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The Amalgamating Reorganization Provisions: The Asymmetry in Treatment of Forward and Reverse Triangular Mergers and Other Problems

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COMMENT

THE AMALGAMATING REORGANIZATION PROVISIONS: THE ASYMMETRY IN TREATMENT OF FORWARD AND REVERSE TRIANGULAR MERGERS AND OTHER PROBLEMS

> There is something wrong with provisions which remain so obscure, in spite of filigree detail in the statute and the regulations, that hardly any prediction as to their meaning can be made without the feeling that it is little better than a dignified guess.[1]

I. INTRODUCTION

A corporation is a separate entity which is required to file returns and pay income taxes in a way similar to that required of individual taxpayers.[2] The gross income of both corporations and individuals is determined under Internal Revenue Code (hereinafter "the Code") Section 61.[3] However, choosing to do business in the corporate form carries with it the disadvantage of incurring double taxation of distributed earnings.[4] More specifically, a corporation must pay taxes not only on its own net income, but its shareholders must also pay tax on the distribution of the corporation's after-tax earnings.[5]

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1. RANDOLPH E. PAUL, STUDIES IN FEDERAL TAXATION, Third Series 164 (1940).
2. *See* CEB, TAX PLANNING FOR S CORPORATIONS UNDER THE NEW RULES, program handbook at 8-9, January 1991.
3. I.R.C. § 61.
4. CEB, *supra* note 2, at 1.
5. *Id.* at 8-9.

One of the fundamental principles of tax law is that unrealized appreciation in the value of property should be taxed only when the property is sold or otherwise transferred.[6] If there is an exchange of property for money or other property, a taxable event occurs if the property received materially difffers from the property transferred.[7] Recognizing that mere changes in the form of corporate holdings should not trigger the recognition of unrealized gain, Congress enacted a statute in 1918 which makes an exchange of stock or securities for other stock or securities tax-free if made in connection with a "reorganization, merger or consolidation."[8]

Today, special rules may apply when a corporation sells its assets, or when its shareholders exchange their stock for the stock of another corporation. Provided certain requirements are satisfied, the transaction can be accomplished tax-free to all the involved parties.[9] Following the transaction, a selling shareholder's investment continues to be represented by shares of stock; however, such shares constitute interest in a different corporation.[10] Thus, a reorganization may provide the opportunity for a shareholder to change the substance of an investment in a tax-free manner.[11]

Unfortunately, the complex and varied reorganization definitions have proven to be a formidable barrier to achieving tax equipoise within the Code. The current reorganization principles vary from provision to provision, seemingly without rhyme or reason.[12] No sound tax policy justifies the disparate

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6. I.R.C. § 1001(a).

7. Treas. Reg. § 1.1001-1(a) (1960).

8. Revenue Act of 1918, § 202(b), 40 Stat. 1057, 1060 (1919). Tax Mgmt. (BNA) Portfolios, *Corporate Acquisitions — (A), (B) and (C) Reorganizations*, No. 771 at A-47 (1994).

9. *Id.* The Code provides generally for nonrecognition of gain or loss at both the shareholder level (§§ 354 and 356) and the corporate level (§ 361); any unrecognized gain or loss is reflected in the substituted basis of qualifying property received by the shareholder (§ 362), and is preserved for recognition in a subsequent taxable disposition. P. WEIDENBRUCH, JR. AND K. BURKE, FEDERAL INCOME TAXATION OF CORPORATIONS AND STOCKHOLDERS, at 195 (3rd ed., 1989).

10. CEB, *supra* note 2, at 90.

11. *Id.*

12. *See* ABRAMS AND DOERNBERG, FEDERAL CORPORATE TAXATION, at 233 (3rd ed., 1995). See *infra* Section III entitled "DISCUSSION: THE LACK OF A UNIFYING PRINCIPLE IN THE CURRENT AMALGAMATING REORGANIZATION DEFINITIONS" for ex-

treatment of economically equivalent or near-equivalent corporate acquisition transactions.[13] While tax planning for reorganizations has certainly become a more predictable endeavor in the past decade due to the plethora of illustrative Regulations and Letter Rulings,[14] a need for further clarification and unification of the Code remains.[15]

This comment will discuss the amalgamating reorganizations generally (types A through C as well as some D's)[16] and, specifically, triangular reorganizations.[17] This comment will first provide an overview of the general requirements of the amalgamating reorganization provisions. It will then continue to the following topics: (1) a discussion of the Code's triangular reorganization provisions, giving attention to both forward and reverse triangular mergers;[18] (2) an analysis of the asymmetry in treatment of triangular mergers based on whether they take the form of a forward or reverse triangular merger; (3) an

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amples.

13. *See id.* at 233-234.

14. The term "letter ruling" is most commonly associated with the Internal Revenue Service and the Tax Code; in that context, a "letter ruling is "a written statement issued to a taxpayer or his authorized representative by the National Office which interprets and applies the tax laws to a specific set of facts." 26 C.F.R. Section 601.201(a)(2) (1995). Although a letter ruling may be revoked or modified unless it is accompanied by a "closing agreement," *see* Rev. Proc. 95-1, Section 1.01, 1995-1 I.R.B. 9, 13, any "revocation or modification of a ruling will not be applied retroactively with respect to the taxpayer to whom the ruling was originally issued." 26 C.F.R. Section 601.201(l)(5) (1995). A ruling will not be applied retroactively against the taxpayer to whom the ruling was originally issued so long as: (i) there has been no misstatement or omission of material facts, (ii) the facts subsequently developed are not materially different from the facts on which the ruling was based, (iii) there has been no change in the applicable law, (iv) the ruling was issued with respect to a prospective or proposed transaction, and (v) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to his detriment." *Id.*

15. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 233-234.

16. See *infra* notes 76-163 and accompanying text for a detialed discussion of the amalgamating reorganizations.

17. "Triangular reorganizations" involve the use of a subsidiary to acquire the desired target corporation.

18. A "forward" triangular merger entails a subsidiary corporation acquiring the target corporation in a statutory merger using the parent corporation's stock as consideration. *See* I.R.C. § 368(a)(2)(D). A "reverse" triangular merger occurs when the parent corporation's controlled subsidiary merges into the target corporation; the acquired corporation survives, and its shareholders exchange controlling stock of the acquired corporation for voting stock of the acquiring parent corporation. *See* I.R.C. § 368(a)(2)(E).

exploration of the Congressional desire for tax-parity among the reorganization provisions and an assessment of whether the Service has been complying with legislative intent; and (4) a conclusion that, while the Internal Revenue Service (hereinafter "the Service") has made some positive changes towards the goals of clarification and unification of the Code, tax planners should continue to expect the unexpected.

II. BACKGROUND

A complex assortment of statutory provisions within the Code controls the federal income tax treatment of corporate reorganizations. The term "reorganization"[19] is strictly limited to those transactions described in Section 368(a)(1) of the Code.[20] Section 368 is a definitional section only; nowhere in Section 368 are the tax implications of a reorganization mentioned.[21] However, Section 368 is important because many other sections are triggered by transactions meeting the definitions contained in Section 368.[22]

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19. I.R.C. Section 368(a)(1) of the Code defines the term "reorganization" to include mergers, consolidations, recapitalizations, acquisitions by one corporation of the stock or assets of another corporation, and changes in form or place of organization.

20. Treas. Reg. § 1.368-2(a). *See generally* BITTKER AND EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS, (6th ed., 1994).

21. ABRAMS AND DOERNBERG, *supra* note 12, at 209.

22. *Id.* The reorganization and division provisions are contained in Subparts B, C, and D of Part III ("Corporate Organizations and Reorganizations") of Subchapter C. These are labeled "Effects on shareholders and security holders," "Effects on corporations," and "Special rule; definitions." The Code sections are summarized here briefly:

Subpart B
- Sections 354 and 355: nonrecognition at the shareholder and security holder level on receipt of qualifying consideration.
- Section 356: extent to which gain is recognized on receipt of additional consideration (boot).
- Section 357: assumption of liabilities.
- Section 358: shareholder and security holder substituted basis.

Subpart C
- Section 361: nonrecognition exchanges at corporate level.
- Section 362: corporate basis carryover.

Subpart D
- Section 368: definitions of exchanges classified

Section 368 divides reorganizations into four broad groups: (1) amalgamating reorganizations in which two or more corporations are combined into a single corporate structure; (2) divisive reorganizations in which a single corporation is divided into two or more companies; (3) single-party reorganizations in which one corporation undergoes a substantial change in financial structure, modifies its place of incorporation, or another similar corporate characteristic; and (4) bankruptcy reorganizations in which a financially distressed corporation seeks to improve its position.[23] This comment focuses on the amalgamating reorganizations.

A. AMALGAMATING REORGANIZATIONS: GENERAL REQUIREMENTS

To qualify for tax-free treatment, a transaction must first meet one of the definitions of a "reorganization." The term "reorganization" is strictly limited to the specific transactions set forth in Section 368(a).[24] Tax-free treatment of reorganiza-

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as reorganizations.

In addition to these sections the following play an integral role in corporate reorganizations and divisions:

Section 1032: nonrecognition for corporation on issuance of its own stock.

Section 311: nonrecognition for corporation on distribution of its stock in a division.

Sections 108, 269, 381, 382, and 383: survival and carryover of corporate tax attributes.

Also, a brief survey of the Code sections should not ignore the requirements that have been imposed by the Treasury Department and by the courts. ROSE AND CHOMMIE, FEDERAL INCOME TAXATION, at 580, (3rd ed., 1988).

It should be noted that as a result of a reorganization, the acquiring corporation succeeds to a variety of tax attributes of the acquired corporation (*See* § 381(a)(2) — this rule does not extend to a B reorganization, since the acquired corporation in that case remains in existence). Included among the various attributes that carry over to the acquiring corporation are the acquired corporation's earnings and profits, net operating loss carryovers, methods of computing depreciation, and method of accounting (*See generally* I.R.C. § 381(c)). CEB, *supra* note 2, at 101-102.

23. ABRAMS AND DOERNBERG, *supra* note 12, at 209. In terms of I.R.C. § 368, the amalgamating reorganizations consist of types A through C as well as some D's; the divisive reorganizations include the remainder of the D's as well as transactions described in § 355 though not falling within the definitions of I.R.C. § 368(a)(1); the single party reorganizations are the types E and F; and the bankruptcy reorganization is the G. *Id.*

24. Treas. Reg. § 1.368-2. CEB, *supra* note 2, at 91.

tions is premised upon the notion of "continuity of investment;" investors are viewed as preserving their interest in a business enterprise through continuing stock ownership, notwithstanding the change in corporate form.[25] To protect this notion, courts have developed a variety of doctrines to ensure that transactions literally meeting the statutory definitions are genuinely entitled to nonrecognition treatment.[26] Included among these doctrines are (1) continuity of proprietary interest, (2) continuity of business enterprise, (3) business purpose, and (4) step transaction.[27]

1. Continuity of Proprietary Interest Doctrine

The one unifying aspect of statutory reorganizations is that of "continuity of interest."[28] The continuity of proprietary interest doctrine requires that the shareholders of the acquired corporation have received stock representing a substantial proprietary stake in the acquiring corporation.[29] The purpose of this doctrine is to deny nonrecognition when the shareholders have in substance "cashed out" their investment.[30] Thus, early reorganization cases frequently hinged upon the issue of whether there was, in substance, a sale, or whether the share-

25. Treas. Reg. § 1.368-1(b); *See, e.g.,* Commissioner v. Gilmore's Estate, 130 F.2d 791 (3d Cir. 1942). The rationale for tax-free treatment of such organizations is the same as that for § 351 incorporations: not enough is changed by the transaction to warrant immediate imposition of tax. *See* BITTKER AND EUSTICE, *infra* note 26, at 12-10, 12-11. The litigation in this area has often involved whether the lines drawn in § 368 properly distinguish mere changes in form not warranting taxation and other rearrangements that are fully taxable. *See id.*

26. *See* BORIS I. BITTKER AND JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS, at 12-24, 12-25 (6th ed., 1994).

27. *Id.*

28. For recent cases involving the continuity of proprietary interest doctrine, *see, e.g.,* Seagram Corp. v. Commissioner, 104 T.C. No. 4, 95 TNT 16-11 (1995) (rejecting the argument that a pre-acquisition cash purchase of target shares by a corporation unrelated to the acquiring corporation would destroy continuity of interest in an otherwise valid reorganization); Brown Group, Inc. v. Commissioner, 104 T.C. No.5 (1995); Albertson's, Inc. v. Commissioner, 42 F.3d 537 (9th Cir. 1994).

29. *See, e.g.,* Cortland Specialty Co. v. Commissioner, 60 F.2d 937 (2d Cir. 1932) (transfer of assets for cash and short-term notes constituted a sale, not a reorganization); Treas. Reg. § 1.368-1(b) (1960).

30. CEB, *supra* note 2, at 91. Note, this doctrine is embodied in the statutory definitions of B and C reorganizations which require the use of voting stock consideration. Sections 368(a)(1)(B) and (C).

holders maintained a continuity of interest in the post-acquisition corporation.[31]

In *Helvering v. Minnesota Tea Co.*,[32] the Supreme Court upheld the tax-free status of a transfer of corporate assets in exchange for what amounted to $540,000 in stock and $425,000 in cash.[33] Although the stock interest received by the shareholders of the transferor corporation left them with a minority interest in the ongoing venture,[34] the Court concluded that the need for a continuing proprietary interest was satisfied because a "material part" of the consideration was an equity interest in the transferee.[35] For ruling purposes, the Service has indicated that the continuity of interest requirement will be satisfied if there is stock ownership on the part of the former shareholders equal in value to at least 50% of all the formerly outstanding stock of the acquired corporation.[36] Moreover, if a sufficient percentage of stock is received, it does not matter that each shareholder receives a different percentage of stock and other consideration.[37]

A more recent development regarding continuity of interest was announced in *Paulsen v. Commissioner*.[38] In *Paulsen*, the Supreme Court held that continuity of interest was lacking in a merger of two savings and loan associations[39] where shareholders of the acquired corporation gave up their guaranty stock in exchange for passbook accounts and certificates of

31. *See, e.g.*, Le Tulle v. Scofield, 308 U.S. 415 (1940) (holding that a transfer of corporate assets in exchange for cash plus bonds payable over 11 years failed to be a tax-free reorganization); Pinellas Ice & Cold Storage v. Commissioner, 287 U.S. 462 (1933) (holding that a transfer of corporate assets in exchange for cash plus well-secured promissory notes payable in less than four months could not qualify as a reorganization).

32. Helvering v. Minnesota Tea Co., 296 U.S. 378 (1935).

33. *Id.* at 386.

34. Their equity interest represented about 7.5% of the transferee's outstanding stock. *See id.* at 381-382.

35. *Id.* at 386. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 211.

36. *Id. See* Rev. Rul. 66-224, 1966-2 C.B. 114; Rev. Proc. 77-37, 1977-2 C.B. 568. *But See* John A. Nelson Co. v. Helvering, 296 U.S. 374 (1935) (holding that a rearrangement was a reorganization even though it resulted in less than 50% continuity of interest).

37. *See* Rev. Rul. 66-224, 1966-2 C.B. 114.

