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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

TD 9242

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Statutory Mergers and Consolidations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that define the term statutory merger or consolidation as that term is used in section 368(a)(1)(A) of the Internal Revenue Code, concerning corporate reorganizations. These final regulations affect corporations engaging in statutory mergers and consolidations, and their shareholders.

DATES: Effective Date: These regulations are effective January 23, 2006.

FOR FURTHER INFORMATION CONTACT: Richard M. Heinecke, at (202) 622-7930 (not a toll free number).

SUPPLEMENTARY INFORMATION:

Background

The Internal Revenue Code of 1986 (Code) provides for general nonrecognition treatment for reorganizations described in section 368 of the Code. Section 368(a)(1)(A) provides that the term reorganization includes a statutory merger or consolidation. On January 24, 2003, the IRS and Treasury

Department published temporary regulations (TD 9038) in the **Federal Register** (68 FR 3384) (the 2003 temporary regulations), along with a notice of proposed rulemaking by cross-reference to the temporary regulations (REG-126485-01) (the 2003 proposed regulations), defining statutory merger or consolidation. The 2003 temporary regulations generally provide that a statutory merger or consolidation is a transaction effected pursuant to the laws of the United States or a State or the District of Columbia, in which, as a result of the operation of such laws, all of the assets and liabilities of the target corporation are acquired by the acquiring corporation and the target corporation ceases its separate legal existence for all purposes. Under the 2003 temporary regulations, the merger of a target corporation into a limited liability company that is disregarded as a separate entity from the acquiring corporation for Federal income tax purposes may qualify as a statutory merger or consolidation.

No public hearing regarding the 2003 proposed regulations was requested or held. Nonetheless, a number of comments were received.

As described above, under the 2003 temporary regulations, a transaction can only qualify as a statutory merger or consolidation if the transaction is effected “pursuant to the laws of the United States, or a State or the District of Columbia.” Given that many foreign jurisdictions have merger or consolidation statutes that operate in material respects like those of the states, on January 5, 2005, the IRS and Treasury Department proposed regulations (the 2005 proposed regulations) containing a revised definition of statutory merger or consolidation that allows transactions effected pursuant to the statutes of a foreign jurisdiction or of a United States possession to qualify as a statutory merger or consolidation (70 FR 746). Simultaneously with the publication of the 2005 proposed regulations, the IRS and Treasury Department published a notice of proposed rulemaking proposing amendments to the regulations under sections 358, 367, and 884 to reflect that, under the 2005 proposed regulations, a transaction involving a foreign entity and a transaction effected pursuant to the laws of a foreign jurisdiction may qualify as a statutory merger or consolidation (the foreign regulations).

Explanation of Provisions

The IRS and Treasury Department have received comments regarding the 2005 proposed regulations and the foreign regulations. This Treasury decision adopts the 2005 proposed regulations as final regulations, with certain technical changes. The foreign regulations are adopted as final regulations in a separate Treasury decision. The following sections describe a number of the most significant comments received with respect to the 2003 proposed regulations and the 2005 proposed regulations and the extent to which they have been adopted in the final regulations.

A. <u>State Law Conversions</u>

A number of commentators have questioned whether under the 2003 temporary regulations a transaction involving a state law conversion of a corporation into a limited liability company that is disregarded as an entity separate from its owner for Federal income tax purposes can qualify as a statutory merger or consolidation under section 368(a)(1)(A). For example, suppose A, a corporation, acquires all of the stock of T, a corporation, in exchange for consideration 50 percent of which is A voting stock and 50 percent of which is cash. As part of an integrated transaction, immediately after the stock acquisition, T files a form with the secretary of state of its state of organization to convert its form of organization from a corporation to a limited liability company. Some commentators have suggested that the conversion of T into a single member limited liability company disregarded as an entity separate from A should be treated like the merger of T into a pre-existing single member limited liability company that is disregarded as an entity separate from A. In the latter case, the overall transaction may qualify as a statutory merger or consolidation of T into A under the 2003 temporary regulations. Commentators have suggested that there is no policy reason to require T to actually merge into the entity that is disregarded as separate from A for A's acquisition of the T assets to qualify as a statutory merger or consolidation. Although the conversion does not involve the fusion under state or local law of a target corporation into a pre-existing entity, it is similar to a statutory merger in that it accomplishes simultaneously the transfer for Federal income tax purposes of all of the assets of the target corporation to the acquiring corporation and the elimination for Federal income tax purposes of the target corporation as a corporation.

