April 16, 2008

Hon. Douglas H. Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Proposed and Temporary Regulations Under Code Section 368(a)(1)(D)

Dear Commissioner Shulman:

Enclosed are comments concerning proposed and temporary regulations under section 368(a)(1)(D) of the Internal Revenue Code. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stanley L. Blend
Chair, Section of Taxation

Enclosure

cc: Hon. Donald L. Korb, Chief Counsel, Internal Revenue Service
    Hon. Eric Solomon, Assistant Secretary (Tax Policy), Department of the Treasury
    Michael J. Desmond, Tax Legislative Counsel, Department of the Treasury
These comments ("Comments") concerning certain proposed and temporary Regulations are submitted on behalf of the American Bar Association Section of Taxation ("Section") and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for preparing these Comments was exercised by Jasper L. Cummings, Jr., of the Section’s Corporate Tax Committee. Other committee members participating in the preparation of these Comments included Philip B. Wright, Lisa M. Zarlenaga, Rose L. Williams, R. David Wheat, John P. Barrie, Philip J. Levine, Steven M. Flanagan and Julie A. Divola. The Comments were reviewed by Robert H. Wellen of the Section’s Committee on Government Submissions and Peter H. Blessing, Council Director for the Committee.

Although members of the Section of Taxation who participated in preparing these Comments have clients who might be affected by the federal income tax principles addressed by these Comments, 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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Executive Summary

On December 19, 2006, the Department of the Treasury (“Treasury”) issued a Notice of Proposed Rule Making\(^1\) and Temporary Regulations\(^2\) (the “Temporary Regulations”) dealing with one aspect of an “acquisitive” (as distinguished from “divisive”) section 368(a)(1)(D)\(^3\) reorganization (hereinafter referred to as an “acquisitive type D reorganization”). Specifically, the Temporary Regulations address the question of when the distribution requirement under sections 368(a)(1)(D) and 354(b)(1)(B) is satisfied if there is no actual distribution of stock and/or securities. The Notice of Proposed Rule Making requested comments on the Temporary Regulations, as well as on several broader issues relating to these reorganizations.

We commend Treasury and the Internal Revenue Service (“Service”) for issuing the Temporary Regulations and exploring the other issues raised in the Notice of Proposed Rule Making. We comment here on the Temporary Regulations, on the issues described in the Notice of Proposed Rule Making and related matters. In Part I of this letter, we comment on the principal parts of the Temporary Regulations. We recommend that the Temporary Regulations, when finalized, provide certain modifications and clarifications, including elimination of the nominal share construct or clarification that no consequences flow from the nominal share other than satisfying section 356.

Part II addresses the issues that the Service and Treasury requested input on in the Notice of Proposed Rule Making. Our recommendations with respect to these issues may be summarized as follows:

1. **Continuity of Interest.** Beyond the Temporary Regulations, clarify the definition of the type D reorganization further by changing the exception to the continuity requirement in Regulation section 1.368-1(b) to state that, in the case of an acquisitive type D reorganization, continuity of interest is present if either of the following tests is satisfied:
   a. The acquirer and the target are under common control as defined in section 304(a)(1), taking into account the stock ownership of each person, including ownership by virtue of indirect or attributed stock ownership, only to the extent of the lower of such person’s percentages of stock ownership in the two corporations.
   b. The target shareholders receive the normally-required continuity-of-interest type consideration (*i.e.*, at least 40% stock).\(^4\)

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\(^3\) All references to sections herein are references to sections of the Internal Revenue Code of 1986, as amended (the “Code”), unless otherwise expressly stated herein, and references to regulations are to the Treasury Regulations issued under the Code.
\(^4\) Section 3.02 of Rev. Proc. 77-37, 1977-2 C.B. 568, provides that, for advance ruling purposes, the continuity of interest requirement is satisfied if there is a continuing interest through stock ownership in the acquiring corporation on the part of the former shareholders of the acquired corporation which is equal in value, as of the effective date of the reorganization, to at least 50% of the value of all of the formerly outstanding stock of the acquired corporation. The Service, however, acknowledges that advanced ruling guidelines do not define, as a matter of law, the lower limits of the judicially imposed continuity of interest requirement. For example, the Supreme Court, in *Nelson v. Helvering*, 296 U.S. 374 (1935), held that the requisite continuity of interest existed where assets were transferred for consideration composed of 38% preferred stock and 62% cash. In fact, recently issued regulatory examples provide that continuity of interest is satisfied if at least 40% of the fair...
Treasury should also consider whether continuity-of-interest in an acquisitive type D reorganization should be satisfied if the target shareholders receive the consideration normally required for continuity-of-interest with respect to substantially all the assets of the target.

2. **Consolidated Groups.** Apply the final Regulations to consolidated groups but make clear that the deemed nominal share (if that construct is retained) is not taken into account for any purpose other than satisfying the requirement of section 356, so that no taxable gain with respect to the stock of the target corporation is recognized (including gain not taken into account under Regulation section 1.1502-13).

3. **Liquidation-Reincorporation.** Either—
   a. Eliminate the non-reorganization “alter ego” alternative to complete liquidations in conjunction with clarifying the application of the acquisitive type D (see paragraph 1, above) and section 368(a)(1)(F) (“type F”) reorganizations, so that they will cover all possible cases in which formal liquidations will not be respected as such, or
   b. Limit the liquidation-reincorporation doctrine to rare and extraordinary cases (preferably the general type of which would be identified) to prevent abuse of the liquidation and reorganization rules, while also clarifying the acquisitive type D and type F reorganization definitions currently under consideration.

Also, if a liquidation qualifies as reorganization, the reorganization should be respected. For example, if a liquidation or merger of the target corporation into its parent corporation qualifies as a reorganization followed by a section 368(a)(2)(C) drop-down of assets, the liquidation or merger should be so characterized. Only if it does not so qualify should the liquidation or merger be characterized as a cross chain type D or type F reorganization or a taxable alter ego transfer (if that construct is retained).

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market value of the target shareholders’ stock ownership is preserved through continuing stock ownership in the acquiring corporation. *See* Reg. § 1.368-1(e)(2)(v) Example 1. In contrast, in *Kass v. Commissioner*, 60 T.C. 218 (1973), the Tax Court held that 16% continuity was not sufficient.
Comments

I. Proposed and Temporary Regulations

The Temporary Regulations address uncertainties as to the application of section 368(a)(1)(D) when the same person or persons own, directly or indirectly, all of the stock of the transferor and transferee corporations in identical proportions (“identical common ownership”), and no stock or securities are issued.

An acquisitive type D reorganization is described in relevant part under section 368(A)(1)(D) as a transfer by a corporation (transferor corporation) of all or a part of its assets to another corporation (transferee corporation) if, immediately after the transfer, the transferor corporation 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 transferee corporation; but only if stock or securities of the controlled corporation are distributed in pursuance of a plan of reorganization in a transaction that qualifies under section 354 or 356.

Section 354(a)(1) provides that no gain or loss is recognized if stock or securities in a corporation a party to a reorganization are, in pursuance to a plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization. Section 354(b)(1)(B) provides that section 354(a)(1) will not apply to an exchange pursuant to a plan of reorganization described in section 368(a)(1)(D) unless the transferee corporation acquires substantially all of the assets (the “substantially all requirement”) of the transferor corporation, and the stock, securities, and other properties received by such transferor corporation, as well as the other properties of such transferor corporation, are distributed (the “distribution requirement”) in pursuance of the plan of reorganization. Section 356 provides in relevant part that if section 354 would apply to any exchange but for the fact that the property received in the exchange consists not only of property permitted by section 354 without the recognition of gain or loss but also of other property or money, then the gain, if any, to the recipient is recognized, but not in excess of the amount of money and fair market value of such other property. Thus, a transaction cannot qualify as an acquisitive type D reorganization unless one or more target shareholder receives some property permitted to be received tax free under sections 354 or 356.