38. Paulsen v. Commissioner, 469 U.S. 131 (1985).

39. One authorized to issue "guaranty stock" to its owners and the other having no stock of any kind. *Id.* at 133

deposit in the surviving corporation.[40] The result was reasonable since the consideration could be viewed as a cash equivalent without significant equity features.[41] However, the taxpayers had argued that the continuity of interest test should focus on the nature of the consideration received rather than the relative change in proprietary interest.[42] If this is the appropriate test, it is difficult to distinguish the *Paulsen* situation from a merger of two non-stock savings and loan associations, which has been held to constitute a tax-free reorganization.[43] Although, the Supreme Court addressed this point in its *Paulsen* opinion, the Court was sufficiently unclear as to leave some uncertainty concerning the appropriate standard.[44]

2. Continuity of Business Enterprise and Business Purpose Doctrines

A reorganization requires the business enterprise of the acquired corporation to continue under the modified corporate form.[45] Therefore, when a corporation reorganizes, but its core business continues to operate, only the corporate form has changed, and no taxable transaction has occurred.[46] The "continuity of business enterprise" requirement is met if the acquiring corporation either continues the transferor's historic business or continues to use a "significant portion" of the transferor's historic business assets in a different business.[47]

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40. *Id.* at 134-135.

41. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 212-213.

42. *See Paulsen*, 469 U.S. at 141.

43. *See* Rev. Rul. 69-3, 1969-1 C.B. 103. P. WEIDENBRUCH, JR. AND K. BURKE, *supra* note 9, at 198.

44. *See Paulsen*, 469 U.S. at 142; *see also* ABRAMS AND DOERNBERG, *supra* note 12, at 213. The *Paulsen* Court gave a brief explanation involving a comparison of the equity interests received and those given up in the exchange. *See Paulsen*, 469 U.S. at 142. However, the Court's explanation did not address the taxpayers' argument — that the continuity of interest test turns on the nature of the consideration received and not on the relative change in proprietary-equity interest. *See id.*

45. *See* Treas. Reg. § 1.368-1(b) (1960); *See also* Pridemark, Inc. v. Commissioner, 345 F.2d 35 (4th Cir. 1965).

46. ABRAMS AND DOERNBERG, *supra* note 12, at 214.

47. *Id.* Treas. Reg. § 1.368-1(d) (1960). The phrase "significant portion of [target's] historic business assets" is partially explained in Treasury Regulation § 1.368-1(d)(4)(iii): "In general, the determination of the portion of a corporation's

Distinct from the continuity of business enterprise doctrine is the business purpose doctrine. The business purpose doctrine does not recognize transactions that serve only the purpose of avoiding taxes.[48] Under the Regulations, the doctrine requires that the transactions "be undertaken for reasons germane to the continuance of the business of a corporation."[49]

3. Step Transaction Doctrine

The step transaction doctrine is an extension of the tax principle that a transaction's substance, but not its form, determines tax consequences.[50] Attention is paid to the overall result of a series of interdependent transactions; the results of each transaction are not viewed in isolation.[51] A roundabout approach taken by a taxpayer to achieve a technically legitimate result is ignored where the only purpose for the detour is tax avoidance.[52] The courts have long held the view that "[a] given result at the end of a straight path is not made a different result because reached by following a devious path."[53]

Unfortunately, the circumstances in which the step transaction doctrine is properly applicable have by no means been consistently delineated by the Service or the courts.[54] Moreover, even when there is agreement that a particular case

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assets considered 'significant' is based on the relative importance of the assets to operation of the business. However, all other facts and circumstances, such as the net fair market value of those assets, will be considered." *Id. See* Laure v. Commissioner, 653 F.2d 253 (1981).

48. *See, e.g.*, Gregory v. Helvering, 293 U.S. 465 (1935).

49. Treas. Reg. § 1.368-2(g) (1960). *See also* Treas. Reg. § 1.368-1(b) and (c) (1960).

50. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-208, 12-209.

51. *See* Rev. Rul. 79-250, 1979-2 C.B. 156 (incorporation of several subsidiaries under Section 351, a merger of an unrelated corporation into one of the subsidiaries in a forward triangular merger, and a reincorporation of the parent under Section 368(a)(1)(F) were respected as separate steps where each transaction "is sufficiently meaningful on its own account, and is not dependent upon the other transaction for its substantiation.").

52. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-209.

53. Minnesota Tea Co. v. Helvering, 302 U.S. 609, 613 (1938); *See generally* Mintz and Plumb, *Step Transactions in Corporate Reorganizations*, 12 N.Y.U. TAX INST. 247 (1954).

54. Tax Mgmt. (BNA) Portfolios, *Corporate Acquisitions — (A), (B) and (C) Reorganizations*, No. 771 at A-63 (1994).

warrants a step transaction analysis, no universally accepted set of legal standards exists for applying the doctrine.[55] Courts have applied three alternative tests in determining whether to invoke the step transaction doctrine in a particular transaction: the "end result" test,[56] the "mutual interdependence" test,[57] and the "binding commitment"[58] test.[59] Based on the Tax Court cases in the post-transaction continuity area[60] and the Service's stance on this issue,[61] the mutual interdependence test is most commonly applied.[62]

Step transaction issues may overlap with continuity of interest issues in a variety of ways. For example, an interesting step transaction problem involves whether planned post-merger sales of the surviving corporation stock by former

55. *Id.*

56. Under this, the most liberal test, the step transaction doctrine will be invoked if it appears that a series of formally separate steps are in fact prearranged parts of a single transaction intended from the beginning to arrive at the ultimate result. *Id.* at A-64. *See* Penrod v. Commissioner, 88 T.C. 1415, 1428 (1987); *See also* Christian Est. v. Commissioner, 57 T.C.M. 1231, 1239 (1989). The end result test is based upon the actual intent of the taxpayers, although the results desired by the parties are often difficult to ascertain. *See id.*

57. The mutual interdependence test focuses on whether "the steps are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series." Redding v. Commissioner, 630 F.2d 1169, 1178 (7th Cir. 1980), *cert denied*, 450 U.S. 913. *See also* Kass v. Commissioner, 60 T.C. 218 (1973), *aff'd without published opinion*, 491 F.2d 749 (3d Cir. 1974); Farr v. Commissioner, 24 T.C. 350 (1955); American Wire Fabrics Corp. v. Commissioner, 16 T.C. 607 (1951); American Bantam Car Co. v. Commissioner, 11 T.C. 397 (1948), *aff'd* 177 F.2d 513 (3d Cir. 1949). BNA, No. 771, *supra* note 54, at A-64 and n. 770.

58. The narrowest alternative for applying the step transaction doctrine, the binding commitment test forbids use of the doctrine unless, at the time the first step is commenced, there is a binding agreement to take a later step. BNA, No. 771, *supra* note 54, at A-64. *See Redding*, 630 F.2d at 1178; Commissioner v. Gordon, 391 U.S. 83, 96 (1968). The binding commitment test is generally designed for the characterization of steps which span several tax years and are "not only indeterminable but unfixed for an indefinite and unlimited period in the future, awaiting events that might or might not happen." McDonald's Restaurants of Il. v. Commissioner, 688 F.2d 520, 525 (7th Cir. 1982), *citing* Commissioner v. Gordon, 391 U.S. 83, 96 (1968). BNA, No. 771, *supra* note 54, at A-64.

59. *Id.* at A-63.

60. *See, e.g., Christian Est.*, 57 T.C.M at 1231; *Penrod*, 88 T.C. at 1415.

61. *See* Rev. Rul. 79-250, 1979-2 C.B. 156 (substance of each of a series of independent steps will be recognized, and step transaction doctrine not applied if step has independent economic significance, is not a sham, and was undertaken for a valid business purpose).

62. BNA, No. 771, *supra* note 54, at A-63.

transferor corporation shareholders cause the transaction to lose its reorganization status.[63] Corporate tax professors Howard E. Abrams and Richard L. Doernberg considered both sides of this issue:

> If so, such sales will affect the other shareholders who choose to continue to hold their investment in the surviving corporation as well the acquiring corporation whose basis varies depending on whether the transaction qualifies as a reorganization. If not, then the empty formalism of issuing registered shares in a merger involving a publicly-held corporation will eviscerate the continuity of proprietary interest doctrine.[64]

Therefore, absent a binding commitment to dispose of the shares, even a prompt post-merger disposition should not break continuity,[65] so long as the former transferor corporation shareholders are "at risk" with respect to the acquiring corporation's shares and have the option to retain such shares.[66]

However, it is possible that a court may accept a broader interpretation of the step transaction doctrine, as did the Seventh Circuit in the controversial *of McDonald's Restaurants of Illinois v. Commissioner.*[67] In *McDonald's*, companies of a franchise group were merged into McDonald's Corporation.[68] Seven months later, the former shareholders of the acquired companies sold the McDonald's stock they had received in the merger.[69] The taxpayers, subsidiaries of McDonald's to which

63. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 213-214.

64. *Id.* at 214. Howard E. Abrams and Richard L. Doernberg are professors at Emory University.

65. Herbert N. Beller, *Final Regulations Ease Planning for Tax-Free Reverse Subsidiary Mergers*, 64 J.TAX'N 80 (Feb. 1986). If post-merger sales have an adverse effect on the non-selling shareholders, then the tax implications of a corporate rearrangement cannot be determined with certainty until well after the transaction. In addition, it may be impossible to determine which shareholders sell their shares and when they do so.

66. *Id.*

67. *McDonald's*, 688 F.2d at 520. *See generally* P. Faber, *The Use and Misuse of the Plan of Reorganization Concept*, 38 TAX L. REV. 515 (1983).

68. *Id.* at 522.

69. *Id.*

the assets of the franchise companies had been transferred after the merger, argued that the step transaction doctrine should apply to disqualify the transaction as a tax-free reorganization.[70] The taxpayers claimed that McDonald's merger, followed by a sale of stock, violated the continuity of interest requirement.[71] Therefore, contended that the assets should hold a sterred-up basis rather than a carry-over basis.[72]

The Seventh Circuit agreed with the taxpayers and held that the step transaction doctrine was applicable because ultimate sale of the stock received by the former shareholders of the acquired companies was an integral part of the transaction.[73] Thus, *McDonald's* shows that no definitive judicial application of the step transaction doctrine exists[74] and that the tax fate of certain transactions may turn on a particular court's unique interpretation of the doctrine on a case-by-case basis.[75]

B. REQUIREMENTS OF "A" THROUGH "D" AMALGAMATING REORGANIZATIONS

Under Section 368, tax-free amalgamating reorganizations are designated by four subtypes: A, B, C or D.[76] Generally speaking, these reorganizations are different methods of combining two or more corporations by tax-free means.[77] A typical "A" reorganization involves one corporation acquiring the assets of another corporation, in exchange for stock of the acquir-

70. *See McDonald's*, 688 F.2d at 522-524.

71. *See id.* at 524; *see also* ROSE AND CHOMMIE, FEDERAL INCOME TAXATION, at 596 (3rd ed., 1988).

72. *See McDonald's*, 688 F.2d at 522.

73. *See id.* at 524. In *Robert A. Penrod*, 88 T.C. 1415, 1437 (1987), the Tax Court held that the exchange of stock of corporations that operated fast-food restaurants under McDonald's franchises for stock of McDonald's Corporation qualified as a reorganization under § 368(a)(1)(A) even though the taxpayers sold the McDonald's stock eight months after acquiring it due to events that occurred after the stock was acquired. Hence, the acquisition of the stock and its subsequent sale were not transactions that should be stepped together. *Id.*

74. *See generally* BNA, No. 771, *supra* note 54, at A-63, A-64.

75. *See id.*

76. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 209.

77. *See id.*

ing corporation plus additional consideration.[78] The Code defines a "B" reorganization as the acquisition of stock of one corporation in exchange solely for voting stock of the acquiring corporation or its parent.[79] In a "C" reorganization, one corporation acquires "substantially all" of the assets of another corporation in exchange for voting stock of the acquiring corporation or its parent.[80] Finally, a non-divisive "D" reorganization requires that one corporation transfer all or part of its assets to another "controlled" corporation, and that the transferor then distribute stock or securities of the controlled corporation.[81] While in many instances the choice of one or another may be simply a matter of convenience, there are qualifying differences that may dictate the most advantageous technique for a given situation.[82] Moreover, tax considerations may not be the over-riding factors when structuring these transactions.[83]

1. "A" Reorganizations

An "A" reorganization is defined as a statutory merger or consolidation.[84] Every state statutorily provides for mergers and consolidations.[85] A statutory merger is the most flexible

78. *See* I.R.C. § 368(a)(1)(A).

79. *See* I.R.C. § 368(a)(1)(B).

80. *See* I.R.C. § 368(a)(1)(C).

81. *See* I.R.C. § 368(a)(1)(D).

82. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-21, 12-22 and 12-42; *see also* ABRAMS AND DOERNBERG, *supra* note 12, at 233. For example, permissible consideration in A reorganizations and in forward triangular mergers is limited only by common law, whereas the only allowable consideration in B reorganizations and reverse triangular mergers (at least 80%) is voting stock. *Id.* In between these opposites lies the C reorganizations, which allow up to 20% boot. *Id.*

83. Tax Mgmt. (BNA) Portfolios, Structuring Corporate Acquisitions — Tax Aspects, No. 770 at A-144 (1993).

84. I.R.C. Section 368(a)(1)(A). "Statutory" for this purpose refers to applicable state law. In a merger, one corporation absorbs the corporate enterprise of another corporation. BITTKER AND EUSTICE, *supra* note 26, at 12-41. Consolidations involve the combination of two or more corporations into a newly created entity. *Id.* Mergers are much more common than consolidations, since it is generally desirable for one of the combining corporations to survive the transaction, particularly where one of the corporations owns assets with restriction, or assignment. BNA, No. 771, *supra* note 54, at A-6. The creation of a new corporation in a consolidation may add to the necessity or expense of qualifying to do business or exchanging shares of the surviving corporation. *Id.* A consolidation is most useful where the combining corporations desire a new state of incorporation. *Id.*

85. BNA, No. 771, *supra* note 54, at A-6. *See, e.g.,* DEL. CODE ANN. TIT. 8, §

form of the tax-free reorganizations[86] but generally requires shareholder approval.[87] After approval, the assets and liabilities of the acquired corporation pass to the acquiring corporation by operation of law and the acquired corporation disappears as a separate legal entity.[88]

The Code does not specifically prescribe the consideration that can be paid by the acquiring corporation in a merger, as it does in a B or C reorganization.[89] Voting stock, nonvoting stock, debt securities, cash, or other property may be used without disqualifying the transaction as a tax-free reorganization.[90] "Substantially all" of the transferor corporation's assets need not be acquired, as in a C reorganization.[91] The transferor corporation may dispose of assets which the transferee corporation does not want prior to the transaction.[92] In addition, a no "control" requirement exists.[93] However, courts have interpreted the continuity of interest doctrine to require that stock of the acquiring corporation comprise a substantial part of the consideration.[94] Under the current guidelines of

251(a)(1953):

> Any 2 or more corporations existing under the laws of this State may merge into a single corporation, which may be any 1 of the constituent corporations or may consolidate into a new corporation formed by the consolidation, pursuant to an agreement of merger or consolidation, as the case may be, complying and approved in accordance with this section.

Id.

86. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-42. For example, unlike the types B and C reorganizations, the type A reorganization imposes no restrictions on the kind of consideration to be used in a statutory merger or consolidation. *Id.*

87. *See, e.g.,* CAL. CORP. CODE § 1201 (West 1988).

88. *See, e.g.,* CAL. CORP. CODE § 1107 (West 1988).

89. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-42.

90. Jack F. Thorne, *Mergers of Corporations Can Take Various Forms Each With Its Own Tax Consequences,* TAXATION FOR ACCOUNTANTS, 35 T.A. 38 (July 1985).

91. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-42. Thus, for example, an A reorganization is generally the preferred vehicle where target has distributed unwanted assets prior to the reorganization by means of a spin-off or redemption. BNA, No. 771, *supra* note 54, at A-6.

92. BITTKER AND EUSTICE, *supra* note 26, at 12-47.

93. *See id.* at 12-42. For example, in a B reorganization, "control" means ownership of at least 80% of the total combined voting power of voting stock and at least 80% of the total number of shares of all other classes of stock. *See* I.R.C. § 368(c).

94. *See, e.g.,* Southwest Natural Gas Co. v. Commissioner, 189 F.2d 332 (5th

the Service, a favorable ruling that a merger qualifies as an A reorganization requires that the shareholders of the acquired corporation receive at least 50% equity consideration.[95]

The principal disadvantages of an A reorganization are the often burdensome requirements of meeting securities laws, preparation of numerous documents, and providing the approval and appraisal rights to acquirer shareholders as mandated under applicable state law.[96] In addition, because the target corporation's assets and liabilities transfer to the acquiring corporation by operation of law, the acquiring corporation cannot choose which of the target's liabilities it will assume.[97]

2. "B" Reorganizations

A "B" reorganization is defined as the acquisition of stock of one corporation in exchange "solely" for all or part of the *voting* stock of the acquiring corporation or its parent,[98] but not both,[99] provided the acquiring corporation is in control of

Cir.), *cert. denied*, 342 U.S. 860 (1951).

95. *See* Rev. Proc. 77-37, 1977-2 C.B. 568. *But see* John A. Nelson Co. v. Helvering, 296 U.S. 374 (1935) (38%); Miller v. Commissioner, 84 F.2d 415 (1936) (25%).

96. Thorne, *supra* note 90, at 38.

97. BNA, No. 771, *supra* note 54, at A-6, A-7.

98. "Parent" is the purchasing or acquiring corporation which desires to make an acquisition, either directly or through its subsidiary.

99. In a standard B reorganization, stock of the parent corporation or of its subsidiary may be used, but not both. *See* Treas. Reg. § 1.368-2(c). This limitation is intended to ensure that a shareholder of the target corporation cannot cash out part of her investment without losing a proportionate share of her interest in the transferred assets. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 217, stating:

> For example, suppose that A Corp acquired all the stock of T Corp in exchange for its own stock as well as stock of its parent. If a (former) shareholder of T Corp sold the stock of A's parent, the shareholder would obtain cash from the transaction without substantially diluting his interest in A (and through A, in T).

Id.

Were such transactions permitted, the force of the "solely voting stock to acquire control" requirement of the B reorganization would be reduced. *Id.* Although beyond the scope of this discussion, one may want to reconsider this point in the context of divisive reorganizations because the effect of using stock of *both* the parent and its subsidiary in a standard B reorganization could be to turn the B into a divisive reorganization. *Id.* at 217-218.

the acquired corporation immediately after the transaction.[100] "Control" requires the possession of stock representing at least 80% of both the total combined voting power of all the acquired corporation's voting stock and the total number of shares of all other classes of the corporation's stock.[101]

An "acquisition" may consist of a series of acquisitions that are part of the same transaction.[102] Generally, aggregation is permitted for acquisitions "taking place over a relatively short period of time such as 12 months."[103] Although aggregation may allow earlier acquisitions to qualify for nonrecognition treatment even though control did not exist after such earlier acquisitions,[104] it may also serve to disqualify the whole series of acquisitions if any of them involved any consideration other than voting stock.[105] If the earlier stock purchase were unrelated or sufficiently remote in time,[106] however, it would not violate the "solely for voting stock" requirement of Section 368(a)(1)(B).[107]

The "solely for voting stock" requirement has been strictly applied by the Service and the courts.[108] Even if the acquiring corporation acquired more than 80% of the acquired corporation's stock in exchange for its voting stock, the entire transaction is taxable if it acquired any stock for nonvoting stock consideration[109] as part of the same acquisition.[110] A

100. I.R.C. Section 368(a)(1)(B). CEB, *supra* note 2, at 94.

101. I.R.C. Section 368(c). The relevant question is whether the acquiring corporation is in control immediately after the acquisition, and not whether control existed before, or as a result of, the acquisition. I.R.C. Section 368(a)(1)(B) (last parenthetical); Reg, § 1.368-2(c). CEB, *supra* note 2, at 94.

102. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-53.

103. Treas. Reg. § 1.368-2(c).

104. Referred to as a "creeping" B reorganization.

105. Treas. Reg. § 1.368-2(c). CEB, *supra* note 2, at 94.

106. Often referred to as being "old and cold."

107. *See* Chapman v. Commissioner, 618 F.2d 856, 861-862 (1st Cir. 1980) (holding that however much stock of the target corporation is acquired in the transaction, the *total* consideration furnished by the acquiring corporation must be its voting stock or voting stock of its parent). However, the court reasoned that "old and cold" stock need not have been acquired solely for voting stock. *Id.* at 862, 875.

108. *Id. See also* Helvering v. Southwest Consolidated Corp., 315 U.S. 194 (1942). The voting stock may be common or preferred, or both. Rev Proc. 77-37, 1977-2 C.B. 568.

109. Cash, for example, may constitute nonvoting stock consideration.

110. Heverly v. Commissioner, 621 F.2d 1227 (3d Cir. 1980). *See generally*

limited exception to the "no boot in a B"[111] rule allows an acquiring corporation to pay cash in lieu of fractional shares of stock.[112]

Although a B reorganization requires absolute compliance with the "solely for voting stock" requirement, there is no requirement that the target corporation hold substantially all of its historic assets following the acquisition.[113] Thus, a B reorganization provides flexibility in acquiring a target corporation that, prior to the acquisition, has distributed unwanted assets to its shareholders.[114] In addition, because a B reorganization constitutes an acquisition of stock of the target, the liabilities of the target do not become liabilities of the acquiring corporation as they would in an A reorganization or possibly a C reorganization.[115]

3. "C" Reorganizations

The "C" reorganization more closely resembles the A reorganization than the B reorganization does because the C reorganization contemplates a transfer of assets[116] rather than a transfer of stock.[117] The C reorganization is defined as the acquisition by one corporation of "substantially all" the properties of another corporation in exchange solely for voting stock of the acquiring corporation or its parent, but not both.[118] The

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Dailey, *The Voting Stock Requirement of B and C Reorganizations*, 26 TAX L. REV. 725 (1971).

111. The term "boot" is not defined in the Code. Boot refers to cash or other nonpermitted property that triggers recognition when received in an otherwise tax-free exchange. *See* BITTKER AND EUSTICE, *supra* note 26, at 11-53, 11-54. For example, boot may refer to consideration such as nonvoting stock, debt securities, cash or other property. *Id.*

112. Rev. Rul. 66-365, 1966-2 C.B. 116. CEB, *supra* note 2, at 95.

113. BNA, No. 771, *supra* note 54, at A-38.

114. *Id.* Also, the absence of the "substantially all" requirement adds flexibility in post-acquisition restructuring. *Id.*

115. This difference is due to the fact that the target corporation remains as the subsidiary of the acquiring parent corporation. *Id. See infra* notes 117-144 and accompanying text for a discussion of C reorganizations.

116. As in a merger. ABRAMS AND DOERNBERG, *supra* note 12, at 218.

117. As in a B reorganization. ABRAMS AND DOERNBERG, *supra* note 12, at 218. In fact, the C reorganization is so similar to the A reorganization that it often is called the "de facto" (or practical) merger provision. *Id.*

118. I.R.C. Section 368(a)(1)(C). It should be noted, however, that if 80% of the

Service has ruled that the transfer constituting 90% of the target's net assets and 70% of the target's gross assets will constitute "substantially all."[119] Generally, the acquired corporation must liquidate following the transaction.[120]

As in a B reorganization, the statute ensures continuity of proprietary interest in a C reorganization by limiting the consideration that can be used by the acquiring corporation to voting stock.[121] However, in contrast to the strict application of the "solely for voting stock" requirement of B reorganizations, some leeway is provided the acquiring corporation in a C reorganization through two provisions: Section 368(a)(1)(C) (final clause) and Section 368(a)(2)(B).[122]

The final clause in Section 368(a)(1)(C) provides that assumption by the acquiring corporation of debts of the target corporation does not constitute impermissible consideration in determining qualification as a C reorganization.[123] This final clause provision overturns the Supreme Court's decision in *United States v. Hendler*,[124] which had held that assumption of a liability, even in the context of a bulk transfer of corporate assets, should be treated as the equivalent of cash consideration.[125] Because most companies are forced to mortgage their fixed or working assets to obtain commercial credit, continuation of the *Hendler* doctrine would have had the effect of rendering the C reorganization commercially unavailable.[126]

Section 368(a)(2)(B), the "boot relaxation rule,"[127] permits

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target's assets are exchanged for voting stock of the acquiring corporation or of its parent, use of the other's stock may be permissible under the boot relaxation rule of I.R.C. § 368(a)(2)(B).

119. Rev. Proc. 77-37, 1977-2 C.B. 568.

120. This liquidation requirement can be avoided only with the permission of the Secretary of the Treasury. I.R.C. Section 368(a)(2)(G)(ii).

121. ABRAMS AND DOERNBERG, *supra* note 12, at 218; *see also* BITTKER AND EUSTICE, *supra* note 26, at 12-69, 12-70.

122. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 218.

123. *See id* at 219.

124. United States v. Hendler, 303 U.S. 564 (1938).

125. *See id.* at 566-567.

126. ABRAMS AND DOERNBERG, *supra* note 12, at 219.

127. Under the "boot relaxation rule" of I.R.C. Section 368(a)(2)(B), up to 20 percent of the consideration can consist of property other than stock of a party to the reorganization, although the 20 percent limitation is reduced by the amount of

the acquiring corporation to use cash or other boot[128] as consideration in a C reorganization as long as 80 percent of the target's assets are acquired solely for voting stock.[129] One drawback to taxpayers who obtain benefits under Section 368(a)(2)(B) is that they must relinquish the benefit of the anti-*Hendler* language contained in Section 368(a)(1)(C).[130] Thus, if boot is used in a C reorganization, then any liabilities assumed by the acquiring corporation are treated as boot for the purposes of the boot relaxation rule of Section 368(a)(2)(C).[131]

One of the pitfalls inherent in the C reorganization arises when the solely for voting stock requirement is applied to an acquiring corporation which had previously purchased stock in the target corporation.[132] Assuming that the acquiring corporation's stock ownership falls short of control,[133] an immediate liquidation of the target following the assets acquisition may invite the application of the step transaction doctrine.[134] The step transaction doctrine would then recharacterize a portion of the acquisition as an exchange for the target's stock.[135] As a result, the acquiring corporation may not be able to meet the solely for voting stock requirement.[136] To avoid this problem, the acquiring corporation may

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liabilities assumed by the acquiring corporation. *See id.*

128. *See* BITTKER AND EUSTICE, *supra* note 26, at 11-53, 11-54.

129. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 219.

130. *Id.*

131. *Id.*

132. CEB, *supra* note 2, at 96.

133. So that an I.R.C. § 332 tax-free liquidation is unavailable. *Id.*

134. *Id.*

135. *Id.*

136. *See* Bausch & Lomb Optical Co. v. Commissioner, 267 F.2d 75 (2d Cir. 1959), *cert. denied*, 361 U.S. 835 (1959). In that case, the acquiring corporation owned 79% of the target corporation's stock. *See id.* In order to obtain the assets of the target corporation, the acquiring corporation exchanged its voting stock for the target's assets. *See id.* The target then liquidated, distributing 79% of the acquiring corporation's stock back to the acquiring corporation and 21% of the stock to the target's minority shareholders. *See id.*

The court held that this transaction failed to qualify as a tax-free C reorganization because the acquiring corporation obtained 79% of the target's assets in exchange for its stock of the target and only 21% of the target's assets in exchange for its own voting stock. *See id.* Hence, the transaction was treated as a taxable liquidation rather than as a tax-free reorganization. *See id.* As corporate tax professors Abrams and Doernberg noted:

> While the court's holding arguably is consistent

have to sell the previously acquired stock before proceeding with the asset acquisition[137] or to use a controlled subsidiary to make the acquisition.[138]

From a purely tax standpoint, a C reorganization is generally less attractive than an A reorganization due to the amount of both disclosed and hidden liabilities typically assumed in the acquisition of an ongoing business.[139] In a C reorganization, great difficulty lies in ensuring that the 20% boot exception to the "solely for voting stock" requirement is a sufficient cushion from disqualification.[140] However, from a nontax perspective, the use of a C reorganization may be advantageous.[141] For instance, it may not be possible to merge the target corporation into the acquiring corporation under applicable state or federal merger laws.[142] Also, unlike an A reorganization, a C reorganization offers the acquiring corporation the ability to choose which of the target corporation's liabilities it will assume.[143] Finally, only the target corporation shareholders may be entitled to approval and appraisal rights, whereas both acquiring

> with the terms of the statute, the "solely for voting stock" requirement seems intended to ensure that the target shareholders continue a proprietary interest in the continuing enterprise. The holding in Bausch & Lomb serves to invalidate a transaction when the acquiring corporation is itself a substantial shareholder of the target corporation, a situation in which the continuity of proprietary interest is most evident.

ABRAMS AND DOERNBERG, *supra* note 12, at 220.

137. Rev. Rul. 72-354, 1972-2 C.B. 188.

138. *See* discussion of triangular reorganizations, *infra* notes 164-229 and accompanying text.

139. BNA, No. 771, *supra* note 54, at A-17.

140. *See id.* Even if it appears that a tax planner knows the amount of liabilities assumed or the boot involved, additional boot may be hidden in a number of places, such as contingent or escrowed stock arrangements, employment agreements, and assumptions of shareholder-guaranteed debt. *Id.* The "substantially all" and liquidation requirements may present additional difficulties. *Id.* Moreover, unlike a merger, title to the target corporation's assets may be physically transferred to the acquiring corporation, a process which can be time-consuming and expensive. *Id.*

141. BNA, No. 771, *supra* note 54, at A-17.

142. *See, e.g.,* Rev. Rul. 57-465, 1957-2 C.B. 250; George v. Commissioner, 26 T.C. 396 (1956), *acq.*, 1956-2 C.B. 5. This is especially true when the target corporation possesses a special charter, such as where the target corporation is a bank or an insurance company. BNA, No. 771, *supra* note 54, at A-17.

143. BNA, No. 771, *supra* note 54, at A-17, A-18.

and target shareholders usually have these rights under Section 368(a)(1)(A).[144]

4. Nondivisive "D" Reorganizations

A nondivisive "D" reorganization most closely resembles the C reorganization.[145] Both involve a transfer of "substantially all" of a corporation's assets, followed by a complete liquidation of the transferor.[146] The two may be distinguished, however, by the statutory implementation of the continuity of proprietary interest doctrine.[147] In the C reorganization, continuity is ensured by the requirement that the transferee corporation obtain the assets in exchange for the voting stock of itself or its parent.[148] In the nondivisive D reorganization, continuity is ensured by the requirement that the transferor or its shareholders have "control" of the transferee immediately after the exchange.[149]

Nondivisive D reorganizations are primarily used by the Service and the courts to control reincorporation abuses.[150] The nondivisive D reorganization provides the Service with a statutory weapon to limit the use of a corporate liquidation, preceded or followed by a transfer of assets to a new or existing corporation, as a device to achieve unwarranted tax objectives.[151] Such a liquidation-reincorporation, if successful, could be significant because it would allow the following tax advantages: (1) a bailout of cash or property taxed as capital gains, (2) the generation of capital losses, (3) a stepped-up basis for depreciable property, (4) the elimination of the ordinary income taint on Section 306 stock,[152] and (5) the elimi-

144. *Id.* at A-18.

