger or combination of two corporations and that Section 368(a)(1)(C) could not be used to avoid the requirements of Section 355 relating to divisive transactions.³⁷

The legislative history in connection with the amendment is instructive as to the purposes of the substantially all requirement:

Prior to 1934, Federal statutes provided for reorganization treatment only in the case of a transaction qualifying as a merger or consolidation under state law. The C reorganization provisions were added to the Code because uniform merger or consolidation statutes had not been enacted in all states, and the Congress believed that for Federal tax purposes substantially similar transactions should be treated consistently without regard to state law. Thus, the provisions were intended to apply to transactions that are acquisitive in nature and resemble statutory mergers or consolidations.

³⁶ Tax Reform Act of 1984, Pub. L. No. 98-369, § 63, 98 Stat. 583, 583 (codified as Section 368(a)(2)(G)).

³⁷ The enactment of this statutory change arguably accomplishes the purpose of the substantially all requirement in preventing divisive transactions that do not meet the requirements of Section 355.

Different provisions are intended to apply to divisive transactions. The committee is concerned that since a distribution by the transferor corporation of all its assets is not required in connection with a C reorganization, and after such a reorganization the transferor may be able to engage in an active trade or business and not merely serve as a holding company for its shareholders' interests in the acquiring corporation, transactions that are somewhat divisive in nature can qualify as reorganizations without qualifying under the provisions generally applicable to divisive transactions.

In addition, as stated above, the C reorganization provisions were intended to apply to transactions that resemble, in substance, statutory mergers or consolidations. In the case of a statutory merger or consolidation, the transferor is liquidated by operation of law. The committee is concerned that substantially similar transactions should be treated consistently for Federal income tax purposes.³⁸

The role of the substantially all test in assuring that a transaction is not divisive was comprehensively articulated several years later in Rev. Rul. 88-48, 1988-1 C.B. 117, which continues to represent the Service's most complete discussion of the substantially all requirement in published guidance. In the ruling, a target corporation operated two businesses, each constituting 50 percent of the target corporation's total historic business assets. Because the acquiring corporation only was interested in acquiring one of the target corporation's businesses, pursuant to an overall plan, the target corporation sold its entire interest in the unwanted business to third-party purchasers in a taxable transaction. The target corporation then transferred all of its assets, including the cash proceeds from the sale of the unwanted business, to the acquiring corporation in exchange for voting stock of, and the assumption of the target corporation's liabilities by, the acquiring corporation. Finally, the target corporation distributed the acquiring corporation stock (the sole asset the target corporation held) to the shareholders of the target corporation in complete liquidation. The ruling concluded that the substantially all requirement

³⁸ S. Rep. No. 98-169, 98th Cong. 2d Sess., Vol. I at 204-05 (1984).

was satisfied, despite the target corporation's sale of 50 percent of its historic business assets to unrelated parties immediately prior to the reorganization.

In reaching its conclusion, the ruling analyzed the purpose of the substantially all requirement stating:

Congress intended that transactions that are divisive in nature not qualify under section 368(a)(1)(C) of the Code, but, instead, be subject to the tests under section 368(a)(1)(D). See S. Rep. No. 1622, 83d Cong., 2d Sess. 274 (1954). The enactment of section 368(a)(2)(G) indicates the continuing interest in furthering this underlying objective of preventing divisive "C" reorganizations.

The ruling also notes the Service's longstanding position that where some assets are transferred to the acquiring corporation and other assets retained, the transaction may be divisive and so fail to meet the "substantially all" requirement of Section 368(a)(1)(C), citing Rev. Rul. 57-518, 1957-2 C.B. 253. However, the Service determined that the facts presented in the ruling were not divisive stating:

Although [the acquiring corporation] acquired substantially all the assets [the target corporation] held at the time of transfer, the prior sale prevented [the acquiring corporation] from acquiring substantially all of [the acquiring corporation]'s historic business assets. The transaction here at issue, however, was not divisive. The sale proceeds were not retained by the transferor corporation or its shareholders, but were transferred to the acquiring corporation. Moreover, the prior sale of the historic business assets was to unrelated purchasers, and the [the target corporation] shareholders retained no interest, direct or indirect, in these assets. Under these circumstances, the "substantially all" requirement of section 368(a)(1)(C) was met because all of the assets of [the target corporation] were transferred to [the acquiring corporation].