A similar question arises when the target corporation is an eligible entity under §301.7701-3(a), rather than a per se corporation, and the status of the target for Federal income tax purposes is changed through an Entity Classification Election under §301.7701-3 rather than through a conversion under state law. In this case, no action under state or local law effects the transfer of the assets of the target corporation to the acquiring corporation. Nevertheless, the election also accomplishes the simultaneous transfer for Federal income tax purposes of all of the assets of the target corporation to the acquiring corporation and the elimination for Federal income tax purposes of the target corporation as a corporation.

As described above, the 2003 temporary regulations provide that a transaction can only qualify as a statutory merger or consolidation if the target corporation ceases its separate legal existence for all purposes. The final regulations retain this requirement. In a conversion, the target corporation's legal existence does not cease to exist under state law. Its legal existence continues in a different form. Therefore, a stock acquisition of a target corporation followed by the conversion of the target corporation from a corporation to a limited liability company under state law cannot qualify as a statutory merger or consolidation under these final regulations. Consequently, pending further consideration of this issue, these final regulations clarify that such an acquisition cannot qualify as a statutory merger or consolidation.

Nevertheless, the IRS and Treasury Department are considering whether a stock acquisition followed by a conversion of the acquired corporation to an entity disregarded as separate from its corporate owner, and whether a stock acquisition followed by a change in the entity classification of the acquired entity from a corporation to an entity disregarded as separate from its corporate owner, should be permitted to qualify as a statutory merger or consolidation. The IRS and Treasury Department are interested in receiving comments in this regard. In addition, the IRS and Treasury Department are interested in comments regarding what implications, if any, permitting these two-step transactions to qualify as a statutory merger or consolidation would have on Revenue Ruling 67-274 (1967-2 C.B. 141) (ruling that an acquisition of stock of a target corporation followed by a liquidation of the target corporation qualified as a reorganization under section 368(a)(1)(C)) and Revenue Ruling 72-405 (1972-2 C.B. 217) (ruling that a forward triangular merger of a subsidiary of an acquiring corporation followed by a liquidation of the subsidiary qualified as a reorganization under section 368(a)(1)(C)).

B. Existence and Composition of the Transferee Unit

The 2003 proposed regulations generally require that, in order for a transaction to qualify as a statutory merger or consolidation, all of the assets and liabilities of each member of the transferor combining unit become the assets and liabilities of one or more members of one other combining unit (the transferee unit). For this purpose, a combining unit is a combining entity and all of its disregarded entities and a combining entity is a business entity that is a corporation (as defined in §301.7701-2(b)) that is not a disregarded entity). As described above, the definition of statutory merger or consolidation allows for the possibility that a merger of a corporation into an entity disregarded as an entity separate from an acquiring corporation could qualify as a statutory merger or consolidation.

One commentator stated that while it is clear that the existence and composition of the transferor unit are tested only immediately before the transaction and that the existence and composition of the transferee unit are tested immediately after the transaction, it is not clear whether the existence and composition of the transferee unit are also tested immediately prior to the transaction. This ambiguity, the commentator argued, creates uncertainty as to whether the following transaction can qualify as a statutory merger or consolidation: A and T, both corporations, together own all of the membership interests in P, a limited liability company that is treated as a partnership for Federal income tax purposes. T merges into P. In the merger, the shareholders of T exchange their T stock for A stock. As a result of the merger, P becomes an entity that is disregarded as an entity separate from A. If the existence and composition of the transferee unit were tested only after the transaction, the transaction could qualify as a statutory merger or consolidation. However, if the existence and composition of the transferee unit were tested both before and after the transaction, the transaction would not qualify for tax-free treatment because, before the merger, P is not a member of the transferee unit because it is not treated as an entity that is disregarded as an entity separate from A for Federal income tax purposes.

