

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001-27, page 1298.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2001. See Rev. Rul. 2001-27, page 1298.

Section 368.—Definitions Relating to Corporate Reorganizations

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

Two-step stock acquisitions. The ruling holds that certain two-step stock acquisitions comprised of a tender offer and a merger qualify as reorganizations under sections 368(a)(1)(A) and 368(a)(2)(E).

Rev. Rul. 2001-26

ISSUE

On the facts described below, is the control-for-voting-stock requirement of § 368(a)(2)(E) of the Internal Revenue Code satisfied, so that a series of integrated steps constitutes a tax-free reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E) and § 354 or § 356 applies to each exchanging shareholder?

FACTS

Situation 1. Corporation P and Corporation T are widely held, manufacturing corporations organized under the laws of state A. T has only voting common stock outstanding, none of which is owned by P. P seeks to acquire all of the outstanding stock of T. For valid business reasons, the acquisition will be effected by a tender offer for at least 51 percent of the stock of T, to be acquired solely for P voting stock, followed by a merger of a subsidiary of P into T. P initiates a tender offer for T stock conditioned on the tender of at least 51 percent of the T shares. Pursuant to the

tender offer, P acquires 51 percent of the T stock from T's shareholders for P voting stock. P forms S and S merges into T under the merger laws of state A. In the statutory merger, P's S stock is converted into T stock and each of the T shareholders holding the remaining 49 percent of the outstanding T stock exchanges its shares of T stock for a combination of consideration, two-thirds of which is P voting stock and one-third of which is cash. Assume that under general principles of tax law, including the step transaction doctrine, the tender offer and the statutory merger are treated as an integrated acquisition by P of all of the T stock. Also assume that all nonstatutory requirements for a reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E) and all statutory requirements of § 368(a)(2)(E), other than the requirement under § 368(a)(2)(E)(ii) that P acquire control of T in exchange for its voting stock in the transaction, are satisfied.

Situation 2. The facts are the same as in *Situation 1*, except that S initiates the tender offer for T stock and, in the tender offer, acquires 51 percent of the T stock for P stock provided by P.

LAW AND ANALYSIS

Section 368(a)(1)(A) states that the term "reorganization" means a statutory merger or consolidation. Section 368(a)(2)(E) provides that a transaction otherwise qualifying under § 368(a)(1)(A) will not be disqualified by reason of the fact that stock of a corporation (the "controlling corporation") that before the merger was in control of the merged corporation is used in the transaction, if (1) after the transaction, the corporation surviving the merger holds substantially all of its properties and of the properties of the merged corporation (other than stock of the controlling corporation distributed in the transaction), and (2) in the transaction, former shareholders of the surviving corporation exchanged, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation that constitutes control of such corporation (the "control-for-voting-stock requirement"). For this purpose, control is defined in § 368(c).

In *King Enterprises, Inc. v. United States*, 418 F.2d 511 (Ct. Cl. 1969), as part of an integrated plan, a corporation acquired all of the stock of a target corporation from the target corporation's shareholders for consideration, in excess of 50 percent of which was acquiring corporation stock, and subsequently merged the target corporation into the acquiring corporation. The court held that, because the merger was the intended result of the stock acquisition, the acquiring corporation's acquisition of the target corporation qualified as a reorganization under § 368(a)(1)(A).

Section 354(a)(1) provides that no gain or loss will be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in another corporation a party to the reorganization.

Section 356(a)(1) provides that, if § 354 would apply to the exchange except for the receipt of money or property other than stock or securities in a corporate party to the reorganization, the recipient shall recognize gain, but in an amount not in excess of the sum of the money and the fair market value of the other property.

Section 1.368-1(c) of the Income Tax Regulations provides that a plan of reorganization must contemplate the *bona fide* execution of one of the transactions specifically described as a reorganization in § 368(a) and the *bona fide* consummation of each of the requisite acts under which nonrecognition of gain is claimed. Section 1.368-2(g) provides that the term plan of reorganization is not to be construed as broadening the definition of reorganization as set forth in § 368(a), but is to be taken as limiting the nonrecognition of gain or loss to such exchanges or distributions as are directly a part of the transaction specifically described as a reorganization in § 368(a).

As assumed in the facts, under general principles of tax law, including the step transaction doctrine, the tender offer and the statutory merger in both *Situations 1 and 2* are treated as an integrated acquisition by P of all of the T stock. The principles of *King Enterprises* support the conclusion that, because the tender offer is integrated with the statutory merger in

both *Situations 1 and 2*, the tender offer exchange is treated as part of the statutory merger (hereinafter the “Transaction”) for purposes of the reorganization provisions. *Cf. J.E. Seagram Corp. v. Commissioner*, 104 T.C. 75 (1995) (treating a tender offer that was an integrated step in a plan that included a forward triangular merger as part of the merger transaction). Consequently, the integrated steps, which result in P acquiring all of the stock of T, must be examined together to determine whether the requirements of § 368(a)(2)(E) are satisfied. *Cf.* § 1.368-2(j)(3)(i); § 1.368-2(j)(6), Ex. 3 (suggesting that, absent a special exception, steps that are prior to the merger, but are part of the transaction intended to qualify as a reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E), should be considered for purposes of determining whether the control-for-voting-stock requirement is satisfied).

In both situations, in the Transaction, the shareholders of T exchange, for P voting stock, an amount of T stock constituting in excess of 80 percent of the voting stock of T. Therefore, the control-for-voting-stock requirement is satisfied. Accordingly, in both *Situations 1 and 2*, the Transaction qualifies as a reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E).

Under §§ 1.368-1(c) and 1.368-2(g), all of the T shareholders that exchange their T stock for P stock in the Transaction will be treated as exchanging their T stock for P stock in pursuance of a plan of reorganization. Therefore, T shareholders that exchange their T stock only for P stock in the Transaction will recognize no gain or loss under § 354. T shareholders that exchange their T stock for P stock and cash in the Transaction will recognize gain to the extent provided in § 356. In both *Situations 1 and 2*, none of P, S, or T will recognize any gain or loss in the Transaction, and P’s basis in the T stock will be determined under § 1.358-6(c)(2) by treating P as acquiring all of the T stock in the Transaction and not acquiring any of the T stock before the Transaction.

HOLDING

On the facts set forth in *Situations 1 and 2*, the control-for-voting-stock requirement is satisfied in the Transaction,

the Transaction constitutes a tax-free reorganization under §§ 368(a)(1)(A) and 368(a)(2)(E), and § 354 or § 356 applies to each exchanging shareholder.

DRAFTING INFORMATION

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