

Department  
of the  
Treasury

Internal  
Revenue  
Service

Office of  
Chief Counsel

**Notice**

N(35)000-148

July 23, 1997

Issues Arising Under  
**Subject:** I.R.C. § 368

**Cancellation Date:** October 21, 1997

The purpose of this Notice is to request all District Counsel and Regional Counsel attorneys to notify the Chief, Corporate Branch, Office of the Assistant Chief Counsel (Field Service), of any cases involving whether the continuity of interest requirement or continuity of business enterprise (COBE) requirement under Treas. Reg. § 1.368-1(b) is violated as a result of transfers of stock or assets acquired in a purported reorganization to subsidiaries or partnerships. These issues are significant and thus are subject to the notification procedures described in Chief Counsel Notice N(35)000-139(a), issued September 24, 1996. These issues will be added to the list of significant issues requiring National Office notification when that list is next updated.

The Internal Revenue Code of 1986 provides general nonrecognition treatment for reorganizations specifically described in section 368. In addition to complying with the statutory requirements, a transaction must satisfy the continuity of interest and COBE requirements to receive nonrecognition treatment.

#### Continuity of Interest Requirement

The Supreme Court, in Groman v. Commissioner, 302 U.S. 82 (1937), and Helvering v. Bashford, 302 U.S. 454 (1938), established what has become known as the "remote continuity of interest doctrine." In Groman, the Court held that continuity of interest did not exist to the extent that the selling shareholders received stock of the acquiring corporation's parent in exchange for their target corporation stock. In Bashford, the Court held that continuity of interest did not exist where, as part of a plan, target properties were acquired by a parent corporation and transferred to a wholly owned subsidiary. In both cases, the Court held that the parent corporation was not a party to the reorganization, and receipt of parent stock by the target's shareholders gave rise to taxable gain.

---

Filing Instructions: Binder Part (35) Master Sets: NO X RO X  
NO: Circulate    Distribute X to: All Personnel    Attorneys X In: all divisions  
RO: Circulate    Distribute X to: All Personnel    Attorneys X In: all divisions  
Other National and Regional FOIA Reading Rooms  
Electronic Filename: IRC368.wpd Original signed copy in: CC:F&M:PA

Congress enacted numerous provisions ameliorating the result of Groman and Bashford. See I.R.C. §§ 368(a)(2)(C), 368(a)(2)(D), 368(a)(2)(E), and the parenthetical provisions of I.R.C. §§ 368(a)(1)(B) and 368(a)(1)(C). In this regard, section 368(a)(2)(C) provides that a transaction, otherwise qualifying under certain reorganization provisions, will not be disqualified by reason of the fact that part or all of the acquired assets or stock are transferred to a corporation controlled by the acquiring corporation. Rev. Rul. 64-73, 1964-1 (Part 1) C.B. 142, holds that a transfer of acquired assets to a second tier wholly owned subsidiary satisfies the continuity of interest requirement.

On January 3, 1997, the Internal Revenue Service published a notice of proposed rulemaking dealing with issues arising under the remote continuity of interest doctrine. The proposed regulations provide that, in a transaction otherwise qualifying under certain reorganization provisions, continuity of interest will not be violated by transfers of target assets or stock among members of a qualified group,<sup>1</sup> and under certain conditions, transfers of target assets to a partnership. See 62 Fed. Reg. 361 (1997) (proposed Jan. 3, 1997).

#### Continuity of Business Enterprise Requirement

In order for a transaction to qualify as a reorganization, Treas. Reg. § 1.368-1(b) requires the acquiring corporation to continue a significant line of the target's historic business or use a significant portion of the target's historic operating business assets in a business.

The notice of proposed rulemaking provides that, for certain reorganizations, transfers or successive transfers of the target corporation's assets or stock among members of a qualified group and, under prescribed conditions, transfers of the target

---

<sup>1</sup> A qualified group is one or more chains of corporations connected through stock ownership with the issuing corporation (generally the acquiring corporation, but in transactions where the stock of a corporation in control of the acquiring corporation is permitted, the issuing corporation is the controlling corporation), where the issuing corporation owns directly stock meeting the requirements of section 368(c), in at least one other corporation, and the stock meeting the requirements of section 368(c), in each of the corporations, is owned directly by one of the other corporations. See Prop. Treas. Reg. § 1.368-1(d)(5)(iii).

corporation's assets to partnerships will not violate the COBE requirement. See 62 Fed. Reg. 361 (1997) (proposed Jan. 3, 1997).

#### Effective Date

The regulations are proposed to apply to transactions occurring after the regulations are published as final regulations in the Federal Register, except that they are proposed to not apply to any transactions occurring pursuant to a written agreement which is (subject to customary conditions) binding on or before the regulations are published as final regulations. As proposed, the regulations would not apply to a transaction that is contracted or started prior to the publication of the final regulations. The proposed regulations are limited to asset or stock transfers that otherwise qualify as section 368(a)(1)(A), (B), (C), or (G) (meeting the requirements of sections 354(b)(1)(A) and (B)) reorganizations.

#### Representative Transactions

Examples of fact patterns in which the issues of continuity of interest requirement and COBE requirement arise are as follows:

(1) Corporation P acquires Target ("T") assets or T stock in a purported reorganization in which the former T shareholders receive P stock. Then, the T assets or T stock are transferred to certain controlled corporations (remote subsidiaries of P) or to a partnership in exchange for a partnership interest.

(2) T merges into corporation X, and the former T shareholders receive stock of the corporation controlling X ("P") in exchange for their T stock in a purported reorganization. P transfers the X stock (or X transfers the T assets) to one or more of P's remote subsidiaries, or to a partnership in exchange for a partnership interest.

If you are assisting a revenue agent or appeals officer with a case in which there are transfers of stock or assets, which were acquired in a purported reorganization, to a partnership or subsidiary (other than a first tier subsidiary of the acquiring corporation), please notify Alfred C. Bishop, Jr., Chief, Corporate Branch, Field Service Division, immediately at (202) 622-7930. Information regarding these cases will help the office ensure that the parties to the transaction consistently report their tax position. Information regarding these cases will also facilitate the office's study of the role of the remote continuity of interest and COBE doctrines as they pertain to sections 368(a)(1)(F), 368(a)(1)(D) and 355. National Office

advice should be sought where the taxpayer adopts the rules of the proposed regulations to a transaction contracted or started prior to the effective date of the final regulations.

\_\_\_\_\_/s/\_\_\_\_\_  
JUDITH C. DUNN  
Associate Chief Counsel  
(Domestic)