The IRS and Treasury Department believe that the transaction described should qualify as a statutory merger or consolidation. Accordingly, these final regulations include an example that illustrates that the existence and composition of the transferee unit is not tested immediately prior to the transaction but instead is only tested immediately after the transaction. Therefore, the merger of T into P may qualify as a statutory merger or consolidation. Moreover, A would be a party to the reorganization, permitting nonrecognition under the operative reorganization provisions of subchapter C of the Code.

Treating the merger of T into P as a reorganization raises questions as to the tax consequences of the transaction to the parties, including whether gain or loss may be recognized under the partnership rules of subchapter K as a result of the termination of P. Similar questions are raised in a merger of T directly into A that qualifies as a reorganization where, in the transaction, P becomes disregarded as an entity separate from A for Federal income tax purposes. The IRS and Treasury Department are considering the tax consequences in these cases, including the extent to which the principles of Revenue Ruling 99-6 apply in these situations and, if they do apply, their consequences. The IRS and Treasury Department request comments in this regard.

C. Consolidations and Amalgamations

Questions have arisen regarding the application of the definition of statutory merger or consolidation to transactions that are effected under state law consolidation statutes and foreign law amalgamation statutes. In a state law consolidation and a foreign law amalgamation, typically, two or more corporations combine and continue in the resulting entity, which is a new corporation that is formed in the consolidation transaction. Some commentators have asked whether a consolidation or an amalgamation can qualify as a statutory merger or consolidation under section 368(a)(1)(A) if effected pursuant to a law that provides that the consolidating or amalgamating corporations continue as one corporation in the resulting corporation. Those commentators are concerned that, because the existence of each of the consolidating corporations or amalgamating corporations continues in the resulting corporation, the requirement that the transferee corporation cease its separate legal existence for all purposes may not be satisfied.

The IRS and Treasury Department believe that the fact that the existence of the consolidating or amalgamating corporations continues in the resulting corporation will not prevent a consolidation from qualifying as a statutory merger or consolidation under the 2003 temporary regulations. The 2003 temporary regulations require that the separate legal existence of the target corporation ceases. In a consolidation or an amalgamation, even if the governing law provides that the existence of the consolidating or amalgamating entities continues in the resulting corporation, the separate legal existence of the consolidating or amalgamating entities does in fact cease. Therefore, the IRS and Treasury Department do not believe that the fact that the existence of the consolidating or amalgamating entities continues in the resulting corporation prevents a consolidation or an amalgamation from qualifying as a statutory merger or consolidation.

Other commentators have questioned whether a consolidation or amalgamation of two operating corporations can involve a reorganization under section 368(a)(1)(F) with respect to one and a reorganization under section 368(a)(1)(A) with respect to the other. For example, suppose that X and Y, both operating corporations, consolidate pursuant to state law. In the consolidation, X and Y result in Z, a new corporation. The shareholders of X and Y surrender their X and Y stock, respectively, in exchange for Z stock. Some commentators have suggested that the consolidation could be viewed as a transfer by X of its assets and liabilities to Z in a reorganization under section 368(a)(1)(F) followed by a merger of Y into Z in a reorganization under section 368(a)(1)(A). Alternatively, it could be viewed as a transfer by Y of its assets and liabilities to Z in a reorganization under section 368(a)(1)(F) followed by a merger of X into Z in a reorganization under section 368(a)(1)(A). The IRS and Treasury Department intend to further study this issue in connection with their separate study of reorganizations under section 368(a)(1)(F).