145. ABRAMS AND DOERNBERG, *supra* note 12, at 222.

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.* Where a transaction qualifies as both a C and a D reorganization, it is treated as a D. *See* I.R.C. Section 368(a)(2)(A).

150. ABRAMS AND DOERNBERG, *supra* note 12, at 222.

151. *See id.* at 223.

152. Stock subject to the disabilities of § 306, called "tainted stock," is defined in § 306(c). ABRAMS AND DOERNBERG, *supra* note 12, at 162. Any stock other than common stock distributed by a corporation is I.R.C. § 306 stock if received by the taxpayer tax-free under I.R.C. § 305(a). *See id.* The definition of § 306 stock also

nation of the earnings and profits account.[153] The shareholders could then use Section 351 to reincorporate without recognition of gain.[154] However, it should be noted that the substantial repeal of the *General Utilities* doctrine[155] by the Tax Reform Act of 1986 has reduced the incentives for a liquidation-reincorporation.[156]

To diminish the trouble that the Service had in meeting the 80% control definition, the Service uses the control definition of Section 304(c).[157] The definition of "control" is relaxed in the case of nondivisive D reorganizations from the usual 80% test down to the 50% test of the Section 304(c) anti-abuse provision.[158] Because the taxpaying shareholders are in control of the new corporation after the transaction, the terms of the nondivisive D reorganization will have been met.[159] Ac-

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includes stock received in a tax-free reorganization if receipt of the stock had the effect of a stock dividend. *Id.* A taxable disposition of § 306 stock generally will produce ordinary income to the transferor. *Id.* at 165. However, § 306 contains a number of exceptions to its strict rules; the relevant exception here being that § 306 does not cover the disposition of § 306 stock as part of the complete liquidation of a corporation. *Id.* at 167. Because the earnings and profits of a corporation are bailed out at capital gains rates in a complete liquidation, there is no reason to treat the disposition of the § 306 stock in this manner as an abusive bailout, unless the taxpayer was effecting a liquidation-reincorporation transaction. *See id.*

153. ABRAMS AND DOERNBERG, *supra* note 12, at 222-223.

154. *See id.* at 223.

155. The *General Utilities* doctrine arose from the 1935 Supreme Court decision in General Utilities & Operating Co. v. Helvering, 296 U.S. 200 (1935), a case which shaped corporate taxation for over 50 years. ABRAMS AND DOERNBERG, *supra* note 12, at 90. Under the repealed *General Utilities* doctrine, a distributing corporation recognized no gain or loss on a distribution of property with respect to a shareholder's stock. *Id.* A corporation which distributed assets in kind in complete liquidation did not recognize any gain on the distribution. BNA, No. 770, *supra* note 83, at A-5. However, with the Tax Reform Act of 1986, although I.R.C. § 311(a) still provides nonrecognition of gain or loss on a distribution with respect to stock, I.R.C. § 311(b) now provides that a distributing corporation must recognize gain on a distribution of property where the fair market value exceeds the adjusted basis of the property. ABRAMS AND DOERNBERG, *supra* note 12, at 90-91. The gain will be recognized as if the property had been sold to the shareholders at fair market value. *Id.* at 91.

156. *See* BNA, No. 770, *supra* note 83, at A-5. See *supra* note 155 for a discussion of the effect of the repeal of the *General Utilities* doctrine.

157. ABRAMS AND DOERNBERG, *supra* note 12, at 222. I.R.C. Section 304(c) defines control as "the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock." *See* § 304(c).

158. ABRAMS AND DOERNBERG, *supra* note 12, at 222.

159. *Id.* at 223.

cordingly, no loss will be recognized at the corporate level,[160] the corporation's earnings and profits account will not be eliminated,[161] and the shareholders will be prohibited from recognizing any loss on the transaction.[162] Moreover, any cash removed from the corporate solution will be taxable to the shareholders.[163]

C. TRIANGULAR REORGANIZATIONS

As contrasted with the typical two-party reorganizations, a "triangular" reorganization entails a reorganization between three parties. In a triangular reorganization, the consideration for the stock or assets of the target corporation includes stock of a parent corporation in control of the acquiring corporation.[164] The transaction could be structured as a normal A, B, or C reorganization in which the controlling corporation acquired the stock or assets of the acquired corporation in exchange for its own stock, followed by a distribution of the stock or assets to the controlling corporation's subsidiary under the "drop-down" provisions of Section 368(a)(2)(C).[165] However, a triangular reorganization achieves the same result in a single step.[166]

A corporate acquirer may choose to effect a triangular reorganization to circumvent the Section 368(a)(2)(C) drop-down provisions.[167] An acquiring parent corporation may also wish to avoid an expensive and burdensome vote of its public

160. *See* I.R.C. § 361(a)-(b).

161. *See* I.R.C. §§ 381(a)(2), (c)(2).

162. *See* I.R.C. §§ 354(a)(1), 356(a).

163. *See* I.R.C. § 356. Taxpaying shareholders have unsuccessfully tried to avoid the nondivisive D reorganization by reincorporating only a small portion of their assets. *See* Smothers v. United States, 642 F.2d 894 (5th Cir. 1981).

164. BITTKER AND EUSTICE, *supra* note 26, at 12-77, 12-78.

165. P. WEIDENBRUCH, JR. AND K. BURKE, *supra* note 9, at 208.

166. Sections 368(a)(1)(B) and 368(a)(1)(C) expressly permit a B or C reorganization, respectively, to be structured as a direct acquisition of the acquired corporation's stock or assets in exchange for voting stock of the acquiring corporation's parent. In an A reorganization, two types of triangular structures are permitted under § 368(a)(2)(D) ("forward triangular reorganization") and § 368(a)(2)(E) ("reverse triangular reorganization"), respectively. *See* P. WEIDENBRUCH, JR. AND K. BURKE, *supra* note 9, at 208-209.

167. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-77.

shareholders on the transaction.[168] Furthermore, an acquiring corporation will normally seek a means to insulate itself from the target corporation's liabilities, both disclosed and undisclosed.[169] However, the acquiring corporation likely does not wish to give target shareholders shares of its subsidiary, which would create an unwanted minority interest.[170] Moreover, the target shareholders normally will want shares in the parent corporation rather than a typically unmarketable minority stock interest in the parent corporation's subsidiary.[171] Because the use of the drop-down provisions cannot achieve all of these objectives,[172] the triangular merger alternatives are the most commonly used acquisition techniques.[173]

1. History of Triangular Reorganizations

In two early Supreme Court cases, the Court held that triangular acquisitions failed to qualify as reorganizations because the shareholders of the target corporation did not have a continuity of interest in the target's assets due to the fact that they held stock of the parent corporation rather than that of the transferee corporation.[174] These two cases, which established the so-called *Groman-Bashford* doctrine,[175] virtually barred triangular acquisitions from qualifying under the reorganization provisions.[176]

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168. *Id.*

169. MARTIN D. GINSBURG, ESQ. AND JACK S. LEVIN, ESQ., MERGERS, ACQUISITIONS AND LEVERAGED BUYOUTS, at 8202 (vol. F5, 1993).

170. BITTKER AND EUSTICE, *supra* note 26, at 12-77.

171. *Id.*

172. Cook and Coalson, Jr., *The "Substantially All of the Properties" Requirement in Triangular Reorganizations— A Current Review*, 35 TAX LAW. 303, 313 n. 39 (Winter 1982). For instance, if the target is merged into parent and parent then drops all of targets assets subject to all its liabilities, down to a wholly-owned subsidiary, parent generally remains responsible for target's liabilities even after the drop-down. *See id.*

173. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-79.

174. Groman v. Commissioner, 302 U.S. 82 (1937); Helvering v. Bashford, 302 U.S. 454 (1938).

175. The *Groman-Bashford* doctrine, which arose from two Supreme Court decisions, Groman v. Commissioner, 302 U.S. 82 (1937) and Helvering v. Bashford, 302 U.S. 454 (1938), prevented the use of triangular acquisitions. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-240. The doctrine maintained that stock of the acquiring corporations parent company did not carry the requisite continuity of interest "genes." *Id.*

176. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-240.

In 1954, the reorganization provisions were amended to allow the stock or assets received in an A, B, or C reorganization to be distributed to a subsidiary of the acquiring corporation promptly after the exchange.[177] Since 1954, the Code has allowed both B and C reorganizations to be accomplished by use of the voting stock of the parent corporation or its subsidiary, but not both.[178] Subsequently, the Service published two landmark rulings in 1967[179] which treated triangular mergers as either B or C reorganizations, depending on whether subsidiary or target survived the merger, provided that the necessary voting stock requirements were met.[180]

Revenue Ruling 67-326 dealt with a prestatutory forward triangular merger involving a direct transfer of assets by the target corporation to the acquiring corporation's controlled subsidiary in exchange for stock of the parent.[181] The Service held that such a transaction could not qualify for tax-free treatment as a Type A reorganization because the parent was not a party to the reorganization.[182] However, the Service ruled that the transaction could qualify for nonrecognition treatment as a Type C reorganization if the conditions of Section 368(a)(1)(C) were met.[183]

Similarly, Revenue Ruling 67-448 involved a prestatutory reverse triangular merger.[184] In Revenue Ruling 67-448, the Service held that a reverse triangular merger qualified as a Type B reorganization where a parent corporation merged a newly created subsidiary into the acquired target corporation.[185] Thus, Revenue Rulings 67-326 and 67-448 laid the

177. *See* I.R.C. Section 368(a)(2)(C).

178. ABRAMS AND DOERNBERG, *supra* note 12, at 217, 221.

179. Rev. Rul. 67-448, 1967-2 C.B. 144 (transitory Subsidiary merges into Target in B reorganization); Rev. Rul. 67-326, 1967-2 C.B. 143 (merger of Target into Subsidiary for Parent stock qualifies as C reorganization).

180. New York State Bar Association Tax Section [hereinafter "NYSBATS"), Comment, *Report on Reverse Triangular Mergers and Basis-Nonrecognition Rules in Triangular Reorganizations,* 36 TAX L. REV. 395, 397 (1981).

181. BITTKER AND EUSTICE, *supra* note 26, at 12-44.

182. *Id.*

183. *Id.*

184. *Id.* at 12-45.

185. *Id.*

foundation for the codification of forward and reverse triangular reorganizations, respectively.[186]

Not until 1969 did the Code allow triangular mergers to qualify as Type A reorganizations.[187] In 1969, Section 368(a)(2)(D) was enacted to permit a "forward" triangular merger of target into subsidiary provided that the subsidiary use only the parent stock to acquire "substantially all" of the properties of the target.[188] The Code also required that the transaction would have qualified as a statutory A reorganization had the target merged directly into the parent.[189]

In 1971, Section 368(a)(2)(E) was enacted to permit a "reverse" triangular merger. In a Section 368(a)(2)(E) transaction, the subsidiary merges into the target provided that, "in the transaction," the target's shareholders exchange for parent *voting* stock an amount of target stock which constitutes Section 368(c) "control."[190] These statutory changes acknowledge that a functionally identical tax result could have been achieved under prior law through a direct merger of the acquired corporation into the parent, and through a Section 368(a)(2)(C) drop-down of the acquired assets into one or more of the parent's controlled subsidiaries.[191] Sections 368(a)(2)(D) and 368(a)(2)(E) do not, however, alter the definition of the type A reorganization.[192] These sections create a fourth and fifth category of acquisitive reorganization, incorporating elements of the type A, type B and type C patterns, while adding their own unique requirements.[193]

186. *Id.*

187. BITTKER AND EUSTICE, *supra* note 26, at 12-77.

188. NYSBATS, *supra* note 180, at 397-398.

189. BITTKER AND EUSTICE, *supra* note 26, at 12-77.

190. NYSBATS, *supra* note 180, at 398. I.R.C. Section 368(c) defines control as "the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation." *See* § 368(c).

191. *See* BITTKER AND EUSTICE, *supra* note 26, at 12-78.

192. *Id.* at 12-78, 12-79.

193. *Id.* at 12-79.

2. Forward Triangular Reorganizations

As discussed,[194] the standard two-party merger transaction between the acquiring corporation and the target corporation may result in substantial nontax problems.[195] First, the acquiring corporation becomes automatically liable for all the debts of the target corporation, including unknown or undisclosed debts.[196] For example, there may be significant target liabilities such as environmental clean-up responsibilities, product liabilities, employee discrimination claims, anti-trust claims, asserted tax deficiencies, or other threatened or pending lawsuits.[197] Also, the target corporation may have hidden liabilities, such as underfunded pension plans, burdensome long-term debt covenants, or labor problems.[198] If the target is merged into the parent and the parent then drops all of target's assets, subject to all its liabilities, down to a wholly-owned subsidiary, the parent would generally remain responsible for the target's liabilities even after the drop-down.[199]

Second, the acquiring corporation and the target corporation must obtain shareholder approval to effectuate the transaction.[200] When the acquiring corporation is publicly-held, it may be expensive and troublesome to obtain the necessary approval of its shareholders.[201] Finally, both corporations face possible exposure for dissenting shareholder claims.[202] To avoid these problems, planners may use a wholly-owned subsidiary of the acquiring corporation to effect the forward triangular merger.[203]

194. See *supra* notes 84-144 and accompanying text for prior discussion of the nontax problems inherent in a standard merger transaction.

195. BNA, No. 770, *supra* note 83, at A-144.

196. BNA, No. 771, *supra* note 54, at A-6, A-7.

197. MARTIN D. GINSBURG, ESQ. AND JACK S. LEVIN, ESQ., MERGERS, ACQUISITIONS AND LEVERAGED BUYOUTS, at 8202 (vol. F5, 1993).

198. *Id.*

199. Cook and Coalson, Jr., *supra* note 172, at 313, n. 39.

200. For example, under California statute, Cal. Corp. Code § 1201 (1995), a merger reorganization must be approved by both corporations' shareholders.

201. Thorne, *supra* note 90, at 38.

202. GINSBURG AND LEVIN, *supra* note 169, at 8222.

203. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 225. For instance, if the target corporation merges into a subsidiary of acquiring parent corporation, then approval of the subsidiary's shareholders is easy to obtain, because that approval

In the typical Section 368(a)(2)(D) forward triangular merger, the parent corporation forms a subsidiary, usually with nominal capitalization, and the target corporation is then merged into the surviving subsidiary.[204] In the merger, the former shareholders of the target receive the parent's stock, or other consideration in exchange for their target stock.[205] The only limitation imposed on the consideration transferred to the target shareholders is that applicable to A reorganizations.[206] That is, a forward triangular merger qualifies for nonrecognition treatment only if: (1) the subsidiary *acquires* "substantially all" the target's properties, (2) it does not use any of its own stock in making the acquisition, and (3) the transaction would have qualified as an A reorganization if the target had merged directly into the parent corporation.[207] This transaction is the A reorganization analog to the "parenthetical"[208] B and C reorganizations.[209]

3. Reverse Triangular Reorganizations

Although the reverse triangular reorganization, codified in Section 368(a)(2)(E), has been part of the tax law since 1971, much uncertainty surrounded the tax treatment of this technique until the publication of regulations in 1985.[210] Subsequently, in the late 1980's an unusually large number of letter rulings shed light on issues not dealt with by the 1985 regulations.[211]

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is merely approval by the board of directors of the acquiring parent corporation. *Id.*

204. *Id.*

205. Cook and Coalson, Jr., *supra* note 172, at 313.

206. ABRAMS AND DOERNBERG, *supra* note 12, at 226. *See* § 368(a)(2)(D)(ii).

207. CEB, *supra* note 2, at 97.

208. A "parenthetical" B or C reorganization occurs when stock of the acquiring corporation's parent is used. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 217.