Prior to the promulgation of the Temporary Regulations, notwithstanding the statutory distribution requirement, the Service and the courts did not require an actual issuance of stock or securities to satisfy the distribution requirement when there was identical common ownership of the transferor and transferee corporations. The prior law in this area was set forth in Rev. Rul. 70-240. There, a target corporation sold all of its operating assets for cash to another corporation owned by the same sole shareholder, and the target then liquidated. The Service treated the absence of stock consideration for the assets transferred as an unnecessary “meaningless gesture,” because the shareholder of the target already owned all the stock of the acquirer.

Taxpayers have been uncertain as to both the scope of the “meaningless gesture” doctrine and the mechanics of treating the transaction as a reorganization with stock deemed issued. The Temporary Regulations essentially adopt and expand on the analysis of Rev. Rul. 70-240

1970-1 CB 81; See also, James Amour, Inc. v. Commissioner, 43 T.C. 295 (1964) and Wilson v. Commissioner, 46 T.C. 334 (1966).
to resolve these uncertainties. The Temporary Regulations provide that the distribution requirement will be satisfied even though no stock is actually issued in the transaction if the same persons or persons own, directly or indirectly, all of the stock of the transferor and transferee corporations in identical proportions. In such cases, the transferee will be deemed to issue a nominal share of stock (the “deemed stock issuance rule”) to the transferor in addition to the actual consideration exchanged for the transferor's assets. The nominal share is then deemed distributed by the transferor to its shareholders and, when appropriate, further transferred through chains of ownership to the extent necessary to reflect the actual ownership of the transferor and transferee corporations.

We recommend that the Temporary Regulations, when finalized, include the following modifications and clarifications:

- **Adoption of Rev. Rul. 70-240 Approach to Characterize Certain Taxable Sales and Reorganizations**

  The Temporary Regulations will preclude taxable sales of “substantially all” the assets between related corporations, unless a more-than-\textit{de minimis} divergence of stock ownership exists or is created in anticipation of the sale. We assume that the issuance to a party outside the attribution rules of as little as five percent in value (relative to total capitalization) of preferred stock of the target corporation, which is not section 1504(a)(4) stock, would avoid application of the Temporary Regulations. Similarly, reorganization treatment would seem to be avoidable if the target corporation would sell substantially all of its assets to more than one related corporation (e.g., to two subsidiaries of one parent) such that neither corporation acquires substantially all of the assets. The availability of such transactions will make the Temporary Regulations effectively elective. If Treasury does not intend this result, it should so indicate.

- **Identical Common Ownership**

  Although we do not believe this requirement is necessary, it seems reasonable, especially because the Temporary Regulations are intended to impute satisfaction of the statutory distribution requirement.

- **Determining Stock Ownership**

  The Temporary Regulations provide four rules for determining stock ownership: (1) disregard \textit{de minimis} differences; (2) apply section 318(a)(2) attribution rules (without a 50% limitation); (3) aggregate stock ownership among family members described in section 318(a)(1); and (4) disregard section 1504(a)(4) stock. Each is appropriate. We agree with the need for the clarification provided by the amendment to the Temporary Regulations issued on February 27, 2007, to treat triangular reorganizations according to their form and not cause the acquisitive type D reorganization to trump them due to the attribution rules and the deemed stock issuance of the Temporary Regulations.\footnote{T.D. 9313, 72 Fed. Reg. 9284-9285; Temp. Reg. § 1.368-2T(l)(2)(iv), 72 Fed.Reg. 9284-9285.}

- **Nominal Share Issuance**

  The deemed stock issuance rule causes us to suggest clarifications. We believe these clarifications would be rendered largely unnecessary if, instead of deeming a stock
issuance, the Temporary Regulations state that the described transactions would be
deemed described in section 356. We believe Treasury has authority to reach that result
without deeming a nominal share to be issued. This approach has been adopted in the
past. For example, to make it possible for a subsidiary liquidation not subject to section
332 to qualify as a section 368(a)(1)(C) (“type C”) reorganization, Regulation section
1.368-2(d)(4) effectively treats “old and cold” subsidiary stock that the parent holds as
exchanged for hypothetical parent voting stock issued in exchange for the subsidiary’s
assets. The explanation of the proposed regulation indicated that, just as an upstream
merger into a corporate shareholder that was not controlled by section 332 could be a
section 368(a)(1)(A) (“type A”) reorganization (see Rev. Rul. 58-93),7 a non-merger
upstream liquidation could be a type C reorganization, even if no voting stock of the
parent were actually issued (as section 368(a)(1)(C) requires).8 The explanation stated:
“An exchange is deemed to occur for purposes of section 354 even if, in form, one does
not occur.” While the deemed issuance of a nominal share is intended to accomplish the
same result,9 we think the “deemed exchange” formulation does not directly raise the
same issues.

Example 2 of the Temporary Regulations states that the transfer of the nominal share
would not be subject to the gift tax. Still, there is uncertainty as to whether the deemed
issuance of a nominal share has any tax significance. If the nominal share concept
remains in the Temporary Regulations, we suggest that the Temporary Regulations be
clarified to state that the deemed stock issuance rule has no significance other than to
meet the distribution rule.

We also understand that the Temporary Regulations apply regardless of whether the sum
paid for the assets is exactly equal to their value. However, if, in Example 1 of the
Temporary Regulations,10 the cash paid were $80 rather than $100, presumably the $20
net increase in the value of S (the asset acquirer) would be reflected in its stock owned by
A. Accordingly, the Service likely would impute a transfer of $20 worth of S stock (not
parent stock), under principles unrelated to the Temporary Regulations (e.g., under
section 482).11 We understand the Temporary Regulations not to preclude any such
imputation.

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7 1958-1 CB 188
10 In Example 1, A owns all the stock of T and S. The T stock has a fair market value of $100x. T sells all of its
assets to S in exchange for $100x of cash and immediately liquidates. Because there is complete shareholder
identity and proportionality of ownership in T and S, the requirements of sections 368(a)(1)(D) and
354(b)(1)(B) are treated as satisfied notwithstanding the fact that no S stock is issued. Pursuant to Temp. Reg. §
1.368-2T(l)(2)(i), S is deemed to issue a nominal share of S stock to T in addition to the $100x of cash actually
exchanged for the T assets, and T is deemed to distribute all such consideration to A. Thus, the transaction
qualifies as a reorganization described in section 368(a)(1)(D).
11 Cf. Willard M. Arnold, T.C.M. (CCH) 49,710(M), 1994 Tax Ct. Memo LEXIS 97; PLR 9623028 (March 7,
1996); PLR 9336029 (June 14, 1993); PLR 9229026 (April 21, 1992).
Effective Date

We understand the effective date provision to permit retroactive application of the Temporary Regulations by consistent use by all parties, but not otherwise to address current law. We agree with this approach.

II. Issues on Which the Treasury Requested Comments

A. Is the Meaningless Gesture Doctrine Inconsistent with the Statutory Distribution Requirement?

No. The courts and the Service created the doctrine, because it makes common sense, at least where there is at least theoretically some excess in value of the assets transferred over the amount of boot paid. The Service applied the doctrine in Rev. Rul. 70-240 to a situation where consideration equal to the full fair market value of the assets transferred was paid in cash. While this case is not as obviously reconciled with the statute, we agree that it is the proper approach, because we do not believe it is appropriate to require a different outcome – either as a policy matter or as an administrative matter – when the only factual difference is whether there is a nominal difference between the value and the cash consideration. Moreover, because valuations are always within a range, “room” for nominal consideration always should exist.

