# Sticking to Your Resolutions: Acting Under a Plan of Reorganization

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In this report, Zablotney explores how to tell when a particular receipt or distribution of property in connection with a divisive D reorganization is in pursuance of the plan of reorganization for purposes of section 361.

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## I. Introduction

Around every New Year, like millions of deluded Americans, I plan to do a lot of things. I usually plan to clean my closets and drawers (more on that later) and keep them that way. I often plan to get things done on time and not procrastinate so much (more on that later, too). And I sometimes make other resolutions — maybe to do more community service or to read some sort of self-improvement book. But these plans have no teeth. I have made resolutions with myself, and ultimately they happen (or not) at the whims of my schedule, interest level, and other commitments. The only consequences for me are too many wire hangers and yet another late-night scramble to finish something I could have done two weeks earlier, when I was otherwise occupied watching *Game of Thrones*.

But federal income tax law is different. Plans (or the lack thereof) can mean the difference between billions of dollars of tax or no tax at all. This is particularly true for the corporate reorganization provisions under section 368, and even more so for divisive reorganizations described in sections 368(a)(1)(D) and 355 (divisive D reorganizations).

To qualify for tax-deferred treatment under sections 368(a)(1)(D) and 355, a transaction must navigate at least four different "plan" standards. First, to even qualify as a reorganization, the distributing corporation's (D's) transfer to its controlled[1] subsidiary (C) of assets constituting an active trade or business in exchange for C stock, C securities, or other property (including cash) must be "in pursuance of the plan" under which stock or securities of C are distributed in a transaction that qualifies under section 355 or 356.[2] Similarly, for D to receive C stock, securities, or other

[1]Within the meaning of section 368(c), meaning 80 percent of the voting stock and 80 percent of each other class of stock of the corporation.

[2]Section 368(a)(1)(D).

property without current tax, that property must be distributed to D shareholders or D creditors "in pursuance of the plan of reorganization."[3] Moreover, D may distribute C stock or securities to its shareholders or creditors without triggering tax on built-in gain if the distribution is "in pursuance of the plan of reorganization," "pursuant to the plan of reorganization," or "in connection with the reorganization."[4]

Second, the section 355 distribution cannot be part of a "plan (or series of related transactions)" — a phrase that itself is a term of art — under which one or more persons acquire a 50 percent or greater interest in D or C.[5] Third, any retention of C stock cannot be "in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax."[6] And finally, the transactions as a whole must not run afoul of the step transaction doctrine, which puts great weight on the taxpayers' plans (that is, their ultimate objectives).[7]

This report focuses on the first sort of plan — the reorganization — and even more narrowly on how to tell when a particular receipt or distribution of property in connection with a divisive D reorganization is under (or "in pursuance of") the plan of reorganization for purposes of section 361. The most interesting inquiry involves the unexpected — when plans are not fulfilled exactly as contemplated.

To explore these questions and to develop some sort of principles, the report first discusses the policy reasons that undergird the ability of D to receive and distribute property without tax under section 361 as part of a plan of reorganization. It then explores the murky use of the plan of reorganization concept in case law and IRS authorities. Next it discusses the (limited) authorities on the meaning of distributions "in pursuance of a plan of reorganization." It finally discusses the application of the developed principles to divisive D reorganizations when the unexpected happens.

## II. The Theory of the Divisive Reorganization

It has been said that "a Section 355 transaction can be thought of as the opposite of an acquisitive reorganization."[8] That is true insofar as an acquisitive reorganization is the combination of two businesses continuing to operate together in modified form, whereas a divisive reorganization is the continuation of two separate businesses in modified corporate form. However, divisive reorganizations have complexities that acquisitive transactions do not. They can have taxable analogues as property sales, distributions, liquidations, and stock sales.

Although the availability of the code's acquisitive reorganization provisions have been a constant for a century, there have been periods when the divisive reorganization provisions have been unavailable because of the potential to bail out corporate earnings without tax.[9] When Congress restored the ability for corporations to accomplish tax-free divisions of their assets, it said that the reason was to allow a corporation to split "into a greater number of enterprises, when undertaken for legitimate business purposes."[10]

In *Parshelsky's Estate*,[11] the Second Circuit put a gloss on legislative history with a statement included in the legislative history for the 1954 code regarding the reorganization provisions in

[3] Section 361(b)(1)(A) and (b)(3).

[4] *Id*. If the qualified property is not distributed in pursuance of or under the plan of reorganization, gain to D will be recognized. Section 361(b)(1)(B). This is, of course, the same "plan" referred to in section 368(a)(1)(D).

[5] Section 355(e) and reg. section 1.355-7. *See, e.g.*, Martin D. Ginsburg, Jack S. Levin, and Donald E. Rocap, *Mergers, Acquisitions & Buyouts: A Transactional Analysis of the Governing Tax, Legal, and Accounting Considerations*, at para. 1010.1.2.4.2 (2018); Thomas F. Wessel et al., "Corporate Distributions Under Section 355," in Practising Law Institute (PLI), *Strategies for Acquisitions, Dispositions, Spin-Offs, Joint Ventures, Financings, Reorganizations and Restructurings*, at 202 and 1131-1163 (2017); and Mark J. Silverman and Lisa M. Zarlenga, "Final Section 355(e) Plan Regulations — the Final Chapter in the Saga," in PLI, *Consolidated Tax Return Regulations*, at 218 (2017).

[6] Section 355(a)(1)(D)(ii) and reg. section 1.355-2(e).