209. *Id.* at 226. While the triangular merger Treasury Regulations do not specifically provide for the acquiring of a related corporation, there is nothing in the legislative history of the triangular merger provision to indicate that the section was not intended to apply where such is the case. *See* Rev. Rul. 77-428, 1977-2 C.B. 118.

210. Robert Willens, *Flexibility of Reverse Mergers Increased by Regs. and Rulings*, 70 J.TAX'N 52 (Jan. 1989). *See generally* NYSBATS, *supra* note 180, discussing in 1981 the uncertainty surrounding 46 Fed. Reg. 112 (basis and nonrecognition rules), 114 (reverse triangular merger rules) (Jan. 2, 1981).

211. Willens, *supra* note 210, at 52. *See* Treas. Reg. § 1.368-2(j).

The reverse triangular merger format involves the same acquiring parent and the same target company as in the forward triangular merger, but it is used in situations in which it is desirable for the target to survive the transaction and continue to hold its own properties.[212] Such a situation could arise, for instance, where the target's shareholders are elderly and wish to benefit from a stepped-up basis for their stock at death.[213] However, the reverse triangular configuration is usually dictated by important nontax considerations.[214] For example, the target may hold a non-assignable franchise, favorable long-term lease, trademarks, or other valuable contract rights that cannot be transferred without third-party approval.[215] Alternatively, the target corporation may be the debtor under a loan agreement that triggers an acceleration of principal payments upon a substantial transfer of its assets.[216] Moreover, nontax state or federal regulatory requirements may require preservation of the existing corporate identity of target.[217] As a result of these considerations, the reverse triangular merger is commonly used in acquisitions involving banks, insurance companies, public utilities and other highly regulated industries.[218] In order to accomplish the acquisition, a parent corporation forms a new subsidiary, which is merged into the target corporation.[219] Under the merger agreement, the former target shareholders receive parent voting stock in exchange for their target stock and the parent becomes the sole shareholder of target.[220]

Section 368(a)(2)(E) requires two important conditions for a reverse triangular merger to receive tax-free reorganization treatment:

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212. *See* MARTIN D. GINSBURG, ESQ. AND JACK S. LEVIN, ESQ., MERGERS, ACQUISITIONS AND LEVERAGED BUYOUTS, at 1003 (vol. F1, 1993).

213. *Id.*

214. *See* BNA, No. 770, *supra* note 83, at A-67.

215. *See* Beller, *supra* note 65, at 80.

216. *Id.*

217. *Id.*

218. *Id.* In addition, the existence of target corporation foreign branches or subsidiaries requiring foreign governmental approval for a change in the target corporation's control may warrant the use of a reverse triangular merger. GINSBURG AND LEVIN, *supra* note 169, at 8203.

219. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 226.

220. *See id.*

> (1) *Immediately* after the transaction, the surviving target corporation must *hold* "substantially all" of its assets and the assets of the merged subsidiary corporation, other than stock of the parent corporation distributed in the transaction. Regulation Section 1.368-2(j)(3)(iii) reiterates that the term "substantially all" has the same meaning under Section 368(a)(2)(E) as in the C reorganization context.[221]
>
> (2) In the transaction, the shareholders of the target corporation must exchange target stock constituting "control" of the target corporation for parent *voting* stock. For this purpose, the two-pronged "control" definition of Section 368(c) applies: at least 80% of the total combined voting power of all voting stock; *and* at least 80% in number of the shares of all classes of nonvoting stock. The Service interprets Section 368(c) as requiring at least 80% in number of *each class* of nonvoting stock.[222]

Thus, a reverse triangular merger may qualify under Section 368(a)(2)(E) even though some consideration other than parent voting stock[223] passes from parent in exchange for target shares.[224] However, the requirements of Section 368(a)(2)(E) are more restrictive than those that apply to a forward triangular merger under Section 368(a)(2)(D).[225] Thus, absent com-

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221. The Service has ruled that the transfer constituting 90% of the target's net assets and 70% of the target's gross assets will constitute "substantially all." Rev. Proc. 77-37, 1977-2 C.B. 568. *See generally* Cook and Coalson, Jr., *The "Substantially All of the Properties" Requirement in Triangular Reorganizations— A Current Review*, 35 TAX LAW. 303 (1982).

222. *See* Treas. Regs. §§ 1.368-2(j)(3)(i), 1.368-2(j)(3)(ii) (1960).

223. Up to 20 percent boot. *See* I.R.C. §§ 368(a)(2)(E), 368(c).

224. If the nonvoting stock consideration takes the form of cash or other property, the recipients will be taxable under the reorganization boot rules of I.R.C. § 356 or, if solely cash or other property is received, under the redemption rules of I.R.C. § 302. *See* Rev. Rul. 75-83, 1975-1 CB 112; Rev. Rul. 74-515, 1974-2 CB 118.

225. I.R.C. Section 368(a)(2)(D) does not require that parent stock be voting stock. Also, in a forward triangular merger the amount of cash or other nonstock consideration flowing from parent is constrained only by the nonstatutory "continuity of interest" doctrine: at least 50% stock is required for advance ruling purposes, but the courts have tolerated substantially lower percentages. *See* Section 3.02 of Rev. Proc. 77-37, 1977-2 C.B. 568; *John A. Nelson Co.*, 296 U.S. 374 (1935) (38%); *Miller*, 84 F.2d 415 (1936) (25%).

pelling nontax reasons for keeping the target corporation alive, the forward subsidiary merger is often the preferred vehicle for tax-free triangular mergers.[226]

The voting stock requirement of the reverse triangular merger also differs from that of the B reorganization.[227] If the acquiring corporation in a reverse triangular merger exchanges voting stock for control of the target, it can use any consideration to acquire the remaining stock of the target.[228] However, because the acquiring corporation must "acquire" control of the target in the transaction, the possibility for a "creeping" reverse triangular merger is substantially restricted.[229]

III. DISCUSSION: THE LACK OF A UNIFYING PRINCIPLE IN THE CURRENT AMALGAMATING REORGANIZATION DEFINITIONS

The current amalgamating reorganization definitions are full of detailed and complex principles, seemingly varied without rhyme or reason.[230] For example, the Code disparately treats boot, continuity of interest, and the "substantially all" test.[231] No tax policy justifies the Code's disparate treatment of these various forms of reorganization.[232]

Regarding boot, the motivation behind the the differences in tax treatment of the following remains a mystery: (1) 50% boot in direct mergers[233] and in forward triangular merg-

226. *See* Beller, *supra* note 65, at 80. *But see generally infra* Section III-J entitled "Taxable Forward Or Reverse Triangular Merger?" *See also* Los Angeles County Bar Association Section of Taxation, *L.A. Bar Members Advocate Consistent Treatment For Taxable Mergers*, TAX NOTES TODAY, (June 10, 1992) at 92 TNT 120-33 [hereinafter "LACBAST"] (discussing the higher tax risks involved in failed forward triangular mergers).

227. ABRAMS AND DOERNBERG, *supra* note 12, at 226.

228. *Id.*

229. *Id.* at 226-227. *See infra* Section III-A entitled "Creeping Reverse Triangular Mergers."

230. ABRAMS AND DOERNBERG, *supra* note 12, at 233.

231. *See* Samuel C. Thompson, Jr., Article, *A Suggested Alternative Approach to the Senate Finance Committee Staff's 1985 Proposals for Revising the Merger and Acquisition Provisions,* 5 VA. TAX REV. 599, 624-625 (Spring 1986).

232. *Id.*

233. *See* I.R.C. Section 368(a)(1)(A).

ers,[234] (2) 20% boot in reverse triangular mergers[235] and in certain stock-for-asset acquisitions,[236] and (3) no boot in stock for stock acquisitions.[237] Similarly, the Code permits nonvoting common or preferred stock to qualify for continuity of interest purposes in direct mergers[238] and in forward triangular mergers.[239] However, the Code requires voting stock for continuity of interest purposes for: (1) stock-for-stock acquisitions under Section 368(a)(1)(B), (2) stock-for-asset acquisitions under Section 368(a)(1)(C), and (3) reverse triangular mergers under Section 368(a)(2)(E).[240] No justification apparently exists for these disparities.[241]

From a tax policy perspective, it is peculiar that a "substantially all" test would be applied to a stock-for-asset reorganizations,[242] and to both forward and reverse triangular mergers,[243] but not to a direct merger or a stock-for-stock acquisition.[244] As a result of the "substantially all" test, it is virtually impossible to spin-off[245] a target's assets in a tax-free transaction under Section 355 prior to effectuating an acquisitive reorganization under Sections 368(a)(1)(C), (2)(D), or (2)(E).[246] However, it is possible to combine a target's pre-acquisition spin-off with a later merger under Section 368(a)(1)(A).[247] This later merger may be accomplished by either merging the distributing target into the acquiring

234. *See* I.R.C. Section 368(a)(2)(D).

235. *See* I.R.C. Section 368(a)(2)(E).

236. *See* I.R.C. Section 368(a)(1)(C)

237. *See* I.R.C. Section 368(a)(1)(B). *See* Thompson, Jr., *supra* note 231, at 625.

238. *See* I.R.C. Section 368(a)(1)(A).

239. *See* I.R.C. Section 369(a)(2)(D).

240. *See* Thompson, Jr., *supra* note 231, at 625.

241. *Id.*

242. I.R.C. Section 368(a)(1)(C).

243. I.R.C. Sections 368(a)(2)(D) and (2)(E).

244. I.R.C. Section 368(a)(1)(B). *See* Thompson, Jr., *supra* note 231, at 625.

245. A "spin-off" involves the pro rata distribution by a corporation of stock of a subsidiary to the corporation's shareholders. Matthew M. McKenna and Kirsten Schlenger, *How to meet the five tests spin-offs, split-offs, and split-ups must pass to provide tax benefits*, TAXATION FOR ACCOUNTANTS, 35 TAX'N ACCTS 298 (May 1985). Because the distributee shareholders do not surrender anything in exchange for the stock, spin-offs resemble § 301 distributions. *See id.*

246. Thompson, Jr., *supra* note 231, at 626. *See, e.g.*, Helvering v. Elkhorn Coal Co., 95 F.2d 732 (4th Cir. 1937), *cert. denied*, 305 U.S. 605 (1938).

247. *See* Commissioner v. Morris Trust, 367 F.2d 794 (4th Cir. 1966).

corporation[248] or by merging the spun-off controlled corporation into the acquiring corporation.[249] It is also possible to have a target spin-off unwanted assets in a Section 355 transaction prior to the acquisition of the distributing target by the acquiring corporation in a stock-for-stock reorganization under Section 368(a)(1)(B).[250]

At a minimum, uniformity should exist regarding boot, continuity of interest, and "substantially all" requirements for each form of amalgamating reorganization.[251] This lack of uniformity is especially evident within the triangular reorganization provisions.[252] The remainder of this discussion will primarily focus on the asymmetry in treatment of forward and reverse triangular mergers.

A. Creeping Reverse Triangular Mergers

Prior to the 1985 regulations, much uncertainty surrounded the tax treatment of creeping reverse triangular mergers.[253] It was unclear if such a reorganization was even permissible, although creeping reorganizations were allowed in forward triangular mergers.[254] A creeping reverse triangular merger is an acquisition in which the parent corporation already owns more than 20% of the target stock and thus cannot *acquire* the requisite 80% in the merger.[255] Tax practitioners believed that such transactions were permissible due to both the reverse triangular merger's B reorganization lineage, and Regulation Section 1.368-2(c), which allows creeping B reorganizations.[256]

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248. *Id.*

249. *See* Rev. Rul. 75-406, 1975-2 C.B. 125.

250. Thompson, Jr., *supra* note 231, at 626. *See* Rev. Rul. 70-434, 1970-2 C.B. 83; *but cf.* Rev. Rul. 70-225, 1970-1 C.B. 80 (no B reorganization where stock of spun-off corporation acquired in a purported B).

251. *See* Thompson, Jr., *supra* note 231, at 625-627.

252. *See* S. REP. NO. 91-1553, 91ST CONG., 2D SESS. AT 2 (1970).

253. *See* Willens, *supra* note 210, at 52; *see generally* C. MACLEAN, *CREEPING ACQUISITIONS*, 21 TAX L. REV. 345 (1966). A creeping reverse triangular merger is an acquisition in which the parent corporation already owns more than 20% of the target stock and thus cannot acquire the requisite 80% in the merger.

254. *See* Willens, *supra* note 210, at 52.

255. *Id.*

256. *Id.* Moreover, many tax practitioners read Rev. Rul. 74-564, 1974-2 C.B.

The 1985 regulations, however, clearly dispelled the notion that creeping reverse triangular mergers were permissible.[257] Indeed, Regulation Section 1.368-2(j)(3)(i) stated that in such a transaction the target shareholders must surrender control[258] of the surviving corporation in exchange for voting stock of the controlling corporation.[259] The amount of stock constituting control is measured immediately before the transaction.[260] Although the "immediately before" analysis invites step-transaction problems,[261] Regulation Section 1.368-2(j)(3)(i) states that redeemed stock is not treated as outstanding so long as the target furnishes the redemption.[262] Thus, redemptions are not fatal to Section 368(a)(2)(E) treatment as long as the survivor is not reimbursed, directly or indirectly, for redemption costs.[263]

Perhaps compelled by the literal language of the statute, the disparate treatment of forward and reverse triangular mergers is nonetheless unwarranted because it ignores Section 368's legislative purpose of eliminating the tax-incongruity of

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124, as suggesting that creeping control and § 368(a)(2)(E) were not incompatible. *See id.* That ruling involved a reverse triangular merger that did not qualify under (a)(2)(E) because stock of a "grandparent" corporation was used and, at the time of the merger, the merging subsidiary's parent (a first-tier sub) "already owned a controlling interest" in target. *See id.* The implication was that an (a)(2)(E) would be possible whenever the amount of stock obtained in the transaction was sufficient to raise the parent's interest to the 80% control level, regardless of how much stock was conveyed in the merger. *Id.* The only transaction clearly barred from § 368 (a)(2)(E) was one in which a corporation already in control sought to increase its percentage of ownership. *Id.*

257. *Id. See* Treas. Regs. §§ 1.368-2 (j)(3)(i) and -2(j)(7), Examples (4) and (9).

258. "Control" in this situation constitutes 80 percent. *See* I.R.C. § 368(c).

259. Willens, *supra* note 210, at 52.

260. *Id.*

261. *See generally* Blanchard, Jr., *The Effect of the Step-Transaction Doctrine on Reverse Subsidiary Mergers: An Analysis,* 55 J.TAX'N 72 (Aug. 1981).