The practical significance of the question is that waiving the distribution requirement prevents an asset “sale” from being taxed according to its form as a taxable exchange, with adjustment of the target’s asset basis to fair market value. We do not see this as a problem warranting a change from the Rev. Rul. 70-240 approach. Taxpayers generally desire nonrecognition treatment, and they have ways to plan around a nonrecognition rule. We are not aware of any widespread discontent with the meaningless gesture doctrine.

B. To What Extent, if Any, Should the Continuity Requirement Apply to an Acquisitive Section 368(a)(1)(D) Reorganization?

We recommend that the definition of the type D reorganization be clarified further by changing the exception to the continuity requirement in Regulation section 1.368-1(b) to read in substance as follows:

Continuity is present in the case of an acquisitive type D reorganization (to which section 354(b) applies) if either (1) the acquirer and the target are subject to common control as defined in section 304(a)(1), taking into account the stock ownership of each person only to the extent such stock ownership is identical with respect to each such corporation, including common control by virtue of stock ownership as described in Regulation section 1.368-2T(l)(2)(ii); or (2) the target shareholders receive consideration satisfying the continuity of interest requirement of Regulation section 1.368-1(e).

1. Discussion

The type D reorganization is a hybrid animal that, outside of the section 355 context (a “divisive” type D reorganization), overlaps with or borders on the type E and F
reorganizations, and less often resembles other acquisitive reorganizations.\textsuperscript{12} It appears that section 368(a)(1)(D), as it applies to acquisitive type D reorganizations, originally was drafted to apply only to transactions in which a corporation transferred all of its assets to another corporation that was controlled by the target corporation or all of its shareholders.\textsuperscript{13}

The 1954 Code amended that section to read as follows:

\begin{quote}
\ldots 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 (emphasis added.)
\end{quote}

The purpose of the 1954 changes was to allow non pro rata split-offs to qualify under section 355.\textsuperscript{14} There is no evidence in the legislative history that Congress noticed the implications of the change on acquisitive type D reorganizations.

Although the face of the 1954 amendment of section 368(a)(1)(D) might be read to include a transaction where, for example, a one percent shareholder of the transferor owns 100\% of the corporation that buys substantially all of the first corporation’s assets for cash (and a relatively small portion, or even one share, of stock), we respectfully submit that such a reading would be myopic.\textsuperscript{15} Normal principles of tax jurisprudence would assume, in respect of the 1954 provision that Congress knew that judicial limitations existed that would prevent application of the provision to such a case. Those limitations must have been assumed by Congress as backstopping the common ownership requirement of the section (although not artfully drafted) and the continuity of interest requirement.\textsuperscript{16} There is no suggestion in the legislative history that Congress intended to override them.

Accordingly, the exclusion of type D reorganizations from the continuity rule in Regulation section 1.368-1(b) should be read to refer only to divisive transactions, which are controlled by Regulation section 1.355-2(c). Furthermore, authorities such

\begin{enumerate}
\item[13] The predecessor of section 368(a)(1)(D) was set forth in § 203(h)(1)(B) of the Revenue Act of 1924, ch. 234, 43 Stat. 253, and provided that a reorganization included 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 were transferred.
\end{enumerate}
as Rev. Rul. 70-240 and American Manufacturing Co. v. Commissioner\textsuperscript{17} should not be read to eliminate the continuity requirement but to deem that requirement satisfied in cases of identical stock ownership regardless of whether normal continuity exists.

This approach might justifiably be expanded, as per the suggestion in the 1954 Conference Report that regulations be adopted to deal with liquidation-reincorporation concerns, by adopting section 304 common control and attribution rules to determine continuity in cases not involving identical stock ownership or normal continuity.\textsuperscript{18} It should not be enough to require that the same persons control both corporations, because this would be true if A and B own X 99:1, and they own Y 1:99. A solution to this problem could be to adopt the approach of section 1551(b)(2)(B) and section 1563(a)(2) and determine whether the 50% common control threshold is met by reference to the person’s smaller holding as between the two corporations. In any event, a transaction in which shares representing at least 40% of the total consideration actually would be delivered for the assets, however, still could qualify as an acquisitive type D reorganization under the existing unembellished control rule for type D reorganizations.

Some of the issues may be illustrated by the following.

Example 1. Unrelated individuals A and B own 30% and 70% of X, respectively. X owns a going business worth $30 and has $70 liquid assets. X liquidates, B receives the $70 cash, and A receives the business, which he reincorporates into Y, his pre-existing wholly owned corporation.

A controls the transferee corporation, which receives “substantially all” of X’s assets under a relaxed standard (excluding the liquid assets) but did not control X. So this transaction would be a type D reorganization under the literal words of the Code, but not under the common control test suggested above;\textsuperscript{19} nor if the standard continuity test (40% equity) were applied given that only 30% of the shareholder ownership continues (though equal to all of the operating asset value).\textsuperscript{20}

One may argue that the transaction should be a nonliquidation, assuming that there would be no business reason for the liquidation-reincorporation as opposed to either keeping the same corporation in existence or merging it with the transferee. However, a potential bailout of B is not at stake, as B would enjoy capital gain treatment in any event under Clark v. Commissioner.\textsuperscript{21} If the transaction is not treated as a reorganization, all gains and losses would be recognized and tax paid on any net gain; thus, while the tax history, including earnings and profits accounts and

\textsuperscript{17} 55 T.C. 204 (1970) (concluding that a cross-chain sale and liquidation of the selling subsidiary was a type D reorganization).

\textsuperscript{18} 1954 USCCAN, Vol. 3, p.5301.

\textsuperscript{19} The transaction would not be a type F reorganization because the transferee is a pre-existing corporation.

\textsuperscript{20} Shareholder continuity, however, would be 100% if the transaction were viewed as a pro rata section 301 distribution of the liquid assets followed by A’s purchase of B’s X stock. Under that approach, however, a dividend tax would be owed, which seems inappropriate.

\textsuperscript{21} 489 U.S. 726 (1989) (for purposes of determining whether “boot” received in a reorganization was dividend equivalent under section 356(a)(2), the Supreme Court recharacterized the transaction as a hypothetical redemption of transferee corporation stock after the reorganization).
tax elections would be lost, it would only be at the cost of a section 336 tax on net gain. If A also received liquid assets in the liquidation, or subsequently from the transferee corporation, an unwarranted recovery of basis would occur (and, if current law’s equivalent rate regime is changed, a possible rate advantage). One may form different views on whether these differences are of enough concern as to warrant imposing nonliquidation reorganization treatment on this type of transaction.

This example also raises the issue of what “substantially all” means in a type D reorganization and how it relates to continuity of shareholder interest in a case where (per our proposal) the requirement is not automatically deemed met. We do not here pursue that question, but we believe the Treasury will have to address it in order to resolve this important question about shareholder continuity. Under certain case law, the operating assets of a corporation that has a substantial business can be substantially all of its assets (i.e., assets such as cash and other liquid assets not used in the business are excluded). Under that approach, using the above example, if shareholder continuity would be measured solely by reference to operating assets, then applying a 40% minimum continuity standard, the stock given need only be 12% (40% of 30%) of the total value of the company (though 40% of the operating business), and even less if, e.g., 85% of operating assets would satisfy “substantially all.” Thus, the appropriate minimum shareholder continuity percent in such a case might be applied by reference to the net value of the operating assets transferred (i.e., just over ten percent of total consideration could suffice if all operating assets are acquired).