[7] For a more comprehensive discussion of the step transaction doctrine in its many forms, see Ginsburg, Levin, and Rocap, *supra* note 5, at para. 608.3.

[8] *See* James Lynch, "Tax Free Spin Offs Under Section 355," in PLI, *Strategies for Acquisitions, Dispositions, Spin-offs, Joint Ventures, Financings, Reorganizations and Restructurings*, at 204-209 (1998).

[9] After being made aware of the potential abuses possible with an unrestricted ability to conduct divisive reorganizations in *Gregory v. Helvering*, 293 U.S. 465 (1935), Congress repealed the spinoff provisions for approximately 15 years, adding them back only in 1951. The history of the spinoff provisions has been written about at length. *See, e.g.*, Lynch, *supra* note 8, at 204-214; and Monica M. Coakley, "The Evolving Business Purpose Requirement for Spin-Off Transactions," *Tax Notes*, May 31, 2004, p. 1141, at 1145-1148.

[10] S. Rep. No. 82-781, at 58 (1951).

[11] *Parshelsky's Estate v. Commissioner*, 303 F.2d 14 (2d Cir. 1962).

general, which stated that their purpose was "to provide for nonrecognition of gain or loss in cases which involve a mere rearrangement of the corporate structure or other shifts in the form of the corporate enterprise which do not involve any distribution of corporate assets to shareholders."[12] In *Wilson*,[13] the Ninth Circuit described the code's divisive reorganization provisions as a matter of legislative grace, stating as follows regarding section 355:

> Its purpose and the purpose of its predecessors is to give to stockholders in a corporation controlled by them the privilege of separating or "spinning off" from their corporation a part of its assets and activities and lodging the separated part in another corporation which is controlled by the same stockholders. Since, after the spin-off, the real owners of the assets are the same persons who owned them before, Congress has been willing that these real owners should be allowed, without penalty, to have their real ownership divided into smaller artificial entities than the single original corporation, if the real owners decide that such a division would be desirable.[14]

And the Supreme Court has noted in passing that "the general purpose of [section 355] was to distinguish corporate fission from the distribution of earnings and profits."[15]

All these authorities, together with the architecture and framework of section 355 and the associated Treasury regulations, suggest that divisive reorganizations exist to permit, in limited and proscribed circumstances, an operating corporation to divide into two or more operating corporations basically owned by the same shareholder group. Moreover, if the strict technical requirements of sections 368(a)(1)(D) and 355 are met, ancillary actions that are reasonably required to accomplish the division and its business purposes should theoretically also receive tax-favored treatment.

The foregoing is the proper lens through which to view the application of section 361 in the divisive reorganization context. Under section 361(a), a corporation that is a party to a reorganization will not recognize gain or loss upon the receipt of stock or securities in another corporation that is a party to the reorganization. If a corporation receives money or other property in a reorganization exchange (boot), that corporation will not recognize gain in the exchange under section 361(b)(1) as long as the money or other property is distributed to shareholders and creditors "in pursuance of the plan of reorganization." Under section 361(b)(3), any transfer of money or other property "in connection with the reorganization" by D to its creditors is treated as a distribution in pursuance of the plan of reorganization (except to the extent that the boot exceeds the basis of the assets transferred to the controlled corporation).

The "in connection with the reorganization" standard provided by section 361(b)(3) and (c)(3) uses different wording from the "in pursuance of the plan of reorganization" standard provided elsewhere throughout section 361 and might therefore be interpreted differently. That section 361(c)(3) treats transfers to creditors "in connection with the reorganization" as distributions "pursuant to the plan of reorganization" is evidence that the two standards are intended to encompass transactions with the same relationship to the reorganization and are not intended to create two different legal standards. There appear to be no significant judicial analyses of the potential difference between the two standards in the context of section 361.[16]

Similarly, D may distribute appreciated qualified property it received in the reorganization to its shareholders and creditors without triggering section 311 gain if that distribution is in pursuance of the plan of

[12] *Id.* at 19 (quoting H.R. Rep. No. 83-1337, at 34 (1954)).

[13] *Commissioner v. Wilson*, 353 F.2d 184 (9th Cir. 1965).

[14] *Id.* at 186.

[15] *Commissioner v. Gordon*, 391 U.S. 83, 92 (1968). Note that *Gordon* predates the repeal of the doctrine announced in *General Utilities & Operating Co. v. Helvering*, 296 U.S. 200 (1935). Post-*General Utilities* repeal, the requirements of section 355 also safeguard against the avoidance of tax on corporate gain. *See* Lynch, *supra* note 8, at 204-214.

[16] However, courts have interpreted the phrase "in connection with" broadly in other contexts. *See, e.g.*, *Huntsman v. Commissioner*, 905 F.2d 1182 (8th Cir. 1990) (section 461(g)(2) context). The remainder of this report assumes that the standards are the same.

reorganization. In other words, if a corporation's receipt of property, and the distribution of that property to its shareholders and creditors, is sufficiently related to a statutorily sanctioned reorganization, that receipt and distribution do not create a taxable event in the hands of the corporation.[17]

Curiously, in a section 355 distribution of an old and cold subsidiary without a first-step divisive D reorganization, D may distribute cash from C and retain the proceeds. Economically there may be no difference between the two transactions, and the distinction has been called "arbitrary."[18] Other commentary has noted that this distinction puts "an unfortunate emphasis on form."[19] As a practical matter, when an old and cold subsidiary exists, the main difference between the two transactions is that absent a divisive D reorganization, the amount of value D may extract from C is, as a practical matter, limited to D's stock basis in C.[20]

But this report does not discuss whether and why a taxpayer could or might structure a divisive transaction as a divisive D reorganization; instead, it discusses how to identify specific transactions that are or are not in pursuance of the relevant plan of reorganization once a divisive D structure has been selected.