262. Willens, *supra* note 210, at 52.

263. *Id. See also* Rev. Rul. 75-360, 1975-2 CB 110, in which a contribution to a target's capital by its new owner, made to defray a loan incurred to fund a redemption, was found to be a disguised payment of boot. *Id.*

In addition to redemption funds furnished by the target, the case law indicates that significant pre-merger stripouts of excess liquid or nonoperating assets of target will not necessarily cause the "substantially all" requirement to be violated. *See, e.g.,* Smothers v. United States, 642 F.2d 894 (5th Cir. 1981) (operating assets only 15% of total assets); Atlas Tool Co. v. Commissioner, 614 F.2d 860 (3rd Cir. 1980) (19%); American Mfg. Co. v. Commissioner, 55 T.C. 204 (1970) (20%).

forward and reverse triangular mergers.[264] Indeed, a 1970 Congressional report stated that there is "no reason why a merger in one direction should be taxable, when the merger in the other direction, under identical circumstances, is tax-free."[265] Thus, the fact that a parent corporation already owns more than 20% of the target stock will not preclude nonrecognition treatment in a forward triangular merger by itself.[266] Moreover, there appears to be no sound policy reason why the same circumstances should bar such treatment in reverse triangular mergers.[267]

Furthermore, application of the anti-creeping control rule to reverse triangular mergers is peculiar given the historical tie[268] between Section 368 (a)(2)(E) and the B reorganization, where creeping control is clearly allowed.[269] One possible objection to creeping control could arise from a concern that a creeping reorganization would allow a majority shareholder to substitute a larger asset basis in the target for the parent corporation's old stock basis.[270] However, the same result occurs when the parent owns no more than 20% of the target's stock prior to the reorganization.[271] Surely no overriding legislative hostility is the cause of the disallowance of creeping reverse triangular reorganizations since creeping reorganizations are also permitted by Sections 368(a)(1)(A) and 368(a)(2)(D).[272]

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264. *See* Rev. Rul. 77-428, 1977-2 CB 118 ("The Committee Reports . . . indicate that I.R.C. Section 368 (a)(2)(E) . . . was enacted to allow as a tax-free reorganization a transaction identical to a transaction described in Section 368 (a)(2)(D) except the surviving corporation was the acquired rather than the acquiring corporation.").

265. S. REP. NO. 91-1553, 91ST CONG., 2D SESS. AT 2 (1970).

266. *See* Beller, *supra* note 65, at 80.

267. *Id.*

268. This historical tie is through Rev. Rul. 67-448. *See infra* section III-I entitled "The Availability of Revenue Ruling 67-448 as an Alternate Theory For Nonrecognition Treatment" for a discussion of Rev. Rul. 67-448.

269. Beller, *supra* note 65, at 80. I.R.C. Section 368 (a)(1)(B) requires that the parent corporation control the target corporation "immediately after the acquisition, . . . (whether or not such parent had control immediately before the acquisition)." *Id.*

270. NYSBATS, *supra* note 180, at 400.

271. *Id.*

272. *See* Beller, *supra* note 65, at 80.

B. ASSET "PUSH-UPS" AND "DROP-DOWNS"

As previously discussed in Section II.C.3.,[273] there are a number of nontax reasons which make reverse triangular mergers desirable.[274] One such nontax reason occurs when the target holds valuable contracts or maintains favorable banking relationships that make it desirable for the parent to keep the target in existence.[275] However, after the reverse triangular merger has taken place, the parent corporation may decide that it is best to conduct business as a single entity.[276] An upstream merger, or "push-up," of the acquired corporation into the parent will then allow an enterprise to conduct itself as a single entity.[277]

Until recently, the Service employed the step-transaction doctrine to collapse the reverse triangular and upstream mergers into one transaction arguing that the surviving corporation no longer "holds" its properties as required by Section 368(a)(2)(E).[278] At the same time, however, the Service allowed push-ups after forward triangular mergers because Section 368(a)(2)(D) merely requires that the subsidiary "acquires" substantially all the target's properties.[279] However, in Letter Ruling 94-20-027, the Service undertook a more reasonable analysis of these transactions.[280] The Service held that the

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273. See *supra* notes 210-229 and accompanying text for prior discussion of the nontax problems inherent in a reverse triangular merger transaction.

274. *See* Emory, Swenson, Lerner and Fuller, *Later Merger of Target Into Parent Was Single A Reorganization*, 81 J.TAX'N 116, at 117 (Aug. 1994).

275. *Id.*

276. *See id.*

277. *See id.*

278. *See id.* The Service would then test the transaction as a C reorganization, but the arrangement often failed to qualify. *Id.* If consideration other than voting stock of the parent corporation was used, or if the parent had a prior interest in the target, disqualification as a C could result from the *Bausch and Lomb* doctrine (*See infra* section III-F entitled "The *Bausch and Lomb* Problem" for an analysis of the *Bausch and Lomb* doctrine). *Id.* The transaction would be a taxable purchase of the target's assets, with that corporation recognizing corporate-level gain. *Id.* The parent corporation would take a stepped-up (or stepped-down) basis in the acquired assets. *Id.* Thus, what began as a qualifying reverse triangular merger would change, by virtue of the later upstream merger, into a failed C reorganization. *Id.*

279. *See* Emory, Swenson, Lerner and Fuller, *supra* note 274, at 117.

280. *Id.* A more reasonable analysis would be to treat the parent as acquiring the target assets directly in exchange for its stock. *Id.* Under this approach, the

later upstream merger would be stepped into the prior reverse triangular merger, even though it was decided to effect the upstream merger after the subsidiary was merged into the target.[281] Thus, the parent was treated as acquiring the target's assets directly in exchange for its stock.[282]

Another important nontax reason which makes triangular mergers attractive is their ability to shelter the acquiring parent corporation from any undesirable target liabilities.[283] This benefit is especially attractive when the target's assets are subject to unknown or undisclosed liabilities.[284] For example, a parent may merge with a target in a C reorganization and drop all of the target's assets, subject to all its liabilities, down into a wholly-owned subsidiary. In such a situation, the parent generally would remain responsible for a target's liabilities even after the drop-down.[285] To avoid this problem, planners use a wholly-owned subsidiary of the acquiring corporation to effect a triangular merger.[286]

Proposed Regulation Section 1.368-2(j)(4) would have provided that a significant post-merger transfer of assets by a target to a controlled subsidiary, even though allowed by Section 368 (a)(2)(C), would fail to satisfy the "substantially all" requirement of a reverse triangular merger.[287] Many practitioners found this proposal unjustified, since the Service permitted a Section 368(a)(2)(C) drop-down following a forward triangular merger.[288] In 1985, however, Final Regulation Section 1.368-2(j)(4) reconsidered asset drop-downs.[289] The Regulation stated that an otherwise qualifying Section 368(a)(2)(E)

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transaction would be a good statutory merger of the target into the parent, under § 368 (a)(1)(A). *Id.* at 118. When analyzed as an A reorganization, the existence of consideration other than voting stock would not defeat the transaction and there would be no *Bausch and Lomb* problem as a result of the parent's prior ownership of target stock. *See id.* (discussing Priv. Ltr. Rul. 94-20-027)(Feb. 18, 1994).

281. *See* Emory, Swenson, Lerner and Fuller, *supra* note 274, at 118.

282. *Id.*

283. Cook and Coalson, Jr., *supra* note 172, at 313 n.39.

284. *Id.*

285. *Id.*

286. *See* ABRAMS AND DOERNBERG, *supra* note 12, at 225.

287. Beller, *supra* note 65, at 80.

288. *See* Rev. Rul. 72-576, 1972-2 CB 217.

289. *See* Treas. Reg. § 1.368-2(j)(4) (1960).

will not fail "merely because . . . part or all of the assets of the surviving corporation . . . or the merged corporation . . are transferred to a corporation controlled by the controlling corporation . . . ."[290] Tax attorney Herbert N. Beller, in an article submitted to *The Journal of Taxation*,[291] asserted:

> [w]hile the obvious intention here was to describe the "dropdown" case, the language used [in Reg. 1.368-2(j)(4)] describes instead a horizontal or "brother-sister" transfer of assets between two controlled subsidiaries of P. The reference to "the controlling corporation" is an error; it should have read "the surviving corporation."[292]

The described brother-sister transfer is not protected by Section 368(a)(2)(C) because that provision requires direct control of the transferee corporation by the transferor corporation.[293]

C. CONSEQUENCES OF A PARENT'S ASSUMPTION OF A TARGET'S LIABILITIES

Until the regulations of 1985, tax practitioners were concerned that an assumption of target's liabilities by a parent might somehow trigger taxable boot consequences to a target or its former shareholders in an otherwise qualifying reverse triangular merger.[294] However, most practitioners believed that liability assumption was a relatively safe maneuver in light of Revenue Ruling 73-257.[295] Revenue Ruling 73-257 stated that a parent's assumption of a target's liabilities in a

290. *Id.* The Service maintains that a drop-down of target stock or assets to a partnership will destroy continuity of interest if the transfer takes place as part of the plan of reorganization, unless sufficient target stock or assets are retained at the acquiror level. BNA, No. 771, *supra* note 54, at A-43, A-44. Such a drop-down could invalidate the prior reorganization, regardless of the extent of the parent's interest in the partnership. *Id. See* GEN. COUNS. MEM. 35,117 (November 15, 1972); *see also* GEN. COUNS. MEM. 39,150 (Mar. 1, 1984).

291. Beller, *supra* note 65, at 80.

292. *Id.* n.41.

293. *See id.*

294. *See id.*

295. Rev. Rul. 73-257, 1973-1 CB 189.

forward triangular merger transaction was protected under Section 357(a), and therefore, that liability assumption did not trigger taxable boot consequences.[296]

Fortunately, Regulation Section 1.368-2(j)(5) affirmed this interpretation by permitting the parent corporation to assume the target's liabilities.[297] The Service now treats the assumption as a contribution to the target's capital by the parent.[298] The parent's basis in the target's stock will then be increased by the amount of the deemed contribution to capital.[299] Moreover, a contemporaneous exchange of target debt securities for debt securities of the parent, or other securities of the target, will not prevent qualification under Section 368(a)(2)(E) and will be governed by the nonrecognition provisions of Sections 354 and 356.[300] Thus, taxable boot consequences will result only where the principal amount of the securities received exceeds that of the securities surrendered.[301] Similarly, if the target issues a debenture or other debt security to the parent corporation for cash, the transaction will be considered separate.[302] Indeed, such a transaction will not affect qualification of the reverse triangular merger.[303] Therefore, this regulation represents a radical departure from B reorganization precedent.[304]

D. THE "EARNINGS AND PROFITS" PROBLEM AFTER *COMMISSIONER V. CLARK*

When property is sold or exchanged, the Code generally treats any resulting gain as capital gain, whereas gain from the receipt of a dividend is normally treated as ordinary in-

296. *See* Beller, *supra* note 65, at 80.
297. *See id.*
298. *See id.*
299. *See* Treas. Reg. § 1.118-1.
300. Beller, *supra* note 65, at 80.
301. *Id. See* Rev. Rul. 79-155, 1979-1 CB 153 (dealing with I.R.C. § 354(a)(1) in an I.R.C. § 368(a)(2)(D) reorganization context).
302. *Id.*
303. *Id. Cf.* Rev. Rul. 69-91, 1969-1 CB 106 (same result in the B reorganization context).
304. Willens, *supra* note 210, at 52. Regarding B reorganizations, Revenue Ruling 69-142, 1969-1 CB 107, views a securities exchange separately from the reorganization, and therefore such transactions are taxable. *Id.*

come.[305] Under Code Section 354(a)(1), however, gain from a stock-for-stock exchange pursuant to a plan of reorganization is not recognized in determining tax liability.[306] If the exchange of stock in the reorganization is not solely for stock and securities, but also includes boot, Section 356(a)(1) provides that gain shall be recognized in an amount not in excess of the fair market value of the property or the sum of money.[307] Section 356(a)(2) controlls whether the gain is given capital gain treatment (as exchanges of property generally are) or ordinary income treatment.[308] Code Section 356(a)(2) provides that, if the exchange has "the effect of the distribution of a dividend," the gain should be treated as a dividend and taxed as ordinary income.[309] Otherwise, the gain would be characterized as gain from the exchange of property and taxed as capital gains.[310]

In *Commissioner v. Clark,*[311] the Supreme Court considered whether the payment of boot as part of a forward triangular merger had the "effect of a dividend" under Code Section 356(a)(2).[312] The Court held that one should assume that a pure stock-for-stock exchange followed by a post-reorganization redemption of a portion of the stock had occurred.[313] In *Clark*, the shareholder transferred 100 percent of the stock of the acquired corporation in a qualifying forward triangular reorganization for one percent of the stock of the acquiring corporation and cash.[314] The Court rejected the Service's position that the receipt of the cash payment should be analyzed as if it were

305. Commissioner v. Clark, 489 U.S. 726, 729 (1989).

306. I.R.C. Section 354(a)(1).

307. I.R.C. Section 356(a)(1).

308. I.R.C. Section 356(a)(2). Section 356(a)(2) specifies that if an "exchange . . . has the effect of the distribution of a dividend," the boot must be treated as a dividend and is therefore appropriately taxed as ordinary income.

309. *See id.* The safe-harbor provision of Section 302(b)(2) provides that a distribution in redemption of stock will not be treated as a dividend if it is "substantially disproportionate." I.R.C. Section 302(b)(2). This means that the shareholder retained less than 80 percent of the voting and common stock of the corporation after the redemption as said shareholder owned before the redemption. *See* I.R.C. Section 302(c).

310. *See* I.R.C. Section 356(a)(2).

311. 489 U.S. 726 (1989).

312. *Id.* at 728-729.

313. *Id.* at 739-740.

314. *Id.* at 731-732.

received immediately prior to the reorganization, which would have resulted in the receipt being taxed as a dividend.[315] Instead, the Court adopted the taxpayer's position that the receipt should be analyzed immediately after the reorganization, as if the taxpayer had received solely stock in the reorganization and the acquiring corporation had redeemed some of the stock for cash.[316] Under this analysis, the receipt of the cash was taxed as a capital gain.[317]

Before the *Clark* decision, amalgamating reorganizations in which the distributee-shareholder did not control both the transferor and transferee corporations were relatively clear.[318] Only the earnings and profits of the transferor corporation were used to measure dividend income under Section 356(a)(2).[319] Unfortunately, the *Clark* court considered only whether the receipt of property other than stock or securities as part of a forward triangular merger had the effect of a dividend distribution.[320] Since the Supreme Court concluded the receipt of property did not have the effect of a dividend distribution, the Court did not address *whose* earnings and profits should be used to measure the amount of a dividend distribution.[321] This failure has created uncertainty.[322] This current uncertainty over whose earnings and profits should provide the benchmark for distribution has been exacerbated by the Service's inconsistent Letter Rulings issued after *Clark*.[323]

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315. *Id.* at 739. The dividend would have been taxed in proportion to the shareholder's stock holdings. *Id.*

316. *Clark*, 489 U.S. at 739.

317. *Id.* at 740.

318. *See* Stewart and Fortin, *The Correct E&P for Measuring Sec. 356(a)(2) Dividend Income*, 24 TAX ADVISER 404, 408 (July 1993).

319. *Id.*

320. *Id.* at 409.

321. *Id.*

322. *See generally id. See also infra* note 323 for a brief discussion of this uncertainty.