2. Another Approach

One recent commentator recommends that the continuity requirement in acquisitive type D reorganizations be dealt with by counting only boot treated as exchange proceeds under section 356(a) against continuity.22 The solution is a neat one, though inconsistent with the traditional continuity approach. The proposal has the merit of focusing on when, under the Supreme Court standard, a transaction results in a bailout of earnings to the transferring shareholders. On the other hand, it undertakes to resolve a major uncertainty in the application of the shareholder continuity doctrine to, and hence the scope of, an acquisitive type D reorganization by reference to the treatment of boot, and by applying a rule whose meaning was debated until resolved in 1989 in Clark. Further, the determination of dividend equivalence under section 301(b)(1) has continuing uncertainties and would not provide a bright line test.

C. Should the Temporary Regulations Apply When the Parties Are Members of a Consolidated Group?

Yes. There is no reason to distinguish a consolidated group’s intragroup sale or reorganization treatment from that of a nonconsolidated affiliated group. While the intercompany transaction system defers the impact of an intragroup sale, deferral is not a substitute for more comprehensive reorganization treatment. The fundamental premise underlying the deferral system is the need to preserve the location of gain or loss within a

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consolidated group, but this premise is inapplicable where Congress has determined that a target’s attributes should shift to the acquirer.

One feature of the consolidated return regulations should be coordinated with the Temporary Regulations’ approach. Regulation section 1.1502-13(f)(3) provides that, in the case of an acquisitive intercompany reorganization, boot is taken into account immediately after the reorganization in a separate transaction. In Regulation section 1.1502-13(f)(7), Example 3, an intercompany reorganization with boot is treated as if the acquirer had issued only its stock in the reorganization, and the deemed shares were then redeemed by the acquirer in exchange for the boot. The effect is to remove the boot from section 356 (dividend within gain) and treat it as received in a redemption in turn taxed as a section 301 distribution.

We assume that Regulation section 1.1502-13(f)(3) would apply to an all cash type D reorganization. The nominal share concept under the Temporary Regulations is consistent with the deemed shares under Regulation section 1.1502-13(f)(3). The nominal share fiction deems a transaction to qualify as a section 368 reorganization, and the shares deemed under the Regulation section 1.1502-13(f)(3) fiction determine the consequences of the reorganization. It may be helpful to add an example to the Temporary Regulations or to Regulation section 1.1502-13 to illustrate this point.

We understand the Temporary Regulations as applied to consolidated groups would have the results of the following Example 2.

**Example 2.** X owns all the stock of S and B, X has a $25 basis in the S stock and a $10 basis in the B stock. All three corporations join in a consolidated return. S sells all of its assets to B for $100 cash, their fair market value, and liquidates.

The Temporary Regulations deem issuance of a nominal share to qualify the transaction under section 368(a)(1)(D), Regulation section 1.1502-13(f)(3) deems issuance of $100 worth of B stock to S, and a distribution by S of all of the deemed shares to X in dissolution. B is then deemed to redeem the Regulation section 1.1502-13(f)(3) deemed shares from X for $100. X’s receipt of the $100 is a section 301 distribution, which results, under Regulation section 1.1502-32, in Y having a $75 ELA ($100 received less $25 basis in S stock). Y does not actually own any B shares to which the ELA can attach. Does the ELA shift to the B stock actually owned by X, as in PLR 9815050,\textsuperscript{23}

However, when S and B are not sister, first-tier subsidiaries, other problems arise.

**Example 3.** Same facts as Example 2, except that the stock of S is owned by Y, and the stock of Y is owned by X. X, Y, B and S all join in the consolidated return.

Now the Regulation section 1.1502-13(f)(3) deemed shares and the nominal share of B are momentarily owned by Y following S’s dissolution. Y then receives $100 in a deemed redemption taxed as a section 301 distribution, which results, under Regulation section 1.1502-32, in Y having a $75 ELA ($100 received less $25 basis in S stock). Y does not actually own any B shares to which the ELA can attach. Does the ELA shift to the B stock actually owned by X, as in PLR 9815050,\textsuperscript{23}

\textsuperscript{23} (Jan. 9, 1998).
or does it attach to the nominal share, which the Temporary Regulations direct to be deemed distributed by Y to X? If the latter, Y’s deemed intercompany distribution to X results in Y recognizing but deferring a $75 gain (i.e., the excess of the nominal share’s $0 fair market value over its $75 ELA) under section 311(b) and Regulation section 1.1502-13(f)(2). This gain is triggered if, inter alia, B is liquidated or merged into X.

We believe the correct answer is that the nominal share does not exist for any purpose other than to satisfy the statutory distribution requirement for a section 354 or section 356 exchange of stock or securities. Therefore, the consolidated return rules should apply in the same way that they would apply to B’s redemption of all of the B stock held by Y (i.e., as if Y did not own the nominal share): Y’s remaining B stock basis or ELA should shift to the member(s) that own B stock under the principles of Regulation section 1.302-2(c).

24 Similarly, we believe that the nominal share should not be taken into account for other consolidated return purposes such as the reverse acquisition rules. See Reg. § 1.1502-75(d)(3). PLR 9806003 (Feb. 6, 1998) denied a group’s continuation following a cross-chain, all cash type D reorganization of its common parent because the common parent’s shareholder did not own more than 50% of the acquirer by virtue of owning the common parent’s stock. The ruling deemed the issuance of nominal acquirer stock, as does the Regulation. Presumably, the group’s termination resulted from no substantial acquirer equity being attributable to the target shareholder’s common parent stock (rather than, for example, imposing any requirement that the target shareholder retain the nominal shares under some sort of shareholder continuity requirement).

25 See, Blatt, Lost on a One Way Street: The Taxpayer’s Ability to Disavow Form, 70 Or. L. Rev. 381 (1991); Bittker & Eustice, supra note 15, at ¶ 1.05[2][b].
liquidating corporation’s assets to a third corporation that is an “alter ego,” with (3) some undefined level of common ownership between the original corporation’s shareholders and the transferee corporation’s shareholders. For ruling purposes, the Service identifies that level as 20%.26

This possibility should be eliminated or severely curtailed. Guidance should clarify Regulation section 1.331-1(c), which currently “defines” extremely broadly when a complete liquidation may be preempted by a reincorporation. This guidance should clarify which competing regime applies, and should eliminate (or at least limit to the greatest extent possible) the threat of a non-reorganization non-complete liquidation.

The chart below depicts the current de facto ordering of the various regimes for ignoring a formal liquidation. We believe its order is appropriate and recommend adoption in formal guidance; that is, the treatment of a transaction, based on its form, as a liquidation, a reorganization with an asset drop, or a cross-chain reorganization, should occur in that order before any resort to an “alter ego” approach (if one is to be retained). The chart states the presumptive results, in order, where:

- Either (1) the target corporation liquidates and transfers substantially all of its assets to the corporate parent, in Case 1 and Case 2, or (2) the target corporation transfers its assets pro rata to all of its shareholders in Case 3, and

- As part of the same transaction, in Situation 2, there is a reincorporation of target’s assets to some extent (Alternative numbers 1-4 which do not differ in terms of facts but in terms of tax treatment set forth a suggested order of alternative clarifications).