Questions have also arisen regarding the application of the definition of statutory merger or consolidation to triangular transactions involving consolidations and amalgamations. For example, suppose that A seeks to acquire both X and Y, each in exchange for consideration that is 50 percent A voting stock and 50 percent cash. Under state law, X and Y consolidate into Z, a corporation that results from the acquisition transaction as a wholly owned subsidiary of A. The IRS and Treasury Department believe that a triangular consolidation or amalgamation should be tested under the reorganization rules as a forward triangular merger of each of the consolidating or amalgamating corporations into a wholly owned subsidiary of the parent corporation. Such a transaction might qualify as a statutory merger or consolidation pursuant to the rules of section 368(a)(2)(D). The IRS and Treasury Department recognize that in triangular consolidations and triangular amalgamations, the corporation the stock of which is used in the transaction (A) does not control the acquiring corporation (Z) immediately before the transaction. Nonetheless, the IRS and Treasury Department do not believe that section 368(a)(2)(D) requires the corporation the stock of which is used in the transaction to control the acquiring corporation immediately prior to the transaction and that such corporation's control of the acquiring corporation immediately after the transaction is sufficient to satisfy that requirement of section 368(a)(2)(D). Therefore, these final regulations include an example that illustrates the application of section 368(a)(2)(D) to a triangular amalgamation.

SPECIAL ANALYSIS

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these final regulations is Richard M. Heinecke of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and record keeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.368-2 is amended by revising paragraph (b)(1) to read as follows:

'1.368-2 Definition of terms.

* * * * *

(b)(1)(i) Definitions. For purposes of this paragraph (b)(1), the following terms shall have the following meanings:

(A) Disregarded entity. A disregarded entity is a business entity (as defined in '301.7701-2(a) of this chapter) that is disregarded as an entity separate from its owner for Federal income tax purposes. Examples of disregarded entities include a domestic single member limited liability company that does not elect to be classified as a corporation for Federal income tax purposes, a corporation (as defined in '301.7701-2(b) of this chapter) that is a qualified REIT subsidiary (within the meaning of section 856(i)(2)), and a corporation that is a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)).

(B) Combining entity. A combining entity is a business entity that is a corporation (as defined in '301.7701-2(b) of this chapter) that is not a disregarded entity.

(C) Combining unit. A combining unit is composed solely of a combining entity and all disregarded entities, if any, the assets of which are treated as owned by such combining entity for Federal income tax purposes.

(ii) Statutory merger or consolidation generally. For purposes of section 368(a)(1)(A), a statutory merger or consolidation is a transaction effected pursuant to the statute or statutes necessary to effect the merger or consolidation, in which transaction, as a result of the operation of such statute or statutes, the following events occur simultaneously at the effective time of the transaction ---

(A) All of the assets (other than those distributed in the transaction) and liabilities (except to the extent such liabilities are satisfied or discharged in the transaction or are nonrecourse liabilities to which assets distributed in the transaction are subject) of each member of one or more combining units (each a transferor unit) become the assets and liabilities of one or more members of one other combining unit (the transferee unit); and

(B) The combining entity of each transferor unit ceases its separate legal existence for all purposes; provided, however, that this requirement will be satisfied even if, under applicable law, after the effective time of the transaction, the combining entity of the transferor unit (or its officers, directors, or agents) may act or be acted against, or a member of the transferee unit (or its officers, directors, or agents) may act or be acted against in the name of the combining entity of the transferor unit, provided that such actions relate to assets or obligations of the combining entity of the transferor unit that arose, or relate to activities engaged in by such entity, prior to the effective time of the transaction, and such actions are not inconsistent with the requirements of paragraph (b)(1)(ii)(A) of this section.

(iii) Examples. The following examples illustrate the rules of paragraph (b)(1) of this section. In each of the examples, except as otherwise provided, each of R, V, Y, and Z is a C corporation. X is a domestic limited liability company. Except as otherwise provided, X is wholly owned by Y and is disregarded as an entity separate from Y for Federal income tax purposes. The examples are as follows:

Example 1. Divisive transaction pursuant to a merger statute. (i) Facts. Under State W law, Z transfers some of its assets and liabilities to Y, retains the remainder of its assets and liabilities, and remains in existence for Federal income tax purposes following the transaction. The transaction qualifies as a merger under State W corporate law.