323. *Id.* at 411. For instance, private Letter Rulings 91-18-004 and 91-27-023 both involved § 368(a)(1)(D) acquisitive reorganizations and held that gains recognized by the transferor shareholders would be treated as a dividend under § 356(a)(2) to the extent of the combined Earnings and Profits of both the transferee and transferor corporations. Priv. Ltr. Ruls. 91-18-004 (Jan 30, 1991) and 91-27-023 (Mar. 4, 1991). *See* Rev. Rul. 70-240, 1970-1 CB 81; *see also* J. E. Davant, 366 F.2d 874 (5th Cir. 1966). However, private Letter Rulings 91-12-026 and 91-43-082, which also dealt with acquisitive § 368(a)(1)(D) reorganizations, held, for no apparent reason, that only the transferor's Earnings and Profits would be used

Under the post-reorganization rationale of *Clark,* only the parent's earnings and profits would be available to measure the amount, if any, of dividend income in a triangular merger.[324] The Service, however, could argue that Section 304(a)[325] applies to reach the earnings and profits of both the parent and target corporations by asserting that the subsidiary accomplishes the redemption of the parent's stock.[326] Of course, the application of Section 304(a) will have no effect if a new subsidiary is the transferee in a forward triangular merger.[327] However, it could be problematic in a reverse triangular merger or where an existing subsidiary with earnings and profits is used in the forward triangular merger.[328]

In a Letter Ruling[329] involving a reverse triangular merger,[330] the Service used the *parent's* earnings and profits to measure the potential Section 356(a)(2) dividend income.[331] The most likely explanation for this ruling entails the Service's application of a "post-reorganization redemption" analysis to determine whose earnings and profits should be used.[332] In doing so, the Service reasoned that the parent's stock is hypothetically being redeemed, and therefore, the parent's earnings and profits should be the benchmark to determine dividend income.[333]

in determining the amount of dividend income to the transferor's shareholders. Priv. Ltr. Ruls. 91-12-026 (Dec. 27, 1990) and 91-43-082 (Aug. 5, 1991). Since all four Letter Rulings were issued after *Clark*, it seems some confusion exists within the Service in regard to how the *Clark* decision affects the determination of whose Earnings and Profits should be used in a § 356(a)(2) boot distribution. *Id.*; Priv. Ltr. Ruls. 91-18-004 (Jan. 30, 1991) and 91-27-023 (Mar. 4, 1991).

324. Stewart and Fortin, *supra* note 318, at 410.

325. I.R.C. Section 304(a) provides for a redemption through the use of a related corporation. I.R.C. Section 304(a).

326. Stewart and Fortin, *supra* note 318, at 410.

327. *Id.* In this situation, the new subsidiary will not yet have any earnings and profits. *Id.*

328. *Id.*

329. Priv. Ltr. Rul. 90-41-086 (July 19, 1990).

330. *See supra* notes 210-229 and accompanying text for an in-depth discussion of reverse triangular mergers.

331. Priv. Ltr. Rul. 90-41-086 (July 19, 1990). Stewart and Fortin, *supra* note 318, at 411.

332. *Id.*

333. *Id.*

E. Reverse Triangular Mergers and Holding Company Formations

There are two transactions available by which a widely-held corporation with publicly traded debt securities may form a holding company.[334] Such a corporation could utilize an exchange offer, in which the new holding company's stock and securities are exchanged for those of the existing entity.[335] Alternatively, the corporation could use a reverse triangular merger by creating two tiers of new corporations.[336] Therefore, the Section 368(a)(2)(E) transaction accomplishes economic results identical to that of the exchange offer.[337]

However, a reverse triangular merger is preferable because Regulation Section 1.368-2(j)(5) affords various tax advantages.[338] For example, a transferor-shareholder who only owns securities is not a member of the requisite "control group" of Section 351 since control under Section 351 is measured by stock, not security, ownership.[339] Therefore, securities holders will be taxed on an exchange offer.[340] However, if a Section 368 (a)(2)(E) occurs, the exchange of securities of the controlling corporation for those of the surviving corporation is governed by Section 354(a)(1).[341] Where the debt instruments qualify as securities, nonrecognition treatment is available so long as the principal amount of the new securities does not exceed that of the old.[342] Thus, changing the form of the holding company transaction drastically changes the taxation of participating debenture holders.[343]

A second benefit of using reverse triangular mergers in holding company formation involves the impact of the original

334. Willens, *supra* note 210, at 52.
335. *Id.*
336. *Id.*
337. *Id.*
338. *Id.*
339. Willens, *supra* note 210, at 52.
340. *Id.*
341. *Id.* at 53.
342. *Id.*
343. *Id.* *See* Priv. Ltr. Rul. 88-17-086 (Feb. 5, 1988) (illustrating the use of § 351 in a holding company situation).

issue discount rules.[344] By using reverse triangular mergers instead of exchange offers, the corporation can avoid the economic and bookkeeping problems that accompany original issue discounts.[345] Thus, a reverse triangular merger offers at least two advantages when forming a holding company: tax-free exchange treatment for debenture holders, and avoidance of original issue discount problems.[346] Additionally, shareholders are not disadvantaged by the use of a reverse triangular merger in holding company formation.[347]

F. THE *BAUSCH AND LOMB* PROBLEM

In 1959, the Second Circuit decided *Bausch & Lomb Optical Co. v. Commissioner*.[348] In *Bausch & Lomb*, the Second Circuit held that an acquisition did not qualify as a type C reorganization when the parent previously owned 80 percent of the target's stock as a result of a prior transaction.[349] In doing so, the court decided that the "solely for voting stock" requirement of the type C reorganization was not satisfied.[350] The court so held because a substantial portion of the assets were not acquired for stock of the parent but rather in exchange for the target stock already owned by the parent.[351]

The *Bausch & Lomb* issue should not be problematic in the context of a forward triangular merger where there are no substantial restrictions on the consideration which may be used in the transaction.[352] However, preexisting ownership of part of the target's stock will present a significant problem to the parent in the reverse triangular merger context.[353] Before the regulations of 1985, the issue was whether the stock of the

344. Willens, *supra* note 210, at 53 (referencing Priv. Ltr. Rul. 88-30-050 (May 3, 1988).
345. *Id.*
346. *Id.*
347. *Id.*
348. 267 F.2d 75 (2d Cir.), *cert. denied,* 361 U.S. 835 (1935). *See supra* note 136 for a prior analysis of the *Bausch & Lomb* decision.
349. *Id.* at 78.
350. *Id.*
351. *Id.*
352. Cook and Coalson, Jr., *supra* note 172, at 335.
353. *Id.* at 336.

target exchanged by the other target shareholders must itself constitute *control* of target as defined in Section 368(c), or whether the requirement would be satisfied so long as the sum of that stock plus the stock previously owned by parent constituted control.[354] Unfortunately for taxpayers, the regulations under Section 368(a)(2)(E) have adopted the former, more restrictive view.[355]

G. THE ABSENCE OF A "RELATIVE SIZE" LIMITATION IN REORGANIZATIONS

An interesting relationship exists between reorganizations and Section 351.[356] Under Section 351, the transferor must be in "control"[357] of the transferee corporation to receive nonrecognition treatment.[358] For example, if the owner of a "mom & pop" grocery store which is operated as a sole proprietorship transfers the business to a conglomerate in exchange for stock, the transaction is undoubtedly taxable.[359] However, if the grocery store is organized as a corporation, the transfer of the stock or assets in exchange for the conglomerate's stock would clearly qualify as a tax-free reorganization.[360] Thus, it appears that this operation of the reorganization provisions is inconsistent with Section 351.[361]

It may appear reasonable to find that the reorganization provisions undermine the main purpose of Section 351 since these provisions extend nonrecognition treatment to certain

354. *Id.* (analyzing the pre-1985 proposed regulations).

355. *Id.*

356. Thompson, Jr., *supra* note 231, at 631.

357. I.R.C. Section 351 defines "control" in terms of § 368(c), which defines control as "the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation."

358. Thompson, Jr., *supra* note 231, at 631-632.

359. *Id.* at 632.

360. *Id.*

361. *Id.* If the sole proprietor were to incorporate her grocery store for the purpose of immediately entering into a reorganization transaction, the Service would take the position that the incorporation and subsequent merger transaction should be subject to step-transaction doctrine and thus be treated as a taxable sale. Rev. Rul. 70-140, 1970-1, CB 73; West Coast Marketing Corp. v. Commissioner, 46 T.C. 32 (1966).

corporate acquisitions that otherwise would not be given such treatment.[362] However, Section 351 may also be used to give nonrecognition treatment to shareholders of a target corporation in a merger transaction that does not, under current law, qualify as a reorganization.[363] Although strong arguments have been advanced in favor of a relative size limitation,[364] the apparent lack of abuse in the absence of such a limitation

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362. Thompson, Jr., *supra* note 231, at 632-33. *See supra* notes 356-363 and accompanying text for a brief discussion of the seeming disparity between Sections 351 and 368.

363. *Id.* Samuel C. Thompson, Jr., stated:

> For example, the acquiring corporation and a minority shareholder of the target (e.g., a fifteen-percent shareholder) can form a new corporation with the acquiring corporation contributing cash and the minority shareholder contributing target stock. The acquiring corporation might receive all of the common stock of the new corporation and the minority shareholder all of the preferred. The transaction on its face qualifies under section 351 and the minority shareholder receives nonrecognition treatment. The new corporation then purchases for cash the eighty-five percent balance of the stock of the target. As a result, the acquiring corporation has acquired all of the common equity in the target for eighty-five percent cash and fifteen percent stock, the minority shareholder has received nonrecognition treatment, and the majority shareholders have a taxable transaction. Further, the new corporation could make a section 338 election and step up the basis of the target's assets.

Id. at 633.

364. *Id.* at 631. The House version of the bill that became the 1954 I.R.C. contained a relative size limitation that would have extended tax-free treatment only to mergers involving corporations of the same relative size. *Id.* at 630. This provision did not become law, but the relative size rule that was contained in the 1954 bill would have denied reorganization treatment to any transaction where the acquiror was more than four times larger than the target. *Id.* & n.138. Thus, this restriction would make it practically impossible for an acquiring corporation that had common stock which was worth more than five times the common stock of the target to acquire the target in a tax-free exchange in which the consideration paid was stock. *Id.* & n.138.

The idea of limiting nonrecognition treatment where stock is involved was proposed in a more restrictive form by Jerome R. Hellerstein, who argued that nonrecognition treatment should not be available in any reorganization transaction where the target's shareholders receive "stock traded on an exchange or in the over-the-counter market if an adequate market exists for the sale of the stock received." Hellerstein, *Mergers, Taxes, and Realism*, 71 HARV. L. REV. 254, 284 (1957). *See* Thompson, Jr., *supra* note 231, at 630-31 n.139.

makes adopting one appear unwarranted.[365] Further, the reasoning employed by Professor Walter Blum against a relative size limitation is persuasive:

> [The absence of a relative size standard] must, I submit, rest on a policy to encourage (or not impede) particular types of corporate business rearrangements. In this light it is easy to dispose of the point about the relative size of firms participating in the union. Would anyone advocate that we adopt a broad policy of encouraging the union of two equal size companies but not two firms of radically different sizes?[366]

Of course, Professor Blum's argument fails to address the rationale of a relative size limitation, which is to award nonrecognition treatment to transactions that only involve a mere change in investment form, and not substance.[367] There must be an equivalent continuity of interest[368] in the new investment form to warrant nonrecognition treatment.[369] If the effect of the merger is essentially a cashing out of the target corporation's investment, then taxable sale treatment would be more appropriate.[370] Perhaps a middle ground approach would withhold any relative size limitations on reorganization treatment, but impose a limitation on permissible boot paid in a reorganization, determined by reference to the relative size of the corporations.[371]

365. *See* Thompson, Jr., *supra* note 231, at 631.

366. Walter J. Blum, *Corporate Acquisitions under the Income Tax: Another Approach,* 50 TAXES 85, 100 (1972).

367. *See generally* ABRAMS AND DOERNBERG, *supra* note 12, at 37.

368. For example, equivalent "risk" and "control."

369. *See* CEB, *supra* note 2, at 92; *see also* ABRAMS AND DOERNBERG, *supra* note 12, at 37.

370. *Id.*

371. Thompson, Jr., *supra* note 231, at 631.

H. PERMISSIBLE BOOT LIMITATION

If reorganization status does not require relative size, the amount of permissible boot[372] consideration should be a function of the relative size of the target and the acquiring corporation.[373] The smaller the target relative to the acquirer, the smaller the amount of permissible boot consideration.[374] Professor Samuel C. Thompson, Jr., proposed the following permissible boot standard:

Relative Size of Target To Acquirer				*Permissible Boot*
Less than	1	to	20	10%
Less than	1	to	10	20%
Less than	1	to	5	30%
More than	1	to	5	40%

According to Professor Thompson, Jr., these amounts of permissible boot should be adequate to satisfy dissenters and other shareholders who desire to be cashed out.[375]

The rationale behind this boot standard is that in order to receive the benefit of tax-free reorganization treatment, the transaction should represent a continuation by the target's shareholders of an equity interest in the combined venture.[376] Thus, the proportion of the consideration that consists of vot-

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372. The term "boot" is not defined in the Code. Boot refers to cash or other nonpermitted property that triggers recognition when received in an otherwise tax-free exchange. *See* BITTKER AND EUSTICE, *supra* note 26, at 11-53, 11-54. For example, boot may refer to consideration such as nonvoting stock, debt securities, cash or other property. *Id.*

373. Thompson, Jr., *supra* note 231, at 631.

374. *Id.* at 682.

375. *Id.* The Permissible Boot chart above was derived from Thompson, Jr., *supra* note 231. It is noteworthy that in 1958 the American Law Institute suggested that the maximum amount of boot be 33.3% of the consideration paid for the target and that only fully participating stock qualify in determining whether the suggested 66.66% continuity of interest test was satisfied. *See* AMERICAN LAW INST., *FEDERAL INCOME, ESTATE AND GIFT TAX PROJECT, INCOME TAX PROBLEMS OF CORPORATIONS AND SHAREHOLDERS, REPORT OF WORKING VIEWS*, at 326 (1958); *see generally* Kringel, *Preventing a Dissenting Shareholder From Destroying a Tax-Free Reorganization,* 31 J. TAX'N 138 (1969). Also, Walter Blum has recommended that the maximum amount of boot in a reorganization be 20%. *See* Blum, *supra* note 366, at 89-90. Thompson, Jr., *supra* note 231, at 642 n.180.

376. Thompson, Jr., *supra* note 231, at 639, 642.

ing common stock should increase as the size of the target becomes smaller in relation to the acquiring corporation.[377] Professor Thompson, Jr. reasonably maintained that this standard would not add unwarranted complexity to the reorganization definition and would be uniform among all forms of reorganization.[378]

I. THE AVAILABILITY OF REVENUE RULING 67-448 AS AN ALTERNATE THEORY FOR NONRECOGNITION TREATMENT

If a tax-free spin-off[379] precedes an attempted reverse triangular merger, Section 368(a)(2)(E) may not apply because the "substantially all" test would likely not be satisfied.[380] If, however, the reasoning of Revenue Ruling 67-448[381] survived the enactment of Section 368(a)(2)(E), the reorganization could qualify as a B reorganization.[382] Therefore, Revenue Ruling 67-448 gives a corporation an alternate theory in favor of nonrecognition treatment.[383]

In 1974, the Service published two Rulings involving transactions which failed to qualify under Section 368(a)(2)(E) because the subsidiary was not directly controlled by the parent corporation.[384] The Rulings held, however, that these transactions did qualify as Section 368(a)(1)(B) reorganizations

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377. *Id.* at 641. The size of the target and the acquiror would be determined by the relative fair market values of the outstanding voting common stock of both the target and the acquiring corporations. *Id.* The boot limitation could be determined simply by referring to the percentage of the voting stock of the acquiring corporation that is held by the target's shareholders as a result of the reorganization. *Id.*

378. *Id.*

379. A "spin-off" involves the pro rata distribution by a corporation of stock of a subsidiary to the corporation's shareholders. *See* Matthew M. McKenna and Kirsten Schlenger, *How to meet the five tests spin-offs, split-offs, and split-ups must pass to provide tax benefits,* TAXATION FOR ACCOUNTANTS, 35 TAX'N ACCTS 298 (May 1985). Because the distributee shareholders do not surrender anything in exchange for the stock, spin-offs resemble § 301 distributions. *Id.*

380. Willens, *supra* note 210, at 54.

381. Rev. Rul. 67-448, 1967-2 C.B. 144 (transitory subsidiary merges into target in B reorganization).

382. *Id. See also* Rev. Rul. 70-434, 1970-2 CB 83 (demonstrating that a spin-off followed by a B reorganization is permissible, because there is no substantially all requirement in a B reorganization).

