

LESSON 9

Introduction to Corporate Reorganizations

[Note: This lesson should be considered optional in all courses.]

GENERAL COMMENTS: Teachers will have widely varying preferences about whether and how to introduce reorganizations and how extensive the coverage of this complex subject should be. The suggested aim of this lesson is to acquaint the student with (1) the sorts of exchanges that can be classified as reorganizations; (2) the general issues surrounding the area; and (3) the statutory mechanics of what happens to whom and when. Those of you who want (or need because of time constraints) to give the reorganizations topic a lighter touch may choose to use this lesson, together with Lessons 10 and 11 on Types A, B, and C reorganizations, as your "coverage package" for this topic.

As a vehicle for illustrating why reorganization is an identifiable event that should be exempt from § 1001(c) (but burdened with the carryover basis corollary), consider discussing the two *Gregory* opinions. While *Gregory* involves step transactions and business purpose/tax avoidance issues, it also contrasts the cash-out transaction to the reorganization. Consider an overview of the typical fact patterns in the current statutory parsings of reorganization (and the related animal, § 355), §§ 368(a)(1)(A) through 368(a)(1)(G); B&E ¶¶ 12.02, 12.20.

Under the heading of ancillary matters, consider discussing generally (1) the "soft" doctrines that overlay the statute—STD, business purpose, business continuity, continuity of proprietary interest (which is dealt with in depth in Lesson 11, Part A); and (2) "comfort rulings" (now unavailable in many reorganization areas) and ruling guidelines. B&E ¶¶ 12.01, 12.03, 12.21, 12.61.

(1) Section 1031(a)(2)(B) has always excluded stock swaps. A Type B reorganization, however, could work. An installment sale can be a surrogate for a reorganization, but "readily tradeable debt" does not qualify for deferral. IRC § 453(f)(4). *Y* may not be

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willing to give \$150,000 in stock value for the land or T stock in a reorganization because of the carryover basis corollary and the built-in gain in the land.

(2) First, diagram Dispositions Nos. 1, 2, and 3 in the typical Type C reorganization. In acquisitive and divisive reorganizations, it is helpful to start with the transfer of the Target's assets, because that literally is the reorganization transaction in those cases.

(2)(a) *T* exchanges its property with *Y* solely for *Y* stock, realizing \$70,000 gain but recognizing nothing under § 361(a). Discuss "party to a reorganization" and "plan of reorganization" and why this is a Type C reorganization under § 368(a)(1)(C). Even though *Y* will not continue the theatre business, *Y* will use the asset in a business and so business continuity is present. Regs. § 1.368-1(d)(4); B&E ¶¶ 12.21[10], 12.40, 12.42, 12.61[2].

Alternative: If *T* also received (some, but not too much, as here) boot, *T* will not recognize any gain under § 361(b)(1)(A) because it distributes the boot in the liquidation as required by § 368(a)(2)(G). The Type C reorganization status is protected by § 368(a)(2)(B) here.

(2)(b) *T*'s basis in the *Y* stock acquired is \$60,000 under § 358(a)(1). Upon its distribution to *A* in liquidation, *T* again realizes gain (probably \$70,000 under § 336(a)), but recognizes nothing under §§ 336(c) and 361(c). B&E ¶ 12.42[2].

(2)(c) *A* realizes \$80,000 gain and recognizes nothing, because of § 354. *A* takes a § 358(a)(1) substituted basis of \$50,000 in the *Y* stock. B&E ¶ 12.44[3].

Alternative: If *A* also received \$1,000 in cash in lieu of an equivalent value of *Y* stock, § 354 would not apply since *A* did not exchange "solely" for stock or securities. Section 354(a)(3) sends us to § 356, which requires that *A* recognize his gain to the extent of the boot, \$1,000. In that case, *A*'s basis in the stock will still be \$50,000 under § 358(a)(1). B&E ¶ 12.44[1].

(2)(d) Under § 1032, *Y* recognizes no gain or loss on the transfer of its stock, and *Y*'s cost in treasury stock is irrelevant. B&E ¶ 12.43[1].

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(2)(e) *Y* takes a transferred basis from *T* of \$60,000 under § 362(b). B&E ¶ 12.43[2]. Note that the “payment” of an additional \$1,000 cash does not increase *Y*’s basis in the land because that payment did not produce any recognized gain at the *T* corporate level. IRC § 362(b).

(2)(f) *T*’s tax attributes carry over to *Y* under § 381(a)(2). Note that the end result is that the corporate-level gain potential is preserved within *Y* and the shareholder-level gain potential is preserved in the *Y* stock in *A*’s hands, to the extent not recognized by *A* because of the \$1,000 boot.

(3) This transaction could be a merger of *T* into *Y*, qualifying as a Type A reorganization. In a merger, the same steps are deemed to occur as in a Type C reorganization, even though *T* does not literally receive the *Y* stock, distributing it to *A* in liquidation. B&E ¶ 12.42[5].

(4) There would, of course, be no Disposition Nos. 1 and 2. In Disposition No. 3, directly between *Y* and *A*, *A* recognizes no gain, because of § 354 and takes a \$50,000 basis in the *Y* stock under § 358(a)(1). *Y* takes a \$50,000 basis in the *T* stock under § 362(b), and *T*’s asset basis remains unchanged, as do *T*’s tax attributes, although § 382 can apply.

(5) If *A* had just incorporated *T* hoping to string together a tax-free § 351 exchange and a tax-free Type B reorganization for publicly traded stock, *A* should fail under the approach of *West Coast Marketing* if the STD applies to “link” these two transactions. This case was also assigned in Lesson 3A. It is not a vocabulary case, but simply a helpful reminder of the STD risk in this area.

(6) Section 1036 somewhat anomalously provides tax free treatment for the exchange of common stock for common stock or preferred for preferred, regardless of whether § 368 is satisfied.