(ii) Analysis. The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section because all of the assets and liabilities of Z, the combining entity of the transferor unit, do not become the assets and liabilities of Y, the combining entity and sole member of the transferee unit. In addition, the transaction does not satisfy the requirements of paragraph (b)(1)(ii)(B) of this section because the separate legal existence of Z does not cease for all purposes. Accordingly, the transaction does not qualify as a statutory merger or consolidation under section 368(a)(1)(A).

Example 2. Merger of a target corporation into a disregarded entity in exchange for stock of the owner. (i) Facts. Under State W law, Z merges into X. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z become the assets and liabilities of X and Z's separate legal existence ceases for all purposes. In the merger, the Z shareholders exchange their stock of Z for stock of Y.

(ii) Analysis. The transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, become the assets and liabilities of one or more members of the transferee unit that is comprised of Y, the combining entity of the transferee unit, and X, a disregarded entity the assets of which Y is treated as owning for Federal income tax purposes, and Z ceases its separate legal existence for all purposes. Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 3. Merger of a target S corporation that owns a QSub into a disregarded entity. (i) Facts. The facts are the same as in Example 2, except that Z is an S corporation and owns all of the stock of U, a QSub.

(ii) Analysis. The deemed formation by Z of U pursuant to '1.1361-5(b)(1) (as a consequence of the termination of U=s QSub election) is disregarded for Federal income tax purposes. The transaction is treated as a transfer of the assets of U to X, followed by X=s transfer of these assets to U in exchange for stock of U. See '1.1361-5(b)(3) Example 9. The transaction will, therefore, satisfy the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z and U, the sole members of the transferor unit, become the assets and liabilities of one or more members of the transferee unit that is comprised of Y, the combining entity of the transferee unit, and X, a disregarded entity the assets of which Y is treated as owning for Federal income tax purposes, and Z ceases its separate legal existence for all purposes. Moreover, the deemed transfer of the assets of U in exchange for U stock does not cause the transaction to fail to qualify as a statutory merger or consolidation. See '368(a)(2)(C). Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 4. Triangular merger of a target corporation into a disregarded entity. (i) Facts. The facts are the same as in Example 2, except that V owns 100 percent of the outstanding stock of Y and, in the merger of Z into X, the Z shareholders exchange their stock of Z for stock of V. In the transaction, Z transfers substantially all of its properties to X.

(ii) Analysis. The transaction is not prevented from qualifying as a statutory merger or consolidation under section 368(a)(1)(A), provided the requirements of section 368(a)(2)(D) are satisfied. Because the assets of X are treated for Federal income tax purposes as the assets of Y, Y will be treated as acquiring substantially all of the properties of Z in the merger for purposes of determining whether the merger satisfies the requirements of section 368(a)(2)(D). As a result, the Z shareholders that receive stock of V will be treated as receiving stock of a corporation that is in control of Y, the combining entity of the transferee unit that is the acquiring corporation for purposes of section 368(a)(2)(D). Accordingly, the merger will satisfy the requirements of section 368(a)(2)(D).

Example 5. Merger of a target corporation into a disregarded entity owned by a partnership. (i) Facts. The facts are the same as in Example 2, except that Y is organized as a partnership under the laws of State W and is classified as a partnership for Federal income tax purposes.

(ii) Analysis. The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section. All of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, do not become the assets and liabilities of one or more members of a transferee unit because neither X nor Y qualifies as a combining entity. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 6. Merger of a disregarded entity into a corporation. (i) Facts. Under State W law, X merges into Z. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of X (but not the assets and liabilities of Y other than those of X) become the assets and liabilities of Z and X's separate legal existence ceases for all purposes.