Thus, the Service made clear that the concern of the substantially all requirement was to prevent divisive transactions from qualifying as tax-free reorganizations. In the facts of the

ruling, the transaction was not divisive because the proceeds from the sale of the unwanted assets constituted a substituted asset. A push-up to the parent of an acquiring subsidiary corporation following an acquisitive reorganization of any or all the assets of a target corporation is also not divisive; all the value of target corporation has been acquired and the assets continue to be held indirectly by the target shareholders through a single proprietary interest, stock of the acquiring parent corporation. Thus, the requirement is not violated by a planned distribution of the acquired assets by the acquiring corporation.³⁹

B. Continuity of Interest

Continuity of interest principles clearly should not be viewed as violated by a push-up. Under Treas. Reg. § 1.368-1(e)(1), “[c]ontinuity of interest requires that in substance a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization.” The Service has long viewed a transaction in which an indirect owner’s interest in the target corporation becomes more direct as preserving continuity of interest.⁴⁰ Thus, a push-up should not raise any continuity of interest concerns. In this case, unlike the facts at *Groman* and *Bashford*, shareholders of target receiving parent corporation stock retain a more direct interest in the target assets.

³⁹ A push-up through P to its shareholders could under some circumstances be viewed as divisive (e.g., if the assets went principally to former T shareholders). Such transactions are discussed in Part VI of this report.

⁴⁰ See Treas. Reg. § 1.368-1(e)(7)(Examples 7 and 8); Rev. Rul. 95-69, 1995-2 C.B. 38 (distribution from a limited partnership to its partners of the stock of an acquiring corporation following the merger of the partnership’s wholly-owned corporation into the acquiring corporation does not violate continuity of interest); Rev. Rul. 84-30, 1984-1 C.B. 114 (distribution from a direct owner to its shareholder following a reorganization does not violate continuity of interest); see also Rev. Rul. 76-528, 1976-2 C.B. 103 (continuity of interest requirement for a spin-off not violated when shareholder partnership dissolves before the distribution); Rev. Rul. 62-138, 1962-2 C.B. 95 (continuity of interest requirement of Section 355 satisfied, notwithstanding the transferor corporation’s distribution of the transferee corporation’s stock to its corporate shareholder followed by the corporate shareholder’s distribution of such stock to its shareholders).

C. Continuity of Business Enterprise

Finally, the continuity of business enterprise rules should be easily satisfied with respect to the push-up transactions that are our focus. To satisfy continuity of business enterprise, the “issuing corporation” must either (1) continue the target corporation’s historic business (“business continuity”) or (2) use a significant portion of target’s historic business assets in a business (“asset continuity”).⁴¹ The “issuing corporation” is the acquiring corporation within the meaning of Section 368(a), except that, in determining whether a reorganization qualifies as a triangular reorganization as defined in Treas. Reg. § 1.358-6(b)(2), the issuing corporation is the corporation in control of the acquiring corporation.⁴² For purposes of the regulations, the “issuing corporation” is treated as holding all of the businesses and assets of all of the members of the “qualified group.” Accordingly, the continuity of business enterprise requirement can be satisfied indirectly because the regulations in effect treat the qualified group as a single entity.⁴³

For continuity of business enterprise purposes, a “qualified group” includes one or more chains of corporations connected through stock ownership with the issuing corporation, but only if the issuing corporation owns directly stock meeting the requirements of Section 368(c) in at least one other corporation, and stock meeting the requirements of Section 368(c) in each of the corporations (except the issuing corporation) is owned directly by one of the other corporations.⁴⁴

⁴¹ Treas. Reg. § 1.368-1(d)(1)-(3).

