Part I

Section 368(a)(1)(A). - - Definitions relating to corporate reorganizations

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Rev. Rul. 2000-5

ISSUES:

Whether a transaction in which (1) a target corporation "merges" under state law with and into an acquiring corporation and the target corporation does not go out of existence, or (2) a target corporation "merges" under state law with and into two or more acquiring corporations and the target corporation goes out of existence, qualifies as a reorganization under § 368(a)(1)(A) of the Internal Revenue Code?

FACTS:

Situation (1). A target corporation transfers some of its assets and liabilities to an acquiring corporation, retains the remainder of its assets and liabilities, and remains in existence following the transaction. The target corporation's shareholders receive stock in the acquiring corporation in exchange for part of their target corporation stock and they retain their remaining target corporation stock. The transaction qualifies as a merger under state X corporate law.

Situation (2). A target corporation transfers some of its assets and liabilities to each of two acquiring corporations. The target corporation liquidates and the target corporation's shareholders receive stock in each of the two acquiring corporations in exchange for their target corporation stock. The transaction qualifies as a merger under state X corporate law.

DISCUSSION:

The purpose of the reorganization provisions of the Code is to provide tax-free treatment to certain exchanges incident to readjustments of corporate structures made in one of the specified ways described in the Code. Section 1.368-1(b) of the Income Tax Regulations. In 1921, Congress defined a reorganization as including ". . . a merger or consolidation (including the acquisition by one corporation . . . of substantially all the properties of another corporation)." In 1934, Congress separated this rule into two distinct provisions. In the predecessor of current § 368(a)(1)(C), an "acquisition by one corporation . . . of substantially all the properties of another corporation" continued to be a reorganization where payment was effectuated with the acquiror's voting stock. In the predecessor of current § 368(a)(1)(A), the terms "merger or consolidation" were qualified by requiring that they be "statutory" mergers and consolidations. The word "statutory" was added to the definition of a reorganization so that the definition " will conform more closely to the general requirements of [state] corporation law." See H. R. Rep. No. 704, 73d Cong., 2d Sess. 14 (1934).

Historically, corporate law merger statutes have operated to ensure that "[a] merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist, and the merging corporation alone survives." Cortland Specialty Co. v. Commissioner, 60 F.2d 937, 939 (2d Cir. 1932), cert. denied, 288 U.S. 599 (1933); for other cases that describe mergers as requiring that the target corporation transfer its assets and cease to exist, see, e.g., Vulcan Materials Company v. U.S., 446 F.2d 690, 694 (5th Cir. 1971), cert. denied, 404 U.S. 942 (1971); Fisher v. Commissioner, 108 F.2d 707, 709 (6th Cir. 1939), cert. denied, 310 U.S. 627 (1939). Thus, unlike § 368(a)(1)(C), in which Congress included a "substantially all the properties" requirement, it was not necessary for Congress to explicitly include a similar requirement in § 368(a)(1)(A) because corporate law merger statutes contemplated an acquisition of the target corporation's assets by the surviving corporation by operation of law.

Compliance with a corporate law merger statute does not by itself qualify a transaction as a reorganization. See, e.g., Southwest Natural Gas Co. v. Commissioner, 189 F.2d 332 (5th Cir. 1951), cert. denied, 342 U.S. 860 (1951) (holding that a state law merger was not a reorganization under § 368(a)(1)(A)); Roebling v. Commissioner, 143 F.2d 810 (3d Cir. 1944), cert. denied, 323 U.S. 773 (1944) (same holding). In addition to satisfying the requirements of business purpose, continuity of business enterprise and continuity of interest, in order to qualify as a reorganization under § 368(a)(1)(A), a transaction effectuated under a corporate law merger statute must have the result that one corporation acquires the assets of the target corporation by operation of the corporate law merger statute and the target corporation ceases to exist. The transactions described in Situations (1) and (2) do not have the result that one corporation acquires the assets of the target corporation by operation of the corporate law merger statute and the target corporation ceases to exist. Therefore, these transactions do not qualify as reorganizations under § 368(a)(1)(A).

In contrast with the operation of corporate law merger statutes, a divisive transaction is one in which a corporation's assets are divided among two or more corporations. Section 355 provides tax-free treatment for certain divisive transactions, but only if a number of specific requirements are satisfied. Congress intended that § 355 be the sole means under which divisive transactions will be afforded tax-free status and, thus, specifically required the liquidation of the acquired corporation in reorganizations under both §§ 368(a)(1)(C) and 368(a)(1)(D) in order to prevent these reorganizations from being used in divisive transactions that did not satisfy § 355. See S. Rep. No. 1622, 83d Cong., 2d Sess. 274 (1954); S. Rep. No. 169, 98th Cong., 2d Sess. 204 (1984). No specific liquidation requirement was necessary for statutory mergers because corporate law merger statutes contemplated that only one corporation survived a merger. The transaction described in Situation (1) is divisive because, after the transaction, the target corporation's assets and liabilities are held by both the target corporation and acquiring corporation and the target corporation's shareholders hold stock in both the target corporation and acquiring corporation. The transaction described in Situation (2) is divisive because, after the transaction, the target corporation's assets and liabilities are held by each of the two acquiring corporations and the target corporation's shareholders hold stock in each of the two acquiring corporations.

HOLDING:

The transactions described in Situations (1) and (2) do not qualify as reorganizations under § 368(a)(1)(A). However, the transactions described in Situations (1) and (2) possibly may qualify for tax-free treatment under other provisions of the Code.

DRAFTING INFORMATION:

The principal author of this revenue ruling is Reginald Mombrun of the Office of the Assistant Chief Counsel (Corporate). For further information regarding this revenue ruling, contact Reginald Mombrun on (202) 622-7750 (not a toll-free call).