The "in pursuance of a plan of reorganization" standard in section 361 (and similarly in section 355(c)) is necessary to distinguish distributions to shareholders and creditors that accomplish the purposes of the divisive reorganization from distributions that are merely adjacent to it.[21] As one commentator noted, "The function of the phrase . . . in the operative provisions is to insure that tax-free treatment is limited to exchanges that are sufficiently related to the transactions defined in section 368 as reorganizations."[22]

In the acquisitive context, the operation of section 361 is relatively intuitive. For instance, in a reorganization described in section 368(a)(1)(C), one corporation transfers substantially all of its assets to another corporation in exchange for stock of the second corporation and then liquidates. In that situation, by operation of law, all the property received in the reorganization (whether boot or not) must be distributed to creditors or shareholders in liquidation. Similarly, in a merger described in section 368(a)(1)(A), the corporate merger statute itself requires merger consideration to be distributed to shareholders by operation of law.[23]

But in a divisive reorganization, the distinction is less natural. There is no nontax *legal* compulsion that would require a distribution of boot proceeds from C to shareholders or creditors to accomplish the separation of D and C. Theoretically, D could retain less than section 368(c) control of C stock, C securities, or other property received from C in the reorganization almost indefinitely without causing the transaction to fail to be a reorganization — if and to the extent that the requirements of section 355 were otherwise met. In that case, the sole consequence to D would be that the retention of boot would give rise to tax at the D level (rather than, for example, at the shareholder level for boot distributed to shareholders).

For retention of C stock under section 355(a)(1)(D), the IRS's normal ruling position is that all C stock must be disposed of within five years of the spinoff.[24] However, the IRS has issued guidance blessing D's retention of boot from C when there were sufficient business reasons for that retention. In Rev. Rul. 75-469, 1975-2 C.B. 126, the distributing corporation (Corp. X) distributed all the stock of the controlled corporation (Corp. Y) to specific dissident shareholders in a section 355

[17] *See* Elliott Manning, "'In Pursuance of the Plan of Reorganization': The Scope of the Reorganization Provisions of the Code," 72 *Harv. L. Rev.* 881, 896 (1959).

[18] Deborah L. Paul, "Spin-Offs, Leverage and Value Extraction — A Spin by Any Other Name . . ." 91 *Taxes* 99, 104 (Mar. 2013).

[19] Jeffrey T. Sheffield, "Spinoffs, Corporate Capital Structure and Disguised Sales," 91 *Taxes* 119 (Mar. 2013).

[20] J. William Dantzler Jr., "Spinoffs: Still Remarkably Tax Friendly," *Tax Notes*, Nov. 8, 2010, p. 683, at 688.

[21] The standard was also necessary for liquidations of C reorganizations before section 361(a)(1)(C) was amended in 1984.

[22] Peter L. Faber, "The Use and Misuse of the Plan of Reorganization Concept," 38 *Tax L. Rev.* 515, 516 (1983).

[23] *See* Manning, *supra* note 17, at 895.

[24] Rev. Proc. 96-30, 1996-1 C.B. 696, Appendix B.

distribution. To obtain the consent of X's creditors who had a lien over Y's stock, Y issued X a security, which X pledged as collateral in support of its obligation to those creditors. The ruling concluded that the retention did not have as a principal purpose the avoidance of tax, and that there would be no gain or loss to the dissident shareholders. Similarly, in Rev. Rul. 75-321, 1975-2 C.B. 123, the IRS ruled that the distributing corporation (Corp. X) could retain 5 percent of the stock of the controlled corporation (Corp. Y) to serve as collateral on a loan needed by X to finance its remaining business.

Because the purpose of the spinoff provisions is to permit shareholders to divide their "real ownership" in a corporate venture into smaller corporate ventures without tax, perhaps the best (though imperfect) analogy is to view D as partially liquidating in connection with a spinoff.[25] As part of the partial liquidation, D must relieve itself of some of its obligations to creditors (because it will have a smaller asset base), some of which may be accomplished through C's assumption of debt under section 357.[26] But it will not always be possible for C to assume D's obligations directly — either by law, or because C's credit capacity is different from D's, so that in exchange for the value contributed to C, D must take back a mix of equity instruments, securities, and other obligations different from the mix that sits on D's balance sheet before the reorganization. Equally, the distribution of assets to shareholders on a tax-favored basis is consistent with this theory. Once creditors are paid off, if assets are not needed in a business, those excess assets theoretically should be distributed to shareholders as a dividend or otherwise.[27] Thus, section 361 should be read to permit D to receive tax-free not only C stock but also other property from C if, in effect, D partially liquidates its pre-transaction balance sheet using that property as part of the plan of reorganization.[28]

## III. The Plan of Reorganization

### A. The Statute and the Treasury Regulations

As described earlier, the plan of reorganization concept is important in divisive reorganizations for two reasons. First, for a series of transactions to constitute a reorganization under section 368(a)(1)(D) in the first place, the transactions need to be "pursuant to the plan." Second, for the receipt of the property in the reorganization to be tax-free, D must distribute or transfer that property to shareholders or creditors in pursuance of the plan of reorganization under section 361.