⁴² Treas. Reg. § 1.368-1(b).

⁴³ Treas. Reg. § 1.368-1(d)(4)(i).

⁴⁴ Treas. Reg. § 1.368-1(d)(4)(ii).

Based on the continuity of business enterprise requirements described above, a “push-up” of assets after a reorganization should not violate the continuity of business enterprise requirement provided that the assets are distributed to a shareholder that is a member of a “qualified group” within the meaning of Treas. Reg. § 1.368-1(d)(4)(i). In the context of a triangular reorganization under Sections 368(a)(1)(C), 368(a)(2)(D), and 368(a)(2)(E), the corporation in control of the acquiring corporation is treated as the “issuing” corporation. Thus, the parent company is the issuing corporation in a triangular reorganization and, therefore, a push-up to the parent corporation would not violate continuity of business enterprise. However, it is unclear whether continuity of business enterprise would be satisfied if the pushed-up assets are ultimately distributed to shareholders outside of the “qualified group,” as discussed further below.

VI. Ancillary Issues

Although the core issues relating to push-up transactions would be addressed by guidance relating to the four simple fact situations discussed above, other push-up related issues can also be implicated. Here, we will discuss two such issues: (i) the assumption of liabilities by the parent of the acquiring corporation in connection with the transaction and (ii) the movement of assets above the corporation the stock of which is provided to target stockholders in the transaction.

A. Assumption or Other Transfer of Liabilities

The first ancillary issue potentially raised in connection with push-ups is the effect of the assumption of liabilities by the parent acquiror (P in the four illustrative cases) as part of the overall plan. This issue, like push-ups generally, has an important impact in practice. In this

regard, it is useful analytically to consider two different cases; first, a transaction in which at least a portion of the liabilities of T are directly assumed by P in an acquisition transaction -- for example, an acquisition by S of T assets in a putative C reorganization; and second, one in which, after the merger of T into S or other acquisition by S of T assets, T's former assets together with associated liabilities are, in a preplanned transaction, moved up to P, which assumes such historic T liabilities or takes the assets subject to such liabilities.

The central authority in this regard is the controversial Rev. Rul. 70-107, which involves a putative C reorganization. In that case, corporation X owned all the stock of corporation Y. Y directly acquired all the assets of corporation Z using voting stock of its parent, X corporation, with part of the liabilities of Z assumed by Y and part by X. The Service held,

. . . in view of the assumption by X of some of Z's liabilities, the exchange does not meet the 'solely for voting stock' requirement of Section 368(a)(1)(C) because that section provides, in part, that in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other shall be disregarded. Since X (the parent of Y) is not the acquiring corporation, its assumption shall not be disregarded.

The first factual variation, in which P directly assumes the liabilities of T in the acquisition, directly implicates Rev. Rul. 70-107. For reasons that include those presented in GCM 39102 summarized above, we believe that there are strong arguments that Rev. Rul. 70-107 should be overruled. However, that issue is beyond the scope of these comments. Thus, we do not address here whether and/or how a direct assumption of a target liability by the parent of an acquiring corporation in a putative triangular C reorganization should affect the treatment of the transaction under the statute.

With respect to the second variation discussed above--the assumption of liabilities by the parent of the acquiring corporation in connection with a push-up of assets to such parent after the

acquisition by the acquiring corporation--we believe that Rev. Rul. 70-107 should not apply and the language of Section 368(a)(1)(C) relating to the assumption of liabilities by S should apply, assuming, as we do in our discussion above, that the acquiring subsidiary S is not liquidated and the amount of the target's assets pushed-up to P does not cause P to be treated as the acquiror for U.S. federal income tax purposes. In other words, the form of the transaction should be respected; because the form does not involve a direct assumption of liabilities by P and because, for the reasons discussed above, we believe that the form should under these circumstances be respected, there is no reason to apply Rev. Rul. 70-107. In this respect, we are proposing treatment analogous to a drop-down transaction, in which the assumption of liabilities by the nonacquiring corporation would be viewed as a separate transaction. In any event, it should be noted in this regard that this issue is of primary importance with respect to C reorganizations because of the greater flexibility afforded to triangular mergers subject to Sections 368(a)(2)(D) and 368(a)(2)(E).

