Reorganizations under section 368(a)(1)(F); series of steps in overall plan. The merger of a corporation with one created in another state is a section 368(a)(1)(F) reorganization even though it is a step in a larger transaction that includes a series of steps.

Rev. Rul. 96–29

ISSUE

Do the transactions described below qualify as reorganizations under § 368(a)(1)(F) of the Internal Revenue Code?

FACTS

Situation 1. *Q* is a manufacturing corporation all of the common stock of which is owned by twelve individuals. One class of nonvoting preferred stock, representing 40 percent of the aggregate value of *Q*, is held by a variety of corporate and noncorporate shareholders. *Q* is incorporated in state *M*. Pursuant to a plan to raise immediate additional capital and to enhance its ability to raise capital in the future by issuing additional stock, *Q* proposes to make a public offering of newly issued stock and to cause its stock to become publicly traded. *Q* entered into an underwriting agreement providing for the public offering and a change in its state of incorporation. The change in the state of incorporation was undertaken, in part, to enable the corporation to avail itself of the advantages that the corporate laws of state *N* afford to public companies and their officers and directors. In the absence of the public offering, *Q* would not have changed its state of incorporation. Pursuant to the underwriting agreement, *Q* changed its place of incorporation by merging with and into *R*, a newly organized corporation incorporated in state *N*. The shares of *Q* stock were converted into the right to receive an identical number of shares of *R* stock. Immediately thereafter, *R* sold additional shares of its stock to the public and redeemed all of the outstanding shares of nonvoting preferred stock. The number of new shares sold was equal to 60 percent of all the outstanding *R* stock following the sale and redemption.

Situation 2. *W*, a state *M* corporation, is a manufacturing corporation all of the stock of which is owned by two individuals. *W* conducted its business through several wholly owned subsidiaries. The management of *W* determined that it would be in the best interest of *W* to acquire the business of *Z*, an unrelated corporation, and combine it with the business of *Y*, one of its subsidiaries, and to change the state of incorporation of *W*. In order to accomplish these objectives, and pursuant to an overall plan, *W* entered into a plan and agreement of merger with *Y* and *Z*. In accordance with the agreement, *Z* merged with and into *Y* pursuant to the law of state *M*, with the former *Z* shareholders receiving shares of newly issued *W* preferred stock in exchange for their shares of *Z* stock. Immediately following the acquisition of *Z*, *W* changed its place of organization by merging with and into *N*, a newly organized corporation incorporated in state *R*. Upon *W*'s change of place of organization, the holders of *W* common and preferred stock surrendered their *W* stock in exchange for identical *N* common and preferred stock, respectively.

LAW AND ANALYSIS

Section 368(a)(1)(F) provides that a reorganization includes a mere change in identity, form, or place of organization of one corporation, however effected. This provision was amended by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97–248, in order to limit its application to one corporation. Certain limitations contained in § 381(b), including those precluding the corporation acquiring property in a reorganization from carrying back a net operating loss or a net capital loss for a taxable year ending after the date of transfer to a taxable year of the transferor, do not apply to reorganizations described in § 368(a)(1)(F) ''in recognition of the intended scope of such reorganizations as em-

bracing only formal changes in a single operating corporation.'' H.R. Rep. No. 760, 97th Cong., 2d Sess. 540, 541 (1982). Although a change in the place of organization usually must be effected through the merger of one corporation into another, such a transaction qualifies as a reorganization under § 368(a)(1)(F) because it involves only one operating corporation. The 1982 amendment of § 368(a)(1)(F) thus overruled several cases in which a merger of two or more operating corporations could be treated as a reorganization under § 368(a)(1)(F). *See, e.g., Estate of Stauffer v. Commissioner*, 403 F.2d 611 (9th Cir. 1968); *Associated Machine, Inc. v. Commissioner*, 403 F.2d 622 (9th Cir. 1968); and *Davant v. Commissioner*, 366 F.2d 874 (5th Cir. 1966).

A transaction does not qualify as a reorganization under § 368(a)(1)(F) unless there is no change in existing shareholders or in the assets of the corporation. However, a transaction will not fail to qualify as a reorganization under § 368(a)(1)(F) if dissenters owning fewer than 1 percent of the outstanding shares of the corporation fail to participate in the transaction. Rev. Rul. 66–284, 1966–2 C.B. 115.

The rules applicable to corporate reorganizations as well as other provisions recognize the unique characteristics of reorganizations qualifying under § 368(a)(1)(F). In contrast to other types of reorganizations, which can involve two or more operating corporations, a reorganization of a corporation under § 368(a)(1)(F) is treated for most purposes of the Code as if there had been no change in the corporation and, thus, as if the reorganized corporation is the same entity as the corporation that was in existence prior to the reorganization. *See* § 381(b); § 1.381(b)–1(a)(2); *see also* Rev. Rul. 87–110, 1987–2 C.B. 159; Rev. Rul. 80–168, 1980–1 C.B. 178; Rev. Rul. 73–526, 1973–2 C.B. 404; Rev. Rul. 64–250, 1964–2 C.B. 333.

In Rev. Rul. 69–516, 1969–2 C.B. 56, the Internal Revenue Service treated as two separate transactions a reorganization under § 368(a)(1)(F) and a reorganization under § 368(a)(1)(C) undertaken as part of the same plan. Specifically, a corporation changed its place of organization by merging into a corporation formed under the laws of another state and, immediately thereafter, it transferred substantially all of its assets in exchange for stock of an unrelated corporation. The ruling holds that the change in place of organization qualified as a reorganization under § 368(a)(1)(F).

Accordingly, in *Situation 1*, the reincorporation by *Q* in state *N* qualifies as a reorganization under § 368(a)(1)(F) even though it was a step in the transaction in which *Q* was issuing common stock in a public offering and redeeming stock having a value of 40 percent of the aggregate value of its outstanding stock prior to the offering.

In *Situation 2*, the reincorporation by *W* in state *N* qualifies as a reorganization under § 368(a)(1)(F) even though it was a step in the transaction in which *W* acquired the business of *Z*.

HOLDING

On the facts set forth in this ruling, in each of *Situations 1* and *2*, the reincorporation transaction qualifies as a reorganization under § 368(a)(1)(F), notwithstanding the other transactions effected pursuant to the same plan.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79–250, 1979–2 C.B. 156, addressed a similar issue on facts that are substantially similar, in all material respects, to those of *Situation 2*. The ruling holds that a merger of *Z* with and into *Y* in exchange for the stock of *W* qualifies as a reorganization under § 368(a)(1)(A) by reason of § 368(a)(2)(D), even though *W* is reincorporated in another state immediately after the merger. The ruling also holds that the reincorporation qualifies as a reorganization under § 368(a)(1)(F). Rev. Rul. 79–250 did not apply the step transaction doctrine in order to combine the two transactions, stating that the merger and the subsequent reincorporation were separate transactions because ''the economic motivation supporting each transaction is sufficiently meaningful on its own account, and is not dependent upon the other transaction for its substantiation.''

Although the holding of Rev. Rul. 79–250 is correct on the facts presented therein, in order to emphasize that central to the holding in Rev. Rul. 79–250 is the unique status of reorganizations under § 368(a)(1)(F), and that Rev. Rul. 79–250 is not intended to reflect the application of the step-transaction doctrine in other contexts, Rev. Rul. 79–250 is modified.

FURTHER INFORMATION

For further information regarding this revenue ruling contact Marnie Rapaport of the Office of Assistant Chief Counsel (Corporate) at (202) 622-7550 (not a toll-free call).