For a concept of such paramount importance, there is surprisingly little statutory and regulatory authority regarding the plan of reorganization.[29] The code itself doesn't define the term "plan of reorganization"; however, reg. section 1.368-2(g) provides:

> The term "plan of reorganization" has reference to a consummated transaction specifically defined as a reorganization under section 368(a). The term is not to be construed as broadening the definition of "reorganization" as set forth in section 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 section 368(a). Moreover, the transaction, or series of transactions embraced in a plan of reorganization must not only come within

[25] Practitioners sometimes talk about the mitosis theory of spinoffs (*i.e.*, equating the division of a single corporation into multiple corporations to the division of a single cell in biology). *See, e.g.*, Dantzler, *supra* note 20, at 683. Divisive transactions in the real world are probably more akin to parthenogenesis, but honestly, we are tax practitioners, not scientists, and we should leave biology to the experts, even by analogy.

[26] At least for debt, sections 357 and 361 can be thought of as largely equivalent in that they both accomplish the division of liabilities between D and C. *See, e.g.*, Ginsburg, Levin, and Rocap, *supra* note 5, at para. 1012; and Sheffield, *supra* note 19.

[27] *Cf. Smothers v. United States*, 642 F.2d 894, 898 (5th Cir. 1981) (discussing the policy reasons behind section 356(a)(2), the court said: "Congress specifically recognized that the throw-off of surplus assets to shareholders in the course of a reorganization can be equivalent to a dividend, and if so, should be taxed as such.").

[28] *Cf.* Rev. Rul. 79-258, 1979-2 C.B. 143 (in the context of a divisive D reorganization, one of P's liabilities attributable to the business contributed to S could not be assumed; therefore, P borrowed new debt, which it caused S to assume, and used the proceeds to pay off a portion of the unassumable liability; the IRS ruled that the assumption of debt did not have a principal purpose of tax avoidance under section 357(b) because the assumption of the liability was "necessary so that the transaction between P and S, which was supported by valid business reasons," could be carried out).

[29] Surprisingly little else has been written. The two leading articles — Manning, *supra* note 17, and Faber, *supra* note 22 — although excellent and authoritative, are 60 and 35 years old, respectively.

> the specific language of section 368(a), but the readjustments involved in the exchanges or distributions effected in the consummation thereof must be undertaken for reasons germane to the continuance of the business of a corporation a party to the reorganization. Section 368(a) contemplates genuine corporate reorganizations which are designed to effect a readjustment of continuing interests under modified corporate forms.

That definition is less than entirely helpful. The first sentence is circular — a plan of reorganization is defined as a transaction that meets the requirements of a reorganization (which itself requires the existence of a plan of reorganization). The second and third sentences are broadly (but not specifically) limiting and are best understood to stand for the proposition that whatever a plan of reorganization is, it is not merely a set of steps that a taxpayer labels "plan of reorganization," nor even each one of a set of steps (related or not) that are ancillary to a transaction otherwise described in section 368(a).[30] However, the concept must be broader than merely the mechanical steps required to satisfy one of the reorganization definitions in section 368(a).[31] For example, before the amendment of the code in 1984, a liquidation was not required for a reorganization to qualify under section 368(a)(1)(C), but liquidations were still unquestionably part of the plan of reorganization in the view of the IRS and the courts.[32]

Reg. section 1.368-1(c) provides additional guidance, stating that a "plan of reorganization must contemplate the bona fide execution of one of the transactions specifically described as a reorganization in Section 368(a) and for the bona fide consummation of each of the requisite acts under which non recognition of gain is claimed." This and the remainder of this regulation appear to be designed to distinguish bona fide transactions from shams.

Reg. section 1.368-3 also requires each of the corporations that is a party to a reorganization to adopt the plan of reorganization.[33] It is not exactly clear what is meant by "adoption," although the term implies action by the board of directors of each corporation. This requirement is particularly curious when applied to a divisive D reorganization. Often C is formed shortly before its distribution by D and is completely subject to D's control in all respects. The adoption of the plan of reorganization by C as a separate corporate formality seems like a strange requirement to impose because C's adoption of the plan is a *fait accompli* and at best fleeting and transitory.

### B. Interpretations of the Plan Concept

Interpretations of the plan of reorganization concept by the IRS and the courts have been chaotic, and the requirement is little discussed in treatises.[34] A good part of the chaos is caused by the interchangeable use of "plan" and "plan of reorganization" in different contexts and for different purposes by the IRS, taxpayers, and courts.

The courts themselves have acknowledged this. In *Seagram*,[35] the Tax Court said that the plan of reorganization concept is "one of substantial elasticity." As demonstrated below, courts appear to find (or not) reorganizations as they wish and define the scope of the plan of reorganization, if

[30] *See* Manning, *supra* note 17, at 885. There are many instances in which transactions are accomplished in anticipation of, or in connection with, a reorganization and yet are treated separately. *See infra* Section III.B.2.

[31] Manning, *supra* note 17, at 883.

[32] *See* Faber, *supra* note 22, at 525-526, for an excellent discussion on this topic. *See also Muskegon Motor Specialties Co. v. Commissioner*, 45 B.T.A. 551 (1941).

[33] Reg. section 1.368-3(a). A previous version appeared to require a writing of some kind (whether a contract or board minutes). Former reg. section 1.368-3(a), before amendment in 2006 by T.D. 9329. The requirement was completely inconsistent with the weight of case law in the area. *See, e.g.*, *Redfield v. Commissioner*, 34 B.T.A. 967 (1936); *Fry v. Commissioner*, 5 T.C. 1058 (1945); *Wilson v. Commissioner*, T.C. Memo. 1961-135, at 61-754; Manning, *supra* note 17, at 910-975; and Faber, *supra* note 22, at 523. Current reg. section 1.368-3(a) also requires each party to file a statement with the IRS including specific facts regarding the reorganization determined as of the completion of the transaction (whenever that is).