B. Push-Ups To Higher Levels

In each of the cases that have been the focus of these comments, which involve triangular reorganizations, the acquired corporation's assets are being pushed-up to a corporation (P in the illustrative cases) the stock of which was utilized in the transaction and which controls the acquiring subsidiary. In such a case, some of the substantive issues raised by push-ups are relatively easy to resolve. For example, in such a case the push-up will not cause the transaction to be divisive as to the target shareholders; and the target shareholders will, through the proprietary interest in P that they received in the transaction, continue to have a continuity of proprietary interest in the T assets – in fact, one that is more direct than if the assets were not pushed up. Other factual variations raise more difficult issues, however.

Two merit discussion here. First, what if T's historic assets were distributed first to P and then out of P to P's shareholders in preplanned transactions. Second, what if S stock were used as the merger consideration so that the transaction were a simple "A" or "C" reorganization, and the historic assets of T were pushed-up to P, the parent or other significant shareholder of S? A variation on this case is a triangular reorganization in which the assets were pushed-up beyond P to P's parent (e.g., a holding company).

As to the first variation, assume, for example, that after T's merger into S for the stock of S's parent, a subsidiary of T, TS, is distributed first by T to P, and then by P to its shareholders including both former T shareholders and historic P shareholders. In addition to complex Section 355(e) issues, two significant policy issues relating to the treatment of the T acquisition under the tax-free reorganization rules are raised by this fact pattern. First, to the extent former T shareholders receive T assets, the transaction could be viewed as divisive under Rev. Rul. 88-48. Second, to the extent shareholders of P other than former T shareholders receive the historic T assets, a continuity of proprietary interest is not retained by former T shareholders in such assets and, in some cases, arguably a continuity of business enterprise is not maintained. For these reasons, we view this case as a more complex case than those that are the focus of this report. Therefore, without further study of these issues, we would not extend relief to these push-up transactions.

As to the second variation, assume that T merges into S in a transaction in which T shareholders get 50 percent S stock and 50 percent cash, and then a substantial portion of T's historic assets are pushed up to P, the former 100-percent shareholder of S. The principal concern here is that the target shareholders will not, through their stock interest in S, continue to own a proprietary interest in a substantial portion of the former T assets; in other words, the

assets have been moved to a level above the level at which the target shareholders have an equity interest. In a sense, P is a “stranger” to S and T, viewed from the perspective of the former T stockholders. As to this case, depending on the size of the distribution, we believe that, at a minimum, application of the continuity of interest test should be affected. Because P is not a member of the qualified group, continuity of business enterprise also is implicated. Thus, pending further study, we would also not extend relief to this push-up transaction.

It is important to recognize that, while push-ups to higher levels raise fascinating issues particularly to *aficionados* of Subchapter C, from our experience in practice, these issues rarely if ever arise. We believe further study is required, and should not delay guidance on the important and extremely practical issues that are the focus of this report.

VII. The Nature of Guidance

The final question that we have considered in connection with push-ups is the form of guidance. Because we believe our recommendations are consistent with existing step transaction authorities, a strong argument could be made that the basic guidance we seek could be articulated in a published revenue ruling or series of revenue rulings. However, because difficult issues are raised analogous to those presented by drop-downs and there is no guidance either in the statute, regulations or case law, we believe that the government can best address these issues in regulations. Because Treas. Reg. § 1.368-2(k) in a sense also addresses step transaction issues, we believe that push-ups appropriately could be addressed in those regulations.