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<table>
<thead>
<tr>
<th></th>
<th><strong>CASE 1</strong></th>
<th><strong>CASE 2</strong></th>
<th><strong>CASE 3</strong></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>80-100% Corporate Parent</td>
<td>&lt; 80% Corporate Parent</td>
<td>No Corporate Shareholder</td>
</tr>
<tr>
<td>Situation 1: complete liquidation with no reincorporation</td>
<td>Section 332&lt;sup&gt;27&lt;/sup&gt;</td>
<td>Section 331; unless trumped by a reorg. into parent</td>
<td>Section 331</td>
</tr>
<tr>
<td>Situation 2: Alt. #1 no complete liquidation due to reincorporation into third corporation</td>
<td>Not section 332; can be A or C reorg. into parent, followed by section 368(a)(2)(C) drop&lt;sup&gt;28&lt;/sup&gt;</td>
<td>Can be a A or C reorg. into parent, followed by section 368(a)(2)(C) drop&lt;sup&gt;29&lt;/sup&gt;</td>
<td>See below</td>
</tr>
<tr>
<td>Situation 2: Alt. #2</td>
<td>If not Alt. #1, reorg. into third corporation with boot&lt;sup&gt;30&lt;/sup&gt;</td>
<td>Same as Case 1</td>
<td>Reorg. into third corporation with boot&lt;sup&gt;31&lt;/sup&gt;</td>
</tr>
<tr>
<td>Situation 2: Alt. #3</td>
<td>If not Alt. #1 or 2, no complete liquidation (alter ego)&lt;sup&gt;32&lt;/sup&gt;</td>
<td>Same as Case 1</td>
<td>If not reorg. into third corporation with boot, no complete liquidation (alter ego)</td>
</tr>
<tr>
<td>Situation 2: Alt. #4</td>
<td>If none of the above alternatives applies, complete liquidation sections 332/337 (no alter ego)&lt;sup&gt;33&lt;/sup&gt;</td>
<td>If none of the above alternatives applies, complete liquidation section 331 (no alter ego)</td>
<td>If none of the above alternatives applies, complete liquidation section 331 (no alter ego)</td>
</tr>
</tbody>
</table>

<sup>27</sup> As between the corporate parties, section 332 trumps section 368. Reg. § 1.332-2(d).

<sup>28</sup> Rev. Rul. 69-617, 1969-2 C.B. 57 (all of the assets reincorporated; type A reorganization); PLR 9222059 (June 13, 1991) (less than all assets reincorporated). In theory, if the amount of reincorporation is sufficiently small to allow the liquidation to be treated as a complete liquidation, then the transaction should not be treated as a reorganization and a drop of assets. However, the Service does not appear to have enforced such a distinction. Reg. § 1.368-2(d)(4) effectively treats “old and cold” subsidiary stock that the parent holds as being exchanged for hypothetical parent voting stock issued or deemed issued in exchange for the subsidiary’s assets, thus making it possible to qualify a subsidiary liquidation that is not subject to section 332 as a type C reorganization. 64 Fed. Reg. 31770-31772 (1999); Proposed Regs. Would Reverse Longstanding IRS Position on “C” Reorgs, 1999 Tax Notes Today 113-15 (June 14, 1990). The explanation of the proposed regulation indicated that just as an upstream merger into a corporate shareholder that was not controlled by section 332 could be a type A reorganization, a similar upstream liquidation without merger that was not subject to section 332 could be a type C reorganization, even if no voting stock of the parent were actually handed out to any shareholder of the subsidiary (as section 368(a)(1)(C) requires). The explanation stated: “An exchange is deemed to occur for purposes of I.R.C. § 354 even if, in form, one does not occur.” See also Prop. Reg. § 1.332-2(e), Example 2, 70 Fed. Reg. 11903 (2005) (the “no net value” regulations), which states that the subsidiary liquidation that results in the parent receiving no more than the preferred stock preference could be a type C reorganization.

<sup>29</sup> Rev. Rul. 58-93, 1958-1 C.B. 188 (target’s assets reincorporated first into new subsidiary and then target merged into 79% shareholder).


<sup>33</sup> A.O.D. 1981-131 (Aug. 24, 1981) (where transferee was not “alter ego” it was a complete liquidation).
Alternative #3 (alter ego) is the problem and is generally attributable to the concept, described in *Telephone Answering Serv. Co. Inc., v. Commissioner* (hereinafter referred to as “TASCO”), 34 that there can be an alter ego outside a reorganization. It is a no-liquidation, no-reorganization conclusion by the Tax Court, in the case of a formal liquidation that taxpayers claimed to be controlled by section 331. The Tax Court has not cited TASCO again since 1974; nevertheless, taxpayers continue to express concern about the scope of its application.

No one knows the scope of the alter ego doctrine, and what portion of assets needs to be reincorporated or what level of cross ownership is necessary. Evidently, the Service thinks an alter ego must receive at least most of the operating assets of the liquidated corporation. 35 This seems generally correct. It also has indicated that only a new corporation can be an alter ego, though that may not be an official view. 36 The low 20% level of cross-ownership that can prevent a ruling is hard to understand.

3. The Proposal

The chart depicts an order of characterization of transactions involving a liquidation and reincorporation. In our view, that order is appropriate and should be followed by the Service. That is, a transaction should be treated, (i) based on its form as a liquidation, (ii) as a reorganization with an asset drop, or (iii) as a cross-chain reorganization, in that order, 37 before resorting to any alter ego approach.

In addition, we believe it is time for the government to say that the non-reorganization alter ego alternative to complete liquidation (Alternative #3) either will not be asserted at all, or will be asserted only in “rare and extraordinary” 38 cases to prevent abuse of the liquidation and reorganization rules. To the extent possible, those abuses should be identified. For example, if concerns exist in the case of Example 1, above, they should be identified.

The universe of formal liquidations that should not receive complete liquidation treatment inhabits the space formed by acquisitive type D and type F reorganizations and the alter ego doctrine. In conjunction with eliminating or limiting the alter ego doctrine, Treasury should clarify the application of acquisitive type D and type F reorganizations so that to the extent possible they will cover all cases in which liquidations should be treated as something else. The alter ego alternative probably owes its longevity to uncertainties about the reorganization alternatives. The better course is to define the reorganization alternatives and, if necessary, save the “alter ego” doctrine for those cases the Service cannot foresee and clarify its application.

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36 TAM 9049001 (Aug. 7, 1990) (reasoned that the liquidation-reincorporation cases involved use of an alter ego of the liquidated corporation.) There was no alter ego here because (1) no new subsidiary was created, and (2) the US parent could not be viewed as target’s alter ego because it had its own tax history.
37 See notes 20-24 supra.
Our general suggestion is that reincorporation into a third corporation (Alternative #2) should be a type F reorganization if the third corporation is newly created to receive only the assets of target, and a type D reorganization if the third corporation is pre-existing, provided it otherwise satisfies the requirements for a D or F reorganization. This would leave little if any room for “off-Code” constructs like alter ego though, as discussed below in part D.4., the Service may consider some remaining cases as involving potential for abuse.

4. Current Role of Liquidation-Reincorporation Doctrine

The stakes involved in a corporate liquidation, outside the section 332 subsidiary liquidation, have changed over time. The doctrine was born when the liquidating corporation did not recognize gain built into assets distributed. In addition, the liquidating redemption of stock was more lightly taxed to the shareholder as capital gain, with basis offset, than would be a dividend, and the shareholder obtained a fair market value basis for any property received.39 Alternately, to the extent loss-limitation provisions such a section 267 would be inapplicable, the liquidating corporation might try to enjoy loss recognition on assets sold to an affiliate, while continuing the business in the affiliate.40 The acquiring corporation would plan to receive a stepped up basis in assets and was cleansed of the old earnings and profits. In a cross-border context, a dividend withholding tax could be avoided.