[34] For an excellent and thorough discussion of this chaos (at least through its publication date), see Faber, *supra* note 22. Ginsburg, Levin, and Rocap, *supra* note 5, at para. 702.4.1, describe the meaning of "plan of reorganization" as "perilously vague." Boris I. Bittker and James S. Eustice describe the function of the requirement as "to separate transactions making up a reorganization from other transactions, however proximate in time, that are not part of the reorganization," and potentially "as an aspect of the broader step transaction doctrine." Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders*, para. 12.02[6].

[35] *J.E. Seagram Corp. v. Commissioner*, 104 T.C. 75, 96 (1995).

any, to fit the desired narrative. Although most reorganization requirements are fixed and rigid, the plan requirement is strangely flexible and lacks clear definition. Still, there are some broad themes that can be derived from the case law.

**1. Step transaction authorities.**

Many of the authorities are better understood as step transaction authorities rather than as delimiting what might constitute a plan of reorganization or actions under that plan. These authorities create a reorganization penumbra and analyze all transactions within the penumbra to determine whether a statutory reorganization has occurred. Basically, courts look at steps that either the government or the taxpayer claim constitute a plan of reorganization entitled to tax-deferred treatment, and they set the scope of analysis accordingly. These step transaction authorities look at the transaction as a whole to determine whether a reorganization has occurred, and in effect provide guidance regarding the amount of interrelatedness transactions must have to be aggregated as a reorganization.

*Gordon*[36] is an example of a step transaction authority that is sometimes imprecisely cited as a plan of reorganization authority.[37] In *Gordon*, the Supreme Court addressed one of the transactions related to the breakup of American Telephone and Telegraph Co. AT&T owned 90 percent of a subsidiary, Pacific Telephone & Telegraph Co. (Pacific), from which it wished to split off a subsidiary, Pacific Northwest Bell Telephone Co. (Northwest). AT&T submitted a document titled "Plan for Reorganization" to Pacific's shareholders for approval.[38] That plan provided that Pacific would distribute to its shareholders transferable rights entitling them to purchase approximately 56 percent of Northwest stock from Pacific at a price expected to be below the fair market value of the Northwest stock. The remaining stock was intended (but not required) to be offered in a second offering, such that more than 80 percent of the Northwest stock ended up in the hands of Pacific shareholders.[39] Pacific shareholders (including the taxpayers in *Gordon* and in its companion case, *Baan*[40]) took the view that Northwest had been distributed in a divisive D reorganization.[41]

Applying a version of the binding commitment step transaction test, the Court found that the steps that actually occurred did not constitute a reorganization — in effect finding that Pacific's plan for reorganization did not constitute a plan of reorganization.[42] It appears that the requirements of sections 368(a)(1)(D) and 355 would have been satisfied if all the steps that actually occurred had been integrated. However, the Court counted only the first step because, when that first step was taken, there was no binding commitment to take the later steps. This caused the transaction to fail to constitute a reorganization (and the plan, such as it was, to fail to be a plan of reorganization, though this is not explicitly stated).[43] *Gordon*, therefore, is perhaps better thought of as a case regarding the scope of the distribution requirement in section 355 rather than a plan of reorganization case.

There is a separate line of authorities that more explicitly holds that transactions that are reasonably contemplated possibilities at the time of the purported reorganization and that actually occur should be included in the reorganization penumbra for plan of reorganization purposes. Before the enactment of section 368(a)(2)(C) in 1954, the entire line of cases decided under the *Groman*[44] and *Bashford*[45] doctrines disqualified transactions from reorganization treatment based on transactions that were either not required but merely contemplated by both parties, or

[36] *Gordon*, 391 U.S. 83.

[37] *See, e.g.*, Bittker and Eustice, *supra* note 34, at para. 12.02[6], n.139.

[38] *Gordon*, 391 U.S. at 85.

[39] *Id.* at 87.

[40] *Commissioner v. Baan*, 382 F.2d 485 (9th Cir. 1967), *aff'd sub nom. Gordon*, 391 U.S. 83.

[41] *Gordon*, 391 U.S. at 96.

[42] *Id.* at 97-98.

[43] *Id.* at 96. The code requires that "the distribution" divest D of all of, or 80 percent control of, C. Clearly, if an initial transfer of less than a controlling interest in the controlled corporation is to be treated for tax purposes as a mere first step in the divestiture of control, it must be identifiable as such when it is made. In other words, a "creeping spinoff" doesn't exist, at least for the distribution of section 368(c) control of C, unless perhaps the binding commitment test is met. However, creeping acquisitive reorganizations do exist, even in the absence of a binding commitment. *See, e.g.*, *King Enterprises Inc. v. United States*, 189 Ct. Cl. 466 (1969); and Rev. Rul. 2001-26, 2001-2 C.B. 321.

[44] *Groman v. Commissioner*, 302 U.S. 82 (1937).

