**“A” Reorganizations**

Code: IRC §§ 368(a)(1)(A) and 368(b)

**Regs:** Treas. Reg. §§ 1.368-1(d) - (e); 1.368-2(b)(1)(i),(ii) & (iii) Examples (2), (5), (6), (7) & (11)

**Bittker & Eustice:** ¶ **12.22**

JOHN A. NELSON CO. v. HELVERING, 56 S.Ct. 273 (1935)

OPINION

Mr. J. S. Seidman, of New York City, for petitioner.

The Attorney General and Mr. J. Louis Monarch, of Washington, D. C., for respondents.

Petition by the John A. Nelson Company to review a decision of the Board of Tax Appeals redetermining a deficiency in the tax imposed by Guy T. Helvering, Commissioner of Internal Revenue. To review a judgment of affirmance by the Circuit Court of Appeals [ 75 F.(2d) 696], petitioner brings certiorari.

Reversed.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

Judge:Mr. Justice McREYNOLDS delivered the opinion of the Court.

The petitioner contests a deficiency income assessment made on account of alleged gains during 1926. It claims that the transaction out of which the assessment arose was reorganization within the statute. Section 203, Revenue Act, 1926, c. 27, 44 Stat. 9, 11 ( 26 U.S.C.A. § 112 [pg. 1263] note), is relied upon. The pertinent parts are in the margin of the opinion in Helvering v. Minnesota Tea Co., 296 U.S. \_\_, 56 S.Ct. 269, 80 L.Ed. \_\_, announced this day.

In 1926, under an agreement with petitioner, the Elliott-Fisher Corporation organized a new corporation with 12,500 shares non-voting preferred stock and 30,000 shares of common stock. It purchased the latter for $2,000,000 cash. This new corporation then acquired substantially all of petitioner's property, except $100,000, in return for $2,000,000 cash and the entire issue of preferred stock. Part of this cash was used to retire petitioner's own preferred shares, and the remainder and the preferred stock of the new company went to its stockholders. It retained its franchise and $100,000, and continued to be liable for certain obligations. The preferred stock so distributed, except in case of default, had no voice in the control of the issuing corporation.

The Commissioner, Board of Tax Appeals, and the court all concluded there was no reorganization. This, we think, was error.

The court below thought the facts showed "that the transaction essentially constituted a sale of the greater part of petitioner's assets for cash and the preferred stock in the new corporation, leaving the Elliott-Fisher Company in entire control of the new corporation by virtue of its ownership of the common stock."

"The controlling facts leading to this conclusion are that petitioner continued its corporate existence and its franchise and retained a portion of its assets; that it acquired no controlling interest in the corporation to which it delivered the greater portion of its assets; that there was no continuity of interest from the old corporation to the new; that the control of the property conveyed passed to a stranger, in the management of which petitioner retained no voice.

"It follows that the transaction was not part of a strict merger or consolidation or part of something that partakes of the nature of a merger or consolidation and has a real semblance to a merger or consolidation involving a continuance of essentially the same interests through a new modified corporate structure. Mere acquisition by one corporation of a majority of the stock or all the assets of another corporation does not of itself constitute a reorganization, where such acquisition takes the form of a purchase and sale and does not result in or bear some material resemblance to a merger or consolidation."

True, the mere acquisition of the assets of one corporation by another does not amount to reorganization within the statutory definition. Pinellas, Ice & Cold Storage Co. v. Commissioner of Internal Revenue, 287 U.S. 462, 53 S.Ct. 257, 77 L.Ed. 428, so affirmed. But where, as here, the seller acquires a definite and substantial interest in the affairs of the purchasing corporation, a wholly different situation arises. The owner of preferred stock is not without substantial interest in the affairs of the issuing corporation, although denied voting rights. The statute does not require participation in the management of the purchaser; nor does it demand that the conveying corporation be dissolved. A controlling interest in the transferee corporation is not made a requisite by section 203(h) (1) (A) ( 26 U.S.C.A. § 112 note). This must not be confused with paragraph (h) (2) ( 26 U.S.C.A. § 112 note).

Finally, as has been pointed out in the Minnesota Tea Case, paragraph (h) (1) (B) was not intended to modify the provisions of paragraph (h) (1) (A). It describes a class. Whether some overlapping is possible is not presently important.

The judgment below must be reversed.

Rev. Rul. 66-224, 1966-2 CB 114

Corporation X was merged under state law into corporation Y. Corporation X had four stockholders (A, B, C, D), each of whom owned 25 percent of its stock. Corporation Y paid A and B each $50,000 in cash for their stock of corporation X, and C and D each received corporation Y stock with a value of $50,000 in exchange for their stock of corporation X. There are no other facts present that should be taken into account in determining whether the continuity of interest requirement of section 1.368-1(b) of the Income Tax Regulations has been satisfied, such as sales, redemptions or other dispositions of stock prior to or subsequent to the exchange which were part of the plan of reorganization.

Held, the continuity of interest requirement of section 1.368-1(b) of the regulations has been satisfied. It would also be satisfied if the facts were the same except corporation Y paid each stockholder $25,000 in cash and each stockholder received corporation Y stock with a value of $25,000.

Rev. Rul. 81-25, 1981-1 CB 132

ISSUE

For a transaction to qualify as a reorganization under section 368(a)(1) of the Internal Revenue Code of 1954, does the continuity of business enterprise requirement apply to the business or business assets of the acquiring <Page 133> (transferee) corporation prior to the reorganization?