383. Willens, *supra* note 210, at 54.

384. Rev. Rul. 74-564, 1974-2 CB 124; Rev. Rul. 74-565, 1974-2 CB 125.

under the transitory merger theory of Revenue Ruling 67-448.[385] This suggests that Revenue Ruling 67-448 has retained its vitality despite Section 368(a)(2)(E).[386] Interestingly, the Service has applied the same theory to permit nonrecognition treatment through Section 351.[387]

Moreover, Regulation Section 1.368-2(j)(7), Examples (4) and (5), indicate that B reorganization treatment can "backstop" a failed Section 368(a)(2)(E).[388] Thus, a failure to satisfy the numerous details of a reverse triangular reorganization does not necessarily preclude tax-free reorganization treatment.[389] Accordingly, in this situation, the relative flexibility of the reverse triangular merger indicates that this transaction

385. *See* Beller, *supra* note 65, at 80. *See also* Rev. Rul. 74-564, 1974-2 CB 124; Rev. Rul. 74-565, 1974-2 CB 125.

386. Willens, *supra* note 210, at 54.

387. Beller, *supra* note 65, at 80, reasoning that:

> One point of difference between characterizing [a reverse triangular merger] as a B reorganization or Section 351 exchange, as opposed to an (a)(2)(E) transaction, has to do with P's [parent's] basis in the T [target's] stock. In a B or Section 351 exchange, P takes a carryover basis in the T stock equal to the exchanging T shareholders' basis plus any gain recognized to such shareholders on the exchange. By contrast, in an (a)(2)(E), the Service now requires a "net asset" basis — that is, P's basis in the T stock is determined with reference to T's basis in its assets less its liabilities.

Id.

Given the right numbers, this difference in basis consequences may dictate deliberately structuring [a reverse triangular merger] to flunk Section 368(a)(2)(E) and qualify instead under Rev. Rul. 67-448. *See generally* Blanchard, Jr., *The Effect of the Step-Transaction Doctrine on Reverse Subsidiary Mergers: An Analysis*, 55 J. TAX'N 72 (August 1981).

388. Willens, *supra* note 210, at 54. Treasury Regulation § 1.368-2(j)(7), Example (4), involves a creeping control situation, and Example (5) involves both a creeping control and a prior redemption of target stock using target funds. *See* Beller, *supra* note 65, at 80. In each, the 80% control requirement is not satisfied, but the statement is made that "if S is a transitory corporation, formed solely for purposes of effectuating the transaction, the transaction may qualify as a reorganization described in section 368(a)(1)(B) provided all of the applicable requirements are satisfied." (The word "solely" is not used in Example (5)). *Id.*

389. Beller, *supra* note 65, at 80.

will occupy a more prominent status among savvy tax practitioners.[390]

J. TAXABLE FORWARD OR REVERSE TRIANGULAR MERGER?

The taxable[391] reverse triangular merger is treated as a sale and purchase of target *stock* by the acquiring corporation.[392] Unless a Section 338 election is made,[393] a taxable reverse triangular merger will result in only one level of tax being levied on the target shareholders.[394] In contrast, the Service treats taxable forward triangular mergers as a transfer of *assets* from the target to the subsidiary, followed by the liquidation of the target.[395] Before the repeal of the *General Utilities* doctrine in 1986,[396] this characterization was of little importance since a Section 337 election was available to avoid a corporate level tax.[397] After the repeal, however, such treatment resulted in the effective imposition of both a corporate level and a shareholder level tax upon the owners of the target corporation.[398] Thus, although the requirements of a forward triangular merger are easier to satisfy than those of a reverse triangular merger, the stakes are much higher.[399]

Members of the Corporate Tax Committee of the Los An-

390. Willens, *supra* note 210, at 54.

391. The term "taxable" is used to refer to triangular mergers which fail to qualify for nonrecognition treatment under I.R.C. Section 368 and are therefore subject to taxation.

392. *See* Los Angeles County Bar Association Section of Taxation, *L.A. Bar Members Advocate Consistent Treatment For Taxable Mergers,* TAX NOTES TODAY (June 10, 1992) at 92 TNT 120-33 [hereinafter "LACBAST"].

393. Under I.R.C. § 338, which replaced § 334(b)(2), a qualified purchase of target stock is now given independent economic significance from a subsequent liquidation of the target regardless of whether a § 338 election is made or deemed made. LACBAST, *supra* note 392.

394. *See* LACBAST, *supra* note 392. As a stock purchase, the basis of the target assets will not be affected as a result of the merger, unless the acquiring corporation makes a § 338 election. *Id.* This has been the rule since 1982 when Congress repealed the *Kimbell-Diamond* doctrine as codified in § 334(b)(2) and replaced it with § 338. *Id.*

395. *Id.*

396. *See supra* note 155 for a discussion of the repeal of the *General Utilities* doctrine.

397. LACBAST, *supra* note 392.

398. *Id.*

399. *Id.*

geles County Bar Association of Taxation[400] (hereinafter "Committee") argue that characterization of a taxable forward triangular merger as a sale of assets is "only a trap for the unwary and could easily be avoided by more sophisticated taxpayers."[401] The Committee maintains that the distinction between stock and asset acquisitions is "scarcely perceptible."[402] The Committee proposes an elective system that puts the participants in control of the tax consequences of the merger, irrespective of which of the participants survives.[403]

The Committee further recommends a policy which encourages the availability of Section 368(a)(2)(D) reorganizations and avoids the current "trap" caused by the choice of which corporation is to survive the merger.[404] Such a policy would treat a taxable merger as a taxable stock acquisition, followed by a deemed Section 332 liquidation if the assets end up directly in the acquiring corporation.[405] This treatment of taxable mergers would result in a carryover basis of the target assets in the possession of the surviving corporation.[406]

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400. *Id.*

401. *Id.* The Committee agrees with the commentator who reasoned:

> "Factually, the line between stock and asset acquisitions is scarcely perceptible . . . If this distinction has become so blurred as to be scarcely perceptible," it is appropriate to ask whether an elective system that puts the participants in control of the tax consequences of the merger, irrespective of which of the participants survives, might be appropriate.

Id. (*quoting* G. Coven, *Taxing Corporate Acquisitions: A Proposal For Mandatory Uniform Rules*, 44 TAX LAW REV. 145 (1989)).

402. LACBAST, *supra* note 392.

403. *Id.*

404. *Id.*

405. *Id.* In some situations, it may be preferable to make an election available to elect asset sale treatment. *Id.* This will result in a corporate level tax and a step-up in basis of the assets transferred to the corporation surviving the merger. *Id.*

406. *Id.*

K. New Proposed Regulations on Basis Adjustment Following a Triangular Reorganization (*Applicable to All Triangular Reorganizations on or after Dec. 23, 1994*)[407]

Congress has failed to provide explicit statutory rules concerning the adjustments, if any, to be made to a parent's basis in its subsidiary or target stock following a triangular reorganization.[408] Further, Congress has not expressly provided that a subsidiary does not recognize gain on its exchange of parent stock for target assets or stock in a triangular reorganization.[409] However, in December 1994 the Service did issue new proposed regulations which employ an "over-the-top model"[410] for determining a parent corporation's basis adjustment in a subsidiary stock as a result of a triangular reorganization.[411]

An over-the-top model would produce a result that treats the transaction as if the parent had acquired the target's assets or stock directly and then transferred the assets or stock to the subsidiary.[412] The Service maintains that this model is appropriate for triangular reorganizations.[413] First, the code expressly defines the basis results in a parent-drop reorganiza-

407. *See* Internal Revenue Service (I.R.S.), Treasury, *Internal Revenue Service Withdrawal of Notice of Proposed Rulemaking and Notice of Proposed Rulemaking and Public Hearing (CO-993-71), Controlling Corporation's Basis Adjustment in Its Controlled Corporation's Stock Following a Triangular Reorganization, Issued Dec. 22, 1994,* Daily Report For Executives (Dec. 23, 1994), 59 FR 66280 (Dec. 1994) [hereinafter "Internal Revenue Service (I.R.S.), Treasury"].

408. *Id.*

409. *Id.* These issues do not arise in a parent/drop reorganization because § 358 applies to determine parent's basis in subsidiary stock on parent's transfer of target's assets or stock to subsidiary, and § 1032 applies to parent's exchange of its own stock for target assets or stock. *Id.*

410. Under that model, following a tax-free triangular reorganization, a controlling corporation would determine its basis in the stock of its target or its acquisition subsidiary as if it had acquired that stock itself and then contributed it to its subsidiary. *Id.*

411. *See* BNA Mgmt. Briefing, *Corporate Taxes — ABA Tax Section at March 31 Hearing to Endorse Triangular Merger Proposal,* (Mar. 30, 1995). The December 1994 proposed Treasury Regulations replace a 1981 proposed rule on the same subject. *Id.*

412. *Id.*

413. *Id.*

tion.[414] Tax policy is furthered, therefore, because cognate reorganizations are treated similarly.[415] Second, subsidiary stock owned by a parent can be perceived as a "surrogate" for the target assets or stock acquired by subsidiary in the reorganization.[416] Therefore a parent achieves neutrality between the sale of subsidiary stock and the sale by subsidiary of the assets or stock acquired in the reorganization.[417]

Newly proposed Section 1.358-6(d) requires the basis in the parent's subsidiary or target stock be reduced by the fair market value of consideration not provided by the parent.[418] Additionally, the newly proposed regulations permit a net negative adjustment to the parent's historic basis in subsidiary only in consolidated group situations.[419] In the consolidated context, the adjustment may mean that the parent experiences an excess loss account under Section 1.1502-19 in its subsidiary or target stock.[420] In the nonconsolidated context, the proposed regulations preclude a net negative adjustment and do not cause a reduction to the parent's historic basis even if that reduction would not result in a negative basis.[421] Thus, the new proposed regulations do not deter the use of an existing subsidiary in the reorganization because none of the parent's historic basis in its subsidiary stock is reduced.[422]

New proposed Section 1.358-6(c)(2)(i) speaks to reverse triangular mergers, maintaining the general rule that a parent's basis in its target stock is adjusted as if the target's assets were acquired. However, if a parent receives less than all of the target's stock, the parent's basis in the target stock received is determined only with respect to an allocable portion

414. *See* Internal Revenue Service (I.R.S.), Treasury, *supra* note 407.

415. *Id.*

416. *Id.* The Service asserts that I.R.C. § 362(b) principles should govern the adjustment to parent's basis in its subsidiary stock. *Id.*

417. *Id.*

418. *Id.* This includes any parent stock not provided by parent pursuant to the plan of reorganization. *Id.*

419. *Id.*

420. *Id. See* new Prop. Treas. Reg. § 1.1502-30, 59 FR 66280 (Dec. 1994).

421. *See* Internal Revenue Service (I.R.S.), Treasury, *supra* note 407.

422. *Id.*

of the basis determined under new proposed Section 1.368-6(c)(2)(i).[423]

Additionally, new proposed Section 1.358-6(c)(2)(iii) includes a special rule for situations when the transaction qualifies as both a reverse triangular merger and a stock acquisition under Section 368(a)(1)(B).[424] This rule permits a parent to adjust its basis in its target stock based either on the target's asset basis or on the aggregate basis of the target stock surrendered in the transaction.[425] To date, the general consensus among tax practitioners appears to be that the Service is correct to follow the over-the-top model.[426]

At an Internal Revenue Service hearing on March 31, 1995, tax attorney Mark Yecies[427] asserted that the new proposal improves the 1981 proposal because it relies on a general, rather than a mechanical approach to the taxation of triangular mergers.[428] However, Mr. Yecies noted that a stock basis approach may be more appropriate than an over-the-top model for reverse triangular mergers.[429] As for the newly proposed regulations permitting taxpayers to choose between basis treatment if the transaction qualifies as both an (2)(E) and a (1)(B), Mr. Yecies asserted that the Service should consider this approach even in cases which qualify only under (1)(B).[430]

Also presenting testimony at the March 31st hearing was tax attorney Reeves Westbrook,[431] who opposed the regulations.[432] Mr. Westbrook argued that no statutory authority

423. *Id.*
424. *Id.*
425. *Id.*
426. *See* BNA Mgmt. Briefing, *supra* note 411.
427. Mark Yecies is a tax attorney at Ernst & Young, Washington, who presented testimony to the I.R.S. advocating the implementation of the new proposed Treasury Regulations. *Id.*
428. *Id.*
429. *See* BNA Mgmt. Briefing, *supra* note 411. The stock basis approach is described in I.R.C. § 368(a)(1)(B). *Id.*
430. *Id.*
431. Reeves Westbrook is a tax attorney at Covington & Burling, Washington, who presented testimony to the I.R.S. against the implementation of the new proposed Treasury Regulations. *Id.*
432. *Id.*

exists for determining basis in a forward triangular merger by constructing a hypothetical transitory step in which the assets of a target are deemed to be transferred to the parent.[433] Mr. Westbrook maintained that "[t]his step is contrary both to the form and substance of a forward triangular reorganization . . . is contrary to the history of the triangular reorganization provisions, and is internally inconsistent with portions of the proposed regulations."[434] Mr. Westbrook proposed that the Service should allow additional flexibility in determining a parent's basis in the stock of its subsidiary for periods beginning before the effective date of the final regulations.[435]

IV. CONCLUSION

Under the current amalgamating reorganization rules and definitions, there remains an asymmetry in treatment of triangular mergers. This disparate treatment is based primarily upon the distinction of whether the reorganization takes the form of a forward or reverse triangular merger. No justification exists for the unequal treatment of these economically cognate transactions.

Since the issuance of the 1985 regulations, tax planning for reverse triangular mergers has certainly been more predictable. However, there remains a need for further clarification and unification of the Code. The legislative history of Section 368(a)(2)(E) suggests that the section's primary purpose was to eliminate the tax-incongruity of forward and reverse triangular reorganizations. Indeed, a 1970 Congressional report argued there is "no reason why a merger in one direction should be taxable when the merger in the other direction, under identical circumstances, is tax-free."[436]

Despite Congressional intent, the Service has been anything but zealous to reconcile Sections 368(a)(2)(D) and (2)(E). In particular, the Service's current contentment with the anti-creeping control rule in (2)(E) is unwarranted. The fact that a

433. *See* BNA Mgmt. Briefing, *supra* note 411.
434. *Id.*
435. *Id.*
436. S. REP'T NO. 91-1553, 91ST CONG., 2D SESS. AT 2 (1970).

parent corporation already owns more than 20% of a target's stock will not alone preclude nonrecognition treatment in forward triangulars. There appears to be no sound policy reason why the same circumstances should bar such treatment in reverse triangular mergers. While the Service has made some positive changes regarding asset push-ups and drop-downs, tax planners should still remain cautious. It can only be hoped that, in time, the reorganization provisions will attain a state of tax equipoise.

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