[45] *Helvering v. Bashford*, 302 U.S. 454 (1938).

transactions that were planned by one party without any knowledge by the other party.[46]

For example, in *Anheuser-Busch*,[47] the Board of Tax Appeals considered whether a transaction in which a transferee corporation exchanged its stock for target assets and dropped those target assets, at its option, into a newly formed subsidiary, qualified as a reorganization. The board found that the transactions did not constitute a reorganization because the parent-transferee's possession of the assets was only transitory, and thus the parent-transferee was not a party to the reorganization. Even though the drop-down of the assets into the subsidiary was not required by the purported plan of reorganization and instead occurred at the parent-transferee's option, the *Anheuser-Busch* court found that "the intervention of a subsidiary will be treated as part of the plan, if it is a contemplated possibility under the plan."[48]

The Tax Court in *Avco*[49] similarly focused on whether a step was a contemplated possibility at the time of a reorganization in determining whether the step was under the same plan of reorganization. An acquiring corporation exchanged its stock for a target corporation's assets, and on the third day after the exchange, the acquirer dropped the assets into a subsidiary. The court found that second transfer to be the ultimate purpose of the transaction. Even though the decision to transfer the assets from the parent-transferee to the subsidiary was made by the board of directors of the acquiring corporation three days after the initial exchange, the *Avco* court found that the drop-down was one of three contemplated options to fulfill the transaction's purpose. Citing *Anheuser-Busch*, the court said that "it, nevertheless, cannot be denied that the subsequent transfer of the property to [the subsidiary] was a contemplated possibility under the plan that actually eventuated. The transfer, therefore, is to be treated as a part of the plan."[50]

The *Avco* court thus found that a corporation contemplating multiple potential options for structuring a reorganization can establish that the options that occur can be part of the plan of reorganization. Another case applying this standard is *Transport Products*,[51] in which the relevant parties to a series of acquisitions had discussed in detail specific transactions resulting in the formation of a new holding entity and in the acquisition of two target entities — before the acquisitions actually occurred. The Tax Court held that the formation and acquisition transactions were all undertaken "in pursuance of the plan of reorganization."

This line of cases approaches an end-result step transaction analysis using "plan of reorganization" language. But the logic of these cases has limits — a standard that aggregates every possibility considered by any taxpayer in connection with a reorganization is overbroad and meaningless.[52] So the proper test is probably short of a true binding commitment standard[53] and more than a mere contemplation/end-result type test. This is supported in case law.

For example, in *Atwood Grain*,[54] the taxpayer owned preferred stock in a corporation that was a party to a reorganization accomplished by merger. Neither the contract nor the certificate of merger mentioned or provided for the disposition of the preferred stock. However, on the date that the merger closed, the board of the combined entity met and adopted a resolution to exchange the outstanding preferred owned by the taxpayer for new preferred of the combined entity. The Tax Court nonetheless found that the new preferred was not issued under the plan of reorganization, because it found that the issuance of the preferred was not contemplated in the merger negotiations

[46] *See, e.g.*, *Anheuser-Busch Inc. v. Helvering*, 40 B.T.A. 1100 (1939); and *Avco Manufacturing Corp. v. Commissioner*, 25 T.C. 975 (1956). *Accord* Rev. Rul. 76-108, 1976-1 C.B. 103 (involuntary transfer of stock to a foreign government taken into account as a step in a "plan of reorganization," thereby disqualifying a purported D reorganization).

[47] *Anheuser-Busch*, 40 B.T.A. at 1107. This case, like many others, discusses "plan" and a "plan of reorganization" concurrently and somewhat interchangeably. The case predates the regulatory definition of plan of reorganization. The court made an explicit assumption that a plan of reorganization existed but found that it did not meet the statutory requirements for tax-free treatment because of impermissible elements in the plan.

[48] *Anheuser-Busch*, 40 B.T.A. at 1106.

[49] *Avco*, 25 T.C. 975.

[50] *Id.* at 985. *See also Atwood Grain & Supply Co. v. Commissioner*, 60 T.C. 412 (1973).

[51] *Transport Products Corp. v. Commissioner*, 25 T.C. 853 (1956), *aff'd per curiam*, 239 F.2d 859 (6th Cir. 1956).

[52] Faber, *supra* note 22, at 547.

[53] Except for a distribution of control.

[54] *Atwood Grain*, 60 T.C. 412.

or in the merger agreement.[55] The Tax Court said that "in order to include events occurring after a merger in the plan of merger there must be some anticipation of the event in the merger."[56]

Similarly, in *National Bank*,[57] a financially troubled bank transferred a significant portion of its assets to a new bank in exchange for stock of the new bank in 1933. In 1937 the old bank sold its building and equipment to the new bank for cash. In finding that the sale of the old bank's building and equipment to the new bank was not part of a plan of reorganization, the *National Bank* court emphasized both the lack of intent by the parties to engage in the sale of the old bank assets at the time of the reorganization and the lack of a "purpose" connection to the reorganization. The court described the potential sale of the building and equipment to the new bank as "fraught with much uncertainty, . . . indefinite and not necessary to the reorganization."[58]

*Seagram*[59] is the most recent of the plan of reorganization authorities. Although it purports to be a binding commitment type authority, *Seagram* is really a penumbra of the plan of reorganization case and is worth studying for its discussion of what it means to have a plan of reorganization.