The repeal of the General Utilities doctrine eliminated the basis step up without corporate level gain recognition,41 but other benefits of reincorporation with liquidation treatment may remain in certain cases.

5. Complete Liquidation Definition

Regulation section 1.331-1(c) is the only Regulation42 that states guidelines for identifying when a formal liquidation can be recharacterized:

A liquidation which is followed by a transfer to another corporation of all or part of the assets of the liquidating corporation or which is preceded by such a transfer may, however, have the effect of the distribution of a dividend or of a transaction in which no loss is recognized and gain is recognized only to the extent of “other property.” See sections 301 and 356.

It is reasonable to apply this definition also for section 332 purposes, except where some feature unique to section 332 requires a different approach.43 Regulation section 1.332-1 refers to section 331 as the “general rule” for liquidations, and the Service has ruled section 332 inapplicable on account of a reincorporation that was not a reorganization.44 For advance ruling purposes, the Service views reincorporation as

39 See e.g., Bard-Parker Co. Inc., v. Commissioner, 218 F.2d 52 (2d Cir. 1954); Bittker & Eustice, supra note 15, at ¶¶ 10.5[5], 10.08, 12.64.
41 See Bittker & Eustice, supra note 15, ¶ 8.20[3].
42 Reg. § 1.301-1(l) also refers to “reincorporation” but does not seem to add anything to this Regulation in terms of enlightening the ascertainment of a complete liquidation or not.
43 For example, see Reg. § 1.332-4, providing special rules for a series of liquidating distributions.
holding the potential for ignoring a formal liquidation, in connection with both
sections 332 and 331, where there is (1) a reincorporation of any amount of assets, (2)
into an alter ego, and (3) there is an overlap of more than 20% in value shareholding
(with attribution). 45

These parameters are too broad and too indefinite. There is no good reason for
taxpayers to worry about the reincorporation of any amount of assets where there is a
20% overlapping ownership. Requiring the corporate successor to be an “alter ego”
does not clarify the situation because no one knows what that term means.

Below we address three basic categories of characterization of a liquidation
reincorporation (in addition to type D reorganization as discussed at part B.2. above).

(a) Reincorporation Treated as Upstream Type A or Type C Reorganizations

Professors Bittker & Redlich observed over half a century ago that it is
unnecessary to resort to general principles to disregard a liquidation, because the
reorganization rules “are directly in point.” 46 An upstream liquidation into a
corporate shareholder can be treated as an upstream reorganization despite a
reincorporating transfer of any amount of the assets to a third corporation,
because of section 368(a)(2)(C). That section states that the surviving corporation
in certain reorganizations can retransfer “part or all” of the assets received to
to controlled corporations without affecting the reorganization. However, this rule
plays different roles, depending on whether the corporate shareholder controls the
liquidated corporation for purposes of section 332 (at least 80% of vote and
value).

Absence of control. Since the reversal of the Bausch & Lomb doctrine, 47 an asset
transfer by a liquidating subsidiary to a noncontrolling parent (for example, a
parent owning 79% of the liquidating corporation’s stock) that otherwise qualifies
as a type A or C reorganization will be so treated, and a related contribution of
any amount of the corporation’s properties to a controlled corporation is allowed
by section 368(a)(2)(C). Therefore, the reincorporation is irrelevant to deciding
whether the liquidation is controlled by section 331 or section 368; if section 368
applies, it trumps due to section 1001(c).

Section 332 control. If the corporate shareholder controls the liquidating
corporation, a different regime applies. Whereas nonrecognition under the
reorganization rules trumps the taxable liquidation rules in the Bausch & Lomb
(non-controlled) type of case, section 332 trumps the reorganization rules unless

from TASCO, supra, as explained in A.O.D. 1981-131 (Aug. 24, 1981). Reg. § 1.331-1(c) indicates that the
reason taxpayers might want to disguise a transaction as a liquidation is to convert a dividend into a capital gain
at the shareholder level, and indeed this seems to have been the predominant scenario in liquidation
reincorporation cases, as discussed above.
46 Boris I. Bittker & Norman Redlich, Corporate Liquidations and the Income Tax, 5 Tax L. Rev. 437, 453
(1950).
47 See Bittker & Eustice, supra note 15, ¶ 12.63[5].
the amount of the reincorporation is so great as to render the liquidation incomplete.\textsuperscript{48}

Section 332 and its regulations show that Congress and Treasury anticipated the case of a controlled subsidiary transferring all of its properties to the controlling parent and none to minority shareholders. It wanted the parent to receive the properties as a liquidating distribution and not in a reorganization, even if the transaction might be a reorganization as to the minority shareholders. That is, as between the two nonrecognition rules, section 332 trumps.\textsuperscript{49}

However, a type A or C reorganization, and hence reincorporation under section 368(a)(2)(C), can exist if the amount of reincorporation is so great as to prevent a complete liquidation.\textsuperscript{50} In such a case, the putative section 332 liquidation is not complete, and the rule that says section 332 trumps a reorganization is inapplicable.

The Service long ago ruled that a merger into a parent corporation followed by a contribution of all of the merged subsidiary’s assets to another controlled corporation qualified as a type A reorganization.\textsuperscript{51} The question then arises as to a reincorporation of a much smaller portion of the assets: how little reincorporation will suffice to prevent the complete liquidation under section 332 and allow a type A or C reorganization into the parent with a drop-down of assets? Although section 368(a)(2)(C) places no limit on the amount of assets that may be reincorporated, the application of the liquidation-reincorporation doctrine must care if the reincorporation is the ticket out of section 332. Most cases appear to involve most or all of the assets, and there is no clarity as to any threshold.\textsuperscript{52}

Most often in the controlling parent cases that could qualify as reorganizations, it does not matter; either the liquidation is a complete liquidation under section 332 or it is usually a type A or C reorganization into the parent with a section 368(a)(2)(C) drop. However, there are issues about using this approach in cases of liquidations preceding spin-offs.

\textsuperscript{48} Section 332(b); Reg. § 1.332-2(d).
\textsuperscript{49} Although this trumping rule literally does not speak to the liquidation of wholly owned subsidiaries, there is no reason to think that Congress intended the competing reorganization regime to trump sections 332 and 337 in that case (which looks even more like a liquidation). \textit{But see Eastern Color Printing Co. v. Commissioner}, 63 T.C. 27 (1974) \textit{acq.}, 1975-2 C.B. 1 (holding that a merger of a wholly owned subsidiary into a holding company parent is both a section 332 liquidation and a type F reorganization (no longer possible)). Similar are \textit{Performance Systems, Inc. v. United States}, 382 F. Supp. 525 (M.D. Tenn. 1973), \textit{aff’d per curiam}, 501 F.2d 1338 (6th Cir. 1974); \textit{Movielab, Inc. v. United States}, 494 F.2d 693 (Ct. Cl. 1974); Rev. Rul. 75-561, 1975-2 C.B. 129, \textit{obsoleted by} Rev. Rul. 2003-99, 2003-2 C.B. 388.
\textsuperscript{50} \textit{But see Richard W. Bailine, The Elucidation of the Liquidation-Reincorporation Doctrine}, J. Corp. Tax’n (Mar/April 2003).
\textsuperscript{51} Rev. Rul. 69-617, 1969-2 C.B. 57. \textit{See also} PLR 200250024 (Sept. 9, 2005).
\textsuperscript{52} \textit{See Bittker & Eustice, supra} note 15, ¶ 12.6[3]. PLR 200532011 (Aug. 12, 2005) (100% reincorporation split between two other corporations); PLR 9422057 (evidently not all subsidiaries owned by liquidated holding company transferred to other controlled corporations); PLR 8348028 (Aug. 29, 1983) (within one ruling, Reg. § 1.332-2(d) to one subsidiary merger/liquidation and Rev. Rul. 69-617, 1962-2 C.B. 57, applied to another subsidiary merger/liquidation after which 100% of the assets were dropped) PLR 200028027 (July 17, 2000) and PLR 200250024 (Dec. 12, 2002) (discussed in Bailine, \textit{supra}, note 50); PLR 9222059 (partial reincorporation in connection with a spin-off treated as a reorganization into parent).
Example 4. D owns all of the stock of X and Y. D wants to combine some assets from X and Y into a new subsidiary that it will spin off. X and Y merge into D; D retains part of their assets and contributes the rest of their assets to C, which it spins off under section 355.

