Treasury Issues Final Regulations on F Reorganizations; Overlap Issues Clarified

Tax Alert
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On September 18, 2015, the Treasury Department (Treasury) and the Internal Revenue Service (IRS) finalized regulations addressing the qualification of a transaction as a corporate reorganization under section 368(a)(1)(F) (an “F reorganization”). The final regulations retain the four requirements articulated in the 2004 proposed regulations, with some clarifications, and impose two additional requirements to address situations in which a potential F reorganization “overlaps” with other nonrecognition provisions. These final regulations apply to transactions occurring on or after September 21, 2015, the date the regulations were published in the Federal Register.

Treasury and IRS also finalized, without substantive change, longstanding temporary regulations under section 367(a) that address outbound F reorganizations in which the transferor corporation is domestic and the resulting corporation is foreign. These final regulations retain the original effective dates from the temporary regulations published in 1990.

Background

The reorganization provisions of the Code permit certain transactions to occur without the recognition of gain or loss, provided that the transactions are required by business exigencies and effect only a readjustment of continuing interests in property under modified corporate forms. Section 368(a)(1)(F) provides that a “reorganization” includes a “mere change in identity, form, or place of organization of one corporation, however effected.”

2004 Proposed Regulations Expanded to Address Overlap with Nonrecognition Provisions

In August 2004, Treasury and IRS proposed regulations articulating four requirements for a transaction to qualify as an F reorganization. The final regulations clarify the original four requirements and impose several additional conditions. The regulations also clarify which steps in a multi-step transaction are to be considered when determining whether the six F reorganization requirements have been satisfied. Subject to limited exceptions, a potential F reorganization must satisfy the following six requirements to qualify as an F reorganization:

1. Immediately after the potential F reorganization, all of the stock of the resulting corporation must have been distributed (or deemed to have been distributed) in exchange for stock of the transferor corporation.

2. The same person or persons must own all the stock of the transferor corporation and the resulting corporation at the beginning and end of the potential F reorganization, in identical proportions. Exchanges of stock in the transferor corporation for stock in the resulting corporation with equivalent value, but different terms, will not disqualify the F reorganization.

3. The resulting corporation cannot hold property or possess any tax attributes immediately before the potential F reorganization.

4. As part of the potential F reorganization, the transferor corporation must completely liquidate for federal income tax (but
The fifth and sixth requirements were added to eliminate uncertainty when a potential F reorganization overlapped with other nonrecognition provisions. For example, under the 2004 proposed regulations, it was possible for a transaction to qualify as an F reorganization while simultaneously qualifying as a complete liquidation under sections 332 and 337, or as an upstream reorganization under section 368(a)(1)(C). The preamble to the final regulations concludes that this “overlap” created “uncertainty as to which corporation should succeed to [the transferor corporation’s] tax attributes.” To eliminate the possibility that multiple corporations would have a claim to the transferor’s tax attributes, the fifth requirement of Treas. Reg. § 1.368-2(m)(1) now mandates that, immediately after a potential F reorganization, only the resulting corporation can hold property of the transferor. Similarly, if more than one corporation transfers property to the resulting corporation, the transaction will not qualify as an F reorganization.

To address these overlap cases, the final regulations also add a new subparagraph, Treas. Reg. § 1.368-2(m)(3)(iv). If a potential F reorganization would qualify as both an F reorganization and an A, C or D reorganization, then the transaction qualifies only as an F reorganization. This clarifies prior inconsistent administrative guidance. However, if the potential F reorganization or a step thereof qualifies as a reorganization or part of a reorganization under another provision of section 368(a)(1), and the corporation in control of the resulting corporation is a party to such other reorganization, the potential F reorganization will not qualify as an F reorganization.

The final regulations include several examples to illustrate these overlap rules, which demonstrate that the statutory language “however effected” is not so broad as to encompass transactions that are subject to Treas. Reg. § 1.368-2(k) that are completed reorganizations under a paragraph other than section 368(a)(1)(F). Among these examples are reminders that, in subchapter C, form continues to matter.

**F Reorganizations Remain in the “Bubble”**

The 2004 proposed regulations endorsed the concept implicit in earlier guidance that related events preceding, accompanying or following a potential F reorganization generally will not cause a potential F reorganization to fail to qualify as a reorganization under section 368(a)(1)(F). Among commentators, this principle has been referred to as F reorganizations occurring within a “bubble.” The final regulations retain this provision, but caution that step transaction principles still apply to the related events that precede, accompany or follow the F reorganization. The final regulations also clarify that the steps within the “bubble” commence with the actual or deemed transfer of assets to the resulting corporation and end when the transferor corporation distributes (actual or deemed) the consideration received from the resulting corporation and liquidates for federal income tax purposes.

**Reassignment of Employer Identification Numbers (EINs) Remains Unresolved**

The regulation package does not resolve the question of which entity is entitled to the EIN of the transferor corporation in situations where the transferor corporation does not liquidate for state law purposes. The preamble indicates that Treasury and IRS continue to study the issue and invites taxpayers to submit comments.
Guidance on Outbound F Reorganizations is Finalized Without Substantive Change

The final regulations under section 367(a) retain the rules from the 1990 Temporary Regulations. Those regulations specify that outbound F reorganizations are treated as resulting in an actual or constructive transfer of assets and an exchange of stock. Specifically, in an outbound F reorganization:

1. The domestic transferor corporation is deemed to transfer its assets to the acquiring foreign corporation under section 361(a) in exchange for stock of the acquiring corporation (and the assumption of liabilities);

2. The transferor corporation is deemed to distribute the stock of the acquiring corporation to the shareholders of transferor; and

3. The shareholders of the transferor corporation are deemed to exchange their stock in the transferor for stock of the acquiring corporation under section 354(a).

The regulations deem such transactions to occur regardless of whether foreign or domestic law treats the acquiring corporation as a continuance of the transferor corporation. The taxable year of the transferor domestic corporation closes on the date of the reorganization.

1. The final regulations allow the resulting corporation to issue a de minimis amount of stock to satisfy corporate law requirements the state of incorporation. The corporation is also permitted to recapitalize its stock, redeem stock or make distributions to shareholders in conjunction with the F reorganization.

2. The requirement is not violated if the resulting corporation holds de minimis assets to satisfy local law requirements or holds proceeds from a loan incurred in connection with the potential F reorganization.

3. If there is a potential for multiple claimants for tax attributes of the transferor corporation, the transaction will not qualify as an F reorganization.


9. Compare Treas. Reg. §1.368-2(m)(X), Ex. 11 with Ex. 12. The only difference in these two examples is the order of the two LLC conversions. In one case, the transaction results in an F reorganization, and in another case the transaction results in an upstream C reorganization followed by a drop down of assets under section 368(a)(2)(C) and Treas. Reg. §1.368-20).

10. See, e.g., Rev. Rul. 2003-48, 2003-1 C.B. 863 (subsequent transfer of stock did not prevent transaction from qualifying as F reorganization); Rev. Rul. 96-29, 1996-1 C.B. 50 (merger of corporation with corporation created in another state is an F reorganization even though it was a step in a larger transaction).


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