The facts of *Seagram* are extremely complex. The case arose out of a bidding war (1980s corporate raider-style) for Conoco Inc. In short, each of Seagram, Mobil Corp., and E.I. DuPont de Nemours and Co. (DuPont) made a competing tender offer to take control of Conoco. Seagram's offer was all cash, but DuPont and Mobil each offered a mix of cash and stock. DuPont and Mobil each intended, if successful, to merge the subsidiary that made the tender offer and Conoco to complete its acquisition in a transaction intended to qualify as a reorganization described in section 368(a)(1)(A).[60]

Litigation and drama ensued, but DuPont was ultimately the successful bidder. Seagram closed its cash tender offer for approximately 29 percent of the outstanding Conoco stock and then tendered that stock to DuPont in DuPont's tender offer. DuPont closed its tender offer and back-end merger, acquiring 100 percent of Conoco's stock in exchange for DuPont stock (in an amount the Tax Court found represented continuity of interest) and cash, with Seagram thereby becoming the largest DuPont shareholder.[61] Seagram claimed a large loss on its tax return as a result of its exchange of its Conoco stock for DuPont stock and cash, asserting that its exchange was not under a plan of reorganization.[62]

In a nutshell, Seagram tried to argue that similar to the facts in *Atwood Grain* and *National Bank*, its tender of Conoco stock to DuPont was not part of a plan of reorganization with the merger. Seagram cited the conditionality attached to the merger and the lack of a binding commitment for it to tender into DuPont's transaction, and it maintained that the DuPont tender offer had independent significance from the merger because the tender offer had a separate business motive and separate legal and economic consequences.[63] Put differently, Seagram's position was that the penumbra of the reorganization did not extend to the closing of the DuPont tender offer and that the tender offer should be analyzed standing alone.

The Tax Court disagreed. It found that the transactions as a whole were clearly contemplated under binding agreements that existed contemporaneously with the transactions and actually occurred as described in those agreements. According to the court, changes in the terms of these agreements, including increases in the tender price and cash portion of the consideration, were merely taken "to assure the success of the plan of reorganization, not to

[55] *Id.* at 422-423.

[56] *Id.* at 423. Defying logic, the Tax Court found that the exchange of the preferred did not even meet the contemplated possibility standard, instead finding a separate section 368(a)(1)(E) reorganization for the preferred. The IRS's more recent published rulings, while not explicitly using the words "plan of reorganization," implicitly reject this decision. *See, e.g.*, Rev. Rul. 2001-46, 2001-2 C.B. 321 (integrating a reverse subsidiary merger followed by a planned forward merger as a reorganization described in section 368(a)(1)(A)); and Rev. Rul. 2017-9, 2017-21 IRB 1244 (providing guidance on when transactions will be integrated in so-called north-south transactions).

[57] *National Bank of Commerce v. United States*, 87 F. Supp. 302 (W.D. Tenn. 1949), *aff'd per curiam*, 180 F.2d 356 (6th Cir. 1949).

[58] *Id.*, 87 F. Supp. at 304.

[59] *Seagram*, 104 T.C. 75.

[60] *Id.* at 81. *See King Enterprises*, 189 Ct. Cl. 466.

[61] *Seagram*, 104 T.C. at 89.

[62] *Id.* at 93-95.

[63] *Id.* at 93.

enlarge it outside its initial confines."[64] The fact that the agreements were not necessarily conditioned on each other was irrelevant. Because DuPont was contractually obliged to complete the merger if the minimum tender condition was met (which it was), the court determined that the entire set of transactions leading up to the merger should be integrated as a single plan of reorganization.[65]

Thus, *Seagram* can be read for the proposition that a plan of reorganization can be amended before the actual execution of the reorganization steps if the steps that actually occur were clearly contemplated or required as between the parties to the reorganization (here, Conoco and DuPont) when the final step within the plan eventually happens — which adds back a flavor of the *Anheuser-Busch* and *Avco* standards.

### 2. The adjacent transactions.

#### *a. Planned transactions treated separately.*

There are also situations in which transactions are clearly contemplated in connection with a reorganization, and in fact occur contemporaneously with steps that are found to constitute a reorganization, but still are disaggregated from the reorganization and analyzed and taxed separately.[66] The best examples of this sort of situation involve dividends declared and paid in connection with reorganizations that otherwise would qualify under section 368(a)(1)(B).

For instance, in Rev. Rul. 68-435, 1968-2 C.B. 155, shareholders of a target (Corp. Y) missed receiving payment of a regular dividend from the acquirer (Corp. X) that they would have received if the transaction had been timely consummated. Therefore, under the plan of reorganization, Y declared and paid a dividend from its own funds to its shareholders in the amount they would have received if they had been X shareholders on the ex-dividend date for X's regular quarterly dividend. Despite finding that this payment was "pursuant to the plan of reorganization," the IRS ruled that the transaction would not affect the "solely for voting stock" requirement of section 368(a)(1)(B).[67]

Similarly, in Rev. Rul. 98-10, 1998-1 C.B. 643, Corp. X acquired all the outstanding capital stock of Corp. Y in exchange for X stock. The ruling recites that "pursuant to the plan of reorganization, X acquires all the outstanding debentures of Y in exchange for an equal principal amount of new six percent fifteen-year debentures of X."[68] The IRS found that despite the somewhat overlapping ownership between Y shareholders and Y debenture holders, the debenture swap occurred in pursuance of the plan of reorganization that included the section 368(a)(1)(B) reorganization and thus qualified for nonrecognition treatment.[69]

The IRS historically has been willing to disaggregate some planned steps from a divisive reorganization, treating specific kinds of payments between D and C as dividends rather than boot, particularly in cases in which dividends were actually declared, and most often when the payment of the dividend could be shown to be merely coincidentally timed in connection with a plan of reorganization.[70] However, in Rev. Rul. 2017-9, 2017-21 IRB 1244, the IRS ruled that if a declared dividend is in pursuance of a plan of reorganization, section 361 and not section 301 will govern its taxation. This latest IRS statement is almost a tautology and raises the question of when a dividend is in pursuance of a plan, but it should be interpreted to bring any distribution — declared dividend or

[64] *Id.* at 98.

