Final, Final Regs on Post-Reorganization Transfers

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Just in time for the American Bar Association Tax Section meeting in Washington D.C., the IRS on May 8, 2008, issued final regulations correcting and clarifying previously issued final regulations dealing with post-reorganization stock and assets transfers. Final regulations were published in October 2007, T.D. 9361, Tax Analysts Document 2007-23670, 2007 T.N.T. 2007-4, Cot. 24, 2007. The latest iteration comes in T.D. 9396, Tax Analysts Document 2008-10175, 2008 T.N.T. 91-10, May 8, 2008.

At its root, these two treasury decisions underscore the notion that one must evaluate the totality of a transaction. In particular, you must survey this broad landscape in determining whether a qualified reorganization occurs. One niche of the regulations—specifically Reg. §1.368-2(k)—says that a transaction otherwise qualifying as a reorganization will not be disqualified as a result of certain subsequent transfer of assets or stock. As in effect before the May 2008 change, this Reg. provision generally permitted one or more post-reorganization transfers (or successive transfers) of assets or stock.

Key to allowing such transfers: the continuity of business enterprise requirement must be satisfied. Plus, the transfer(s) must qualify as distributions or other transfers. The definition of "distributions" appears in Reg. §1.368-2(k)(1)(i); the definition of "other transfers" appears in Reg. §1.368-2(k)(1)(ii).

Latest Clarification

T.D. 9396 amends this rule to clarify that a transfer to the former shareholders of the acquired corporation (other than a former shareholder who is also the acquiring corporation) or the surviving corporation is not covered by Reg. §1.368-2(k)(1) to the extent it constitutes the receipt of consideration for the shareholders' proprietary interests in the acquired corporation or the surviving corporation.

After all, a transfer to former shareholders following an intended tax-free reorganization raises the question whether the underlying transaction actually satisfies continuity of interest. For that matter, questions about permissible consideration (such as the solely for voting stock requirement) can also be raised. To avoid this foot fault, one must examine whether the transfers to former shareholders do or do not constitute consideration for their proprietary interests in the acquired or surviving corporation.

Although the regulations continue to provide safe harbor protection to certain upstream reorganizations followed by a transfer of acquired assets, some caution is needed here. Safe harbor protection does not apply to a transfer by former shareholders of the acquired corporation (other than a former shareholder that is also the acquiring corporation) or to the surviving corporation of consideration to the issuing corporation, or to a person related to the issuing corporation. [*See* Reg. §1.368-2(k)(1).]

Although there is no question that these regulations were intended to liberalize the stock and/or asset transfers taxpayers could make following a reorganization without spoiling the reorganization treatment, the May 2008 clarification of these final regulations cuts back somewhat on this theme.

Conclusion

There's no substitute for wading through the nuances of these rules. Since fear over amorphous doctrines (such as step transaction) can be palpable, anytime you can fit within a safe harbor to avoid such threats, you should do so.

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