LAW AND ANALYSIS

Section 1.368-1(b) of the Income Tax Regulations states that in order for a reorganization to qualify under section 368(a)(1) of the Code there must be continuity of the business enterprise under the modified corporate form.

Rev. Rul. 63-29, 1963-1 C.B. 77, holds that the continuity of business enterprise requirement of section 1.368-1(b) of the regulations was satisfied where a transferee corporation sold its assets and discontinued its business, then acquired the assets of another corporation in exchange for its voting stock, and used the sales proceeds realized from the sale of its assets to expand the business formerly conducted by the acquired corporation. The holding of Rev. Rul. 63-29 is now reflected in the recent amendment to section 1.368-1 (1.368-1(d)) of the regulations, which looks only to the transferor's historic business or historic business assets for determining if the continuity of business enterprise requirement is satisfied.

HOLDING

In a section 368(a)(1) reorganization the continuity of business enterprise requirement does not apply to the business or business assets of the transferee corporation prior to the reorganization.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 63-29 is obsoleted, and Rev. Rul. 79-433, which suspended Rev. Rul. 63-29, is superseded.

Rev. Rul. 81-92, 1981-1 CB 133

ISSUE

Does the acquisition by one corporation of all of the stock of another corporation solely in exchange for voting stock of the acquiring corporation qualify as a tax-free reorganization under section 368(a)(1)(B) if the acquired corporation's assets consist solely of cash that it realized from the sale of assets it previously used in its manufacturing business?

FACTS

T, a corporation engaged in manufacturing, sold all of its assets for cash to Z, an unrelated corporation. The sale was made as part of a plan of reorganization in which P, a corporation engaged in the manufacture of products different than those previously manufactured by T, acquired all of the outstanding stock in T from T's shareholders, in exchange solely for P voting stock. T, as a wholly owned subsidiary of P, then used the cash realized on the sale of its manufacturing assets to engage in a business entirely unrelated to its previous manufacturing business.

LAW AND ANALYSIS

Section 368(a)(1)(B) of the Code provides, in pertinent part, that the term “reorganization” means the acquisition by one corporation, in exchange solely for shares of its voting stock, of the outstanding stock of another corporation if, immediately after the transaction, the acquiring corporation has control of such other corporation.

Section 1.368-1(b) of the Income Tax Regulations states that in order for a reorganization to qualify under section 368(a)(1) of the Code there must be a continuity of the business enterprise under the modified corporate form.

Section 1.368-1(d) of the regulations provides, in general, that the continuity of business enterprise requirement of section 1.368-1(b) is satisfied if the transferee in a corporate reorganization either (i) continues the transferor's historic business or (ii) uses a significant portion of the transferor's historic business assets in a business. Because the continuity of business enterprise requirement must be met for a transaction to qualify as a reorganization, section 1.368-1(d) is applicable to a transaction intended to qualify as a tax free reorganization under section 368(a)(1)(B) of the Code. See section 1.368-1(d)(1)(iii). Therefore, the transferee corporation must continue the transferor's historic business, or continue to use a significant portion of the transferor's historic business assets, in modified corporate form as a subsidiary of the transferee corporation for the transaction to qualify under section 368(a)(1)(B).

HOLDING

In the instant transaction, the acquisition by P of the T stock solely for P's voting stock does not qualify as a tax-free reorganization under section 368(a)(1)(B) since P did not continue T's historic (the manufacturing) business or use a significant portion of T's historic business assets (those used in the manufacturing business) in a business conducted as a subsidiary of P after the transaction.

Accordingly, gain or loss is realized and recognized to the former shareholders of T upon the receipt by them from P of the P voting stock in exchange for their T stock under section 1001 of the Code

EFFECTIVE DATE

This revenue ruling is applicable to the acquisitions that occur after January 30, 1981, the date of acquisition being the date on which the exchange of stock occurs within the meaning of section 1.368-1(d)(1)(iii) of the regulations.

Rev. Rul. 85-197, 1985-2 CB 120

ISSUE

Whether the continuity of business enterprise requirement stated in section 1.368-1(d) of the Income Tax Regulations is satisfied under the facts described below.

FACTS

P is a holding company whose only asset consists of all the stock of an operating subsidiary, S. P merges into S and the P shareholders exchange their P stock for S stock.

LAW AND ANALYSIS

Section 1.368-1(b) of the regulations states that requisite to a reorganization under the Internal Revenue Code is a continuity of the business enterprise under modified corporate form.

Section 1.368-1(d)(3) of the regulations states that the continuity of business enterprise requirement is satisfied if the acquiring corporation continues the historic business of the acquired corporation. Section 1.68-1(d)(2) of the regulations states that:

The application of this general rule to certain transactions, such as mergers of holding companies, will depend on all facts and circumstances. The policy underlying this general rule, which is to ensure that reorganizations are limited to readjustments of continuing interests in property under modified corporate form, provides the guidance necessary to make these facts and circumstances determinations.

In the instant case, the policy enunciated in section 1.368-1(d)(2) of the regulations is satisfied. For purposes of the continuity of business enterprise requirement, the historic business of P is the business of S, its operating subsidiary. Therefore, after the merger, S continues to conduct P's historic business.

HOLDING

The continuity of business enterprise requirement is satisfied when a holding company is merged into its wholly owned operating subsidiary.