If the reincorporation involves enough assets to prevent complete liquidations of X and Y, the mergers could be type A reorganizations with section 368(a)(2)(C) drops of assets but for concerns about continuity of business enterprise: does D have continuity in a business it distributes? The Service evidently recognizes this as a “significant issue” on which it will rule favorably, but its criteria are unclear.\(^{53}\)

A subsidiary liquidation that qualifies as an upstream reorganization followed by a drop of assets might also be a cross-chain reorganization into the subsidiary to which the assets are dropped. If the parties choose an upstream asset movement in form, and it qualifies as both an upstream reorganization and a cross-chain reorganization, the former should trump because it is consistent with the form chosen by the parties.\(^{54}\)

(b) Reincorporation Treated as Type F Reorganization

The type F reorganization necessarily implicates the liquidation-reincorporation doctrine because it will involve either (1) a shareholder that is a newly formed corporation (Newco) into which the subsidiary liquidates and reincorporates, or (2) a Newco that receives the target’s assets accompanied by target’s formal liquidation. In 2004, the Treasury proposed an expansive definition of the type F reorganization.\(^{55}\) As stated above, the scope of both the type F and the type D reorganization (discussed at part B.2 above), each expanded since the doctrine was developed, should reduce the cases covered by it and hence limit the need for it.

Section 368(a)(1)(F) describes a reorganization that is a “mere change of identity, form, or place of organization of one corporation, however effected ....”\(^{56}\) This language suggests that nothing else is to be going on as part of the change. Thus, for most purposes the Code treats a type F reorganization as if the reorganized corporation is the same entity as the corporation that was in existence prior to the

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\(^{53}\) See PLR 200536008; Murray, *The Gregory Rules of Section 355*, p. 741 et seq., Vol. 15, PLI Tax Aspects of Corporate Acquisitions, etc. (PLI 2007). We also understand that the “elimination of a corporate tier” might be viewed as a reason not to apply the liquidation-reincorporation doctrine; any illumination of this view would be helpful.

\(^{54}\) Rev. Rul. 69-617, 1969-2 C.B. 57, treated the merger of a subsidiary into the parent to squeeze out minority shareholders followed by reincorporation of 100% of the assets into a new wholly owned subsidiary as a type A rather than a type D reorganization. *Cf.* Prop. Reg. § 1.368-2(m)(3), 69 Fed. Reg. 49836 (2004) (series of related transaction can result in a type F reorganization; perhaps this Regulation would cause the type F to trump the type A in Rev. Rul. 69-617). *See* Steinberg, *Form, Substance and Directionality in Subchapter C*, 52 Tax Law 457, n.39 (1999) (stating that the regulations show that Treasury agrees that the application of section 368(a)(2)(C) trumps a sideways transfer).


reorganization. Fusion of multiple operating corporations’ assets has been prohibited since 1984 by the “one corporation” reference.

Rulings and cases indicate that the type F reorganization generally required (subject to de minimis exceptions) (1) virtually 100% identity of stock ownership; (2) no shifting of relative equity interests and (3) until 2005, the generally applicable continuity of business enterprise and continuity of interest requirements. These requirements are applied flexibly, in the sense that the Service treats the type F reorganization as separate from certain other, related events, which, if combined, would evidence a change of ownership of the corporation and/or an addition (but not necessarily a disposition) of assets.

The fact that some assets come out of corporate solution in a distribution to the liquidating corporation’s shareholders logically cannot preclude type F treatment, if such treatment is to serve as a tool to combat liquidation-reincorporation, because such “bailout” is the primary example of that abuse. The Regulation proposed in 2004 could allow essentially unlimited redemptions in a type F reorganization. Its clarification and finalization should accompany the general resolution of the liquidation-reorganization doctrine. We do not comment here on that proposed Regulation.

(c) Reincorporation Treated as Non-Reorganization Alter Ego

The residual, non-reorganization recharacterization of a reincorporation is as an alter ego rather than a party to a reorganization. It is this residual category that we suggest should be either eliminated or reduced to near elimination as the type D and F reorganizations are properly defined.

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58 Although the legislative history speaks of “a single operating corporation,” presumably this was meant to preclude the combination of two operating corporations and not to exclude a holding company that does not “operate” “in the active sense from engaging in a type F reorganization. See H.R. Rep. No. 97-760, 2d Sess. at 541 (1982).
60 See, e.g., PLR 200129024 (July 23, 2001) (where many changes occurred in a corporate chain, but the transfer of some assets by a holding company to a new corporation was treated as a type F reorganization).
The prevailing view is that a liquidation can be recharacterized as an incomplete liquidation that is not a reorganization where the surviving corporation has sufficient continuing business assets and shareholder ownership that it may be viewed as an alter ego of the liquidated corporation. This is based on the TASCO opinion, discussed further below, and appears in Rev. Proc. 2007-3. However, the appropriateness of this treatment is subject to question, and ripe for reevaluation.

The underpinnings of the alter ego doctrine are shaky. The reference in Regulation section 1.331-1 to section 301 does not prove that the Regulation contemplates an alter ego surviving a formal liquidation because Regulation section 1.301-1(l) contemplates the possibility of a section 301 distribution occurring in conjunction with, but separate from, a reorganization:

This is most likely to occur in the case of a recapitalization, a reincorporation, or a merger of a corporation with a newly organized corporation having substantially no property.

Similarly, the Regulation’s reference to section 356 is inconclusive because it may simply recognize that the reorganization rules can trump the liquidation rules. Alternately it could refer to a recapitalization that necessarily will be involved.

However, the potential for an alter ego transaction is implied by the legislative history of the 1984 change in the definition of the type D reorganization. Many liquidation-reincorporation cases could not be treated as type D reorganizations until 1984 due to the requirement of 80% control of the transferee corporation by the liquidating corporation’s shareholders, along with a transfer of “substantially all” of the assets. When Congress reduced the control test to 50%, it stated in the Conference Report that it intended the Service to use this change to prevent shareholders from bailing out corporate earnings at capital gains rates. The Conference Report also stated:

For example, it is not intended that this provision supersede or otherwise replace the various doctrines that have been developed by the Service and the courts to deal with such transactions.

The only such authority suggesting a non-reorganization route to recharacterizing a formal liquidation is TASCO. It is weak authority, both because it involved prior section 337, and because it reflected an era when it was harder for the

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63 The case has generated considerable confusion, but seems to represent a de facto reorganization on account of substantial overlapping ownership and reincorporation of the important operating business assets, notwithstanding that the statutory requirements for a reorganization would not be met. It has occasioned a lot of dancing around to avoid its reach. See infra note 53.