(ii) Analysis. The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section because all of the assets and liabilities of a transferor unit do not become the assets and liabilities of one or more members of the transferee unit. The transaction also does not satisfy the requirements of paragraph (b)(1)(ii)(B) of this section because X does not qualify as a combining entity. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 7. Merger of a corporation into a disregarded entity in exchange for interests in the disregarded entity. (i) Facts. Under State W law, Z merges into X. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z become the assets and liabilities of X and Z's separate legal existence ceases for all purposes. In the merger of Z into X, the Z shareholders exchange their stock of Z for interests in X so that, immediately after the merger, X is not disregarded as an entity separate from Y for Federal income tax purposes. Following the merger, pursuant to '301.7701-3(b)(1)(i) of this chapter, X is classified as a partnership for Federal income tax purposes.

(ii) Analysis. The transaction does not satisfy the requirements of paragraph (b)(1)(ii)(A) of this section because immediately after the merger X is not disregarded as an entity separate from Y and, consequently, all of the assets and liabilities of Z, the combining entity of the transferor unit, do not become the assets and liabilities of one or more members of a transferee unit. Accordingly, the transaction cannot qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 8. Merger transaction preceded by distribution. (i) Facts. Z operates two unrelated businesses, Business P and Business Q, each of which represents 50 percent of the value of the assets of Z. Y desires to acquire and continue operating Business P, but does not want to acquire Business Q. Pursuant to a single plan, Z sells Business Q for cash to parties unrelated to Z and Y in a taxable transaction, and then distributes the proceeds of the sale pro rata to its shareholders. Then, pursuant to State W law, Z merges into Y. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z related to Business P become the assets and liabilities of Y and Z's separate legal existence ceases for all purposes. In the merger, the Z shareholders exchange their Z stock for Y stock.

(ii) Analysis. The transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, become the assets and liabilities of Y, the combining entity and sole member of the transferee unit, and Z ceases its separate legal existence for all purposes. Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 9. State law conversion of target corporation into a limited liability company. (i) Facts. Y acquires the stock of V from the V shareholders in exchange for consideration that consists of 50 percent voting stock of Y and 50 percent cash. Immediately after the stock acquisition, V files the necessary documents to convert from a corporation to a limited liability company under State W law. Y’s acquisition of the stock of V and the conversion of V to a limited liability company are steps in a single integrated acquisition by Y of the assets of V.

(ii) Analysis. The acquisition by Y of the assets of V does not satisfy the requirements of paragraph (b)(1)(ii)(B) of this section because V, the combining entity of the transferor unit, does not cease its separate legal existence. Although V is an entity disregarded from its owner for Federal income tax purposes, it continues to exist as a juridical entity after the conversion. Accordingly, Y’s acquisition of the assets of V does not qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 10. Dissolution of target corporation. (i) Facts. Y acquires the stock of Z from the Z shareholders in exchange for consideration that consists of 50 percent voting stock of Y and 50 percent cash. Immediately after the stock acquisition, Z files a certificate of dissolution pursuant to State W law and commences winding up its activities. Under State W dissolution law, ownership and title to Z's assets does not automatically vest in Y upon dissolution. Instead, Z transfers assets to its creditors in satisfaction of its liabilities and transfers its remaining assets to Y in the liquidation stage of the dissolution. Y's acquisition of the stock of Z and the dissolution of Z are steps in a single integrated acquisition by Y of the assets of Z.

(ii) Analysis. The acquisition by Y of the assets of Z does not satisfy the requirements of paragraph (b)(1)(ii) of this section because Y does not acquire all of the assets of Z as a result of Z filing the certificate of dissolution or simultaneously with Z ceasing its separate legal existence. Instead, Y acquires the assets of Z by reason of Z's transfer of its assets to Y. Accordingly, Y's acquisition of the assets of Z does not qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 11. Merger of corporate partner into a partnership. (i) Facts. Y owns an interest in X, an entity classified as a partnership for Federal income tax purposes, that represents a 60 percent capital and profits interest in X. Z owns an interest in X that represents a 40 percent capital and profits interest. Under State W law, Z merges into X. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z become the assets and liabilities of X and Z ceases its separate legal existence for all purposes. In the merger, the Z shareholders exchange their stock of Z for stock of Y. As a result of the merger, X becomes an entity that is disregarded as an entity separate from Y for Federal income tax purposes.