64 See Rev. Rul. 61-156, 1961-2 C.B. 62 (ruling a sale of assets to be both a type F and type E reorganization).


66 Rev. Rul. 76-429, 1976-2 C.B. 97, reached a similar result in a post-liquidation reincorporation case, without citing TASCO, perhaps because the appeal was then pending.
Service to find a type D reorganization due to the 80% control requirement. As pointed out by the dissent, the case did not address the classic bail-out of corporate earnings at capital gains rates that usually motivates Service attacks on a formal liquidation. Rather, it involved the application of prior section 337 to allow a liquidating corporation to avoid recognition of gain on sale of property within 12 months preceding its complete liquidation. In that setting the court’s opinion found no complete liquidation for section 337 purposes, but also stated:

We emphasize that we are dealing herein with the question of nonrecognition of gain at the corporate level and not with the tax consequences of the transactions at the shareholder level; in view of the complexities involved in determining those consequences, under a variety of permutations and combinations, it is conceivable that they might be subjected to a different analysis.  

Moreover, Judge Tannenwald, for the majority, did not literally say that the case could not be a reorganization (although the dissent did).

Of course, section 337 as it was then no longer exists. It could be argued that TASCO is no longer relevant, but that argument is weakened by the uniform concept of corporate liquidation in the same manner throughout Subchapter C. In practice, the repeal of the General Utilities doctrine makes defense of the liquidation regime less important, but in theory it remains important. Our objective is to rationalize the law and reduce the in terrorem effect of a nonliquidation approach that is much less important in a rationalized view of reorganizations.

It also could be argued that the possibility of a non-reorganization alter ego path to recharacterizing a formal liquidation is cast in some doubt by an early Supreme Court decision, which treated a clear reincorporation as taxable in the absence of qualification as a reorganization.  

Although the authorities do not provide a clear ground for rejecting the alter ego reincorporation, it is normally preferable to apply a specific rule to the exclusion of a general doctrine, where the specific rule exists. Here two constructs exist and one, the type F reorganization, actually describes a transaction that involves the formation of an alter ego. The Service’s willingness to not step together other events with a type F reorganization means that the type F definition actually may be to that extent broader in scope than general alter ego analysis. When a transaction cannot be a type F reorganization because the acquirer is not a Newco, 

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67 TASCO, 63 T.C. at n.4 (majority opinion).
68 Marr v. United States, 268 U.S. 536 (1925). Marr required a General Motors preferred and common shareholder to recognize gain or loss on the reincorporation of GM from New Jersey to Delaware. Among other things, the opinion stated: “The new corporation is essentially different from the old. A corporation organized under the laws of Delaware does not have the same rights and powers as one organized under the laws of New Jersey. Because of these inherent differences in rights and powers, both the preferred and the common stock of the old corporation is an essentially different thing from stock of the same general kind in the new.” The opinion went on, however, to describe how the equity structure of the corporation also had slightly changed, rendering the stock interests received not economically identical to those given up. See also TAM 9644033 (July 30, 1996).
then, if substantially all of the target’s assets are so transferred, and subject to the stock receipt requirement and meaningless gesture analysis, the case may be a type D reorganization. If neither applies, then the question is whether any further “defense” of the liquidation concept is needed, and, if so, what the description of such a nonliquidation rule would be.\(^{69}\)

Rev. Proc. 2007-3, §4.01(23), says that the Service ordinarily will not issue a ruling on the tax effect of a liquidation followed or preceded by a transfer of all or part of the business assets to another corporation that is an “alter ego” of the liquidating corporation and which is directly or indirectly owned more than 20% in value by persons owning more than 20% of the liquidating corporation’s stock.\(^{70}\) This is an inadequate description of the problematic cases. The Rev. Proc. does not define “alter ego.”

At one time the Service indicated an alter ego could only be a new corporation,\(^{71}\) but whether that is still its view is unclear. Although a corporation with no tax history understandably is consistent with the alter ego concept, as a matter of policy it may not always make sense to say that a pre-existing corporation is not an alter ego or successor when it is controlled by the shareholder of the target that transferred assets to it.

The Service recently ruled that a cross-chain sale of all of a corporation’s assets was a sale (and not a reorganization) because no stock was paid\(^{72}\) and stock payment would not have been a “meaningless gesture.”\(^{73}\) The Service did not treat acquirer as the alter ego or successor of the target even though there was more than 20% common ownership.

We believe the alter ego/nonliquidation concept should be revisited in light of the diminished room for abuse considering the broad concept of share ownership in a type D reorganization, as discussed above, and the enhanced scope of a type F reorganization as reflected in Rev. Rul. 96-29 and the proposed regulations. For example, in cases in which the “substantially all” requirement is met, potentially abusive transactions should be limited to where there is 50% ownership continuity in the successor entity, which is the scope of type D reorganizations. The type F reorganization will pick up many cases in which “substantially all” is not met, but, importantly, not where, for example, the successor corporation is a pre-existing corporation or where it simultaneously issues shares for property to a non-historic shareholder.

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\(^{69}\) Some cases reject the non-reorganization alter ego approach on the basis of continuity concerns: if there is not sufficient continuity for a reorganization, there should not be sufficient continuity for an alter ego approach. See Berghash v. Commissioner, 43 T.C. 743 (1965), aff’d, 361 F.2d 257 (2d Cir. 1966); Breech v. Commissioner, 439 F.2d 409 (9th Cir. 1971), aff’d 22 AFTR 2d 5663 (C.D. Cal. 1968).


\(^{71}\) See TAM 9049001 (Aug. 7, 1990).

\(^{72}\) Note that, even though continuity exists, the transactions also would not be a type D reorganization under our proposal because we do not abandon the stock receipt requirement.

\(^{73}\) PLR 200551018 (Dec. 23, 2005). A and B each owned half of the target and B and C owned acquirer in the ratio of 90:10.
It is not clear to us that under current law the abuse potential in those remaining cases warrants the invocation of a nonliquidation doctrine. Consider Example 1, which we have discussed above in section B.1. At least if there is no common control of both corporations, we do not think the doctrine should be applied on those facts.

Consider two additional examples.

**Example 5.** X sells 80% of its assets to a third party and, pursuant to the same plan, sells its remaining assets to a pre-existing sister company, Y, for cash and liquidates, distributing all of the cash. Alternatively, the remaining assets are distributed pursuant to the plan of liquidation and transferred by the common shareholder to Y for shares. Alternatively, the remaining assets are transferred by the common shareholder to a new company for 95% of its shares, in which 5% of its shares are simultaneously issued to a related or unrelated party for cash. In this case, the transaction again does not qualify as a type D or type F reorganization. While the liquidation would avoid dividend treatment on the cash proceeds of the sale of 80% of its assets, it generally would result in recognition of any gain at the corporate and shareholder level in respect of all of the assets.

**Example 6.** X sells all of its assets and distributes the proceeds in liquidation. One day later, it contributes 30% of the cash to a pre-existing corporation to commence a similar business. In this case, the transaction would not be a type D or type F reorganization. While the liquidation would avoid dividend treatment in respect of the 70% cash not reincorporated, it generally would result in full recognition of any gain at the shareholder level (as well as at the corporate level).

We acknowledge there is to some extent electivity between the tax results of a liquidation and reincorporation as opposed to a nonliquidation, and that, to the extent tax considerations would control this generally would be exercised against the fisc. On balance, however, we believe that the reasons for retaining an alter ego or nonliquidation doctrine under today’s tax law are, in general, not compelling. We do not believe the tax policy of having the second level tax be as a dividend rather than gain retains such a level of vitality as to justify the uncertainty generated by doctrines of this sort. The analysis might be different for inbound cross-border situations, in which the shareholder-level gain generally would not be taxed; but even in that context, a number of recent income tax treaties have provided for no withholding tax on dividends from 80% (or in one case 50%) controlled subsidiaries.