(ii) Analysis. The transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z, the combining entity and sole member of the transferor unit, become the assets and liabilities of one or more members of the transferee unit that is comprised of Y, the combining entity of the transferee unit, and X, a disregarded entity the assets of which Y is treated as owning for Federal income tax purposes immediately after the transaction, and Z ceases its separate legal existence for all purposes. Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

Example 12. State law consolidation. (i) Facts. Under State W law, Z and V consolidate. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z and V become the assets and liabilities of Y, an entity that is created in the transaction, and the existence of Z and V continues in Y. In the consolidation, the Z shareholders and the V shareholders exchange their stock of Z and V, respectively, for stock of Y.

(ii) <u>Analysis</u>. With respect to each of Z and V, the transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z and V, respectively, each of which is the combining entity of a transferor unit, become the assets and liabilities of Y, the combining entity and sole member of the transferee unit, and Z and V each ceases its separate legal existence for all purposes. Accordingly, the transaction qualifies as the statutory merger or consolidation of each of Z and V into Y for purposes of section 368(a)(1)(A).

<u>Example 13</u>. <u>Transaction effected pursuant to foreign statutes</u>. (i) <u>Facts</u>. Z and Y are entities organized under the laws of Country Q and classified as corporations for Federal income tax purposes. Z and Y combine. Pursuant to statutes of Country Q the following events occur simultaneously: all of the assets and liabilities of Z become the assets and liabilities of Y and Z's separate legal existence ceases for all purposes.

(ii) <u>Analysis</u>. The transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to statutes of Country Q and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z, the combining entity of the transferor unit, become the assets and liabilities of Y, the combining entity and sole member of the transferee unit, and Z ceases its separate legal existence for all purposes. Accordingly, the transaction qualifies as a statutory merger or consolidation for purposes of section 368(a)(1)(A).

<u>Example 14</u>. <u>Foreign law amalgamation using parent stock</u>. (i) <u>Facts</u>. Z and V are entities organized under the laws of Country Q and classified as corporations for Federal income tax purposes. Z and V amalgamate. Pursuant to statutes of Country Q, the following events occur simultaneously: all the assets and liabilities of Z and V become the assets and liabilities of R, an entity that is created in the transaction and that is wholly owned by Y immediately after the transaction, and Z’s and V’s separate legal existences cease for all purposes. In the transaction, the Z and V shareholders exchange their Z and V stock, respectively, for stock of Y.

(ii) <u>Analysis</u>. With respect to each of Z and V, the transaction satisfies the requirements of paragraph (b)(1)(ii) of this section because the transaction is effected pursuant to Country Q law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z and V, respectively, each of which is the combining entity of a transferor unit, become the assets and liabilities of R, the combining entity and sole member of the transferee unit, with regard to each of the above transfers, and Z and V each ceases its separate legal existence for all purposes. Because Y is in control of R immediately after the transaction, the Z shareholders and the V shareholders will be treated as receiving stock of a corporation that is in control of R, the combining entity of the transferee unit that is the acquiring corporation for purposes of section 368(a)(2)(D). Accordingly, the transaction qualifies as the statutory merger or consolidation of each of Z and V into R, a corporation controlled by Y, and is a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D).

(v) Effective date. This paragraph (b)(1) applies to transactions occurring on or after January 23, 2006. For rules regarding statutory mergers or consolidation occurring before January 23, 2006, see '1.368-2T as contained in 26 CFR part 1, revised

April 1, 2005, and '1.368-2(b)(1) as in effect before January 24, 2003 (see 26 CFR part 1, revised April 1, 2002).

* * * * *

§1.368-2T [Removed]

Par. 3. Section 1.368-2T is removed.

Mark E. Matthews

Deputy Commissioner for Services and Enforcement.

Approved: January 17, 2006

Eric Solomon

Acting Deputy Assistant Secretary of the Treasury (Tax Policy).