[65] *Id.* at 104.

[66] As Manning quite astutely states, there is a difference between a plan of reorganization and a "plan that involves" a reorganization. Manning, *supra* note 17, at 897. The IRS and the courts pay attention to this distinction haphazardly.

[67] The ruling relied on the now relatively settled proposition that cash paid by a target (rather than the acquirer) to its own shareholders in a stock reorganization does not constitute boot. *See, e.g.*, New York State Bar Association Tax Section, "Distributions in Connection With Contributions" (June 18, 2008).

[68] *Id.*

[69] *Atwood Grain*, 60 T.C. 412, also probably falls in this category.

[70] *See, e.g.*, LTR 201126010 (before internal spinoff D was contributed to NewCo, and D later declared a dividend to NewCo; dividend taxed under form); LTR 200737017 (C historically paid cash dividends to D, in connection with a divisive D reorganization; C paid cash dividends at its historic level and also paid a special dividend; regular dividend taxed as such; special dividend treated as boot). *See also* Wessel et al., *supra* note 5, at 109-112.

not — from C to D that would not have occurred but for the reorganization within the ambit of section 361 rather than section 301.[71]

There is some case law that extends this concept even to transactions that would have occurred only as a result of a reorganization. In *ITT*,[72] one of International Telephone & Telegraph (ITT) Corp.'s consolidated subsidiaries acquired all the assets of Aetna Finance Co. and Avis Inc., each in a transaction that qualified as a reorganization under section 368(a)(1)(C). As part of the transaction, ITT's subsidiary assumed outstanding convertible Aetna and Avis bonds. As a result of the assumption, the bonds' conversion feature was amended so that bondholders could exercise their conversion right for ITT shares. Shortly after the acquisitions, ITT exchanged the convertible bonds for ITT stock and cash. The IRS contended that the conversion of the bonds was an integral part of the plans of reorganization, thus denying ITT any loss on their retirement. The Tax Court disagreed, finding that the bond exchanges were not an integral part of the reorganization, even though they may have been contemplated contemporaneously with each C reorganization. The fact that the bondholders were not bound was decisive in the Tax Court's view.[73] Similarly, in *Johnson*,[74] the Tax Court declined to integrate transfers between shareholders as part of a reorganization.

Another example is *Becher*.[75] In that case, a corporation in the midst of a liquidation contributed some of its assets to a new corporation in exchange for stock of the new corporation. Eventually the liquidating corporation distributed to its shareholders cash received in the course of its liquidation process and the shares of the new corporation. The Tax Court took the view that although the distributions of cash and stock were contemporaneous, they were merely incidental to one another.[76] It therefore found that the contribution of assets to the new corporation followed by its distribution to the corporation's shareholders constituted a reorganization under the predecessor of section 368(a)(1)(D), but that the dividend was to be taxed separately because it was not part of the plan of reorganization with the formation and distribution of the new corporation.

***b. Transactions that further the plan.***

It equally cannot be, and is not, the case that a taxpayer can cherry-pick which transactions count toward reorganization treatment and which do not.[77] Consistent with this theory, only transactions that further the purposes of a reorganization receive tax-favored treatment. Authorities — which, if not themselves step transaction authorities, are at a minimum step transaction adjacent — discuss the penumbra of the plan of reorganization from this angle. These authorities more directly discuss which transactions may be given tax-free treatment once a court has determined that a reorganization exists.

One example is *Sheldon*.[78] In this case, the Tax Court held that a distribution by one corporation that was about to consolidate with a second corporation was in pursuance of a plan of reorganization — the distribution was necessary to equalize the values of the two corporations, thus facilitating a planned combination in which the shareholders of both corporations owned 50 percent of the combined entity. In treating the distribution as being made in pursuance of the plan of reorganization, the Tax Court noted that

[71] This raises interesting questions for anticipated payments under customary tax allocation or sharing agreements that are entered into between D and C in connection with divisive D reorganizations, discussed in further detail *infra*.

[72] *International Telephone & Telegraph Corp. v. Commissioner*, 77 T.C. 60 (1981), *aff'd per curiam*, 704 F.2d 252 (2d Cir. 1983).

[73] *Id.*, 77 T.C. at 76. As an aside, *ITT* is one of the clearest examples of the conflation of the step transaction doctrine and the plan of reorganization concept.

[74] *Johnson v. Commissioner*, 78 T.C. 564 (1982).

[75] *Becher v. Commissioner*, 22 T.C. 932 (1954), *aff'd*, 221 F.2d 252 (2d Cir. 1955).

[76] *Id.* at 944.

[77] *See, e.g.*, *Sheldon v. Commissioner*, 6 T.C. 510, 517 (1946) ("We accordingly concur in petitioners' assertion that this is a proper case for application of the principle that reorganization transactions are not to be broken down into their separate phases, but should be viewed as a whole."); and *American Potash & Chemical Corp. v. United States*, 185 Ct. Cl. 161, 168 (1968) ("The existence of either a plan to reorganize or a plan to accomplish a particular end result . . . does not necessarily mean that the particular route chosen to accomplish the desired result qualifies as a reorganization.").

[78] *Sheldon*, 6 T.C. 510.

the distribution "was an integral part of the reorganization transaction as a whole and must be treated in connection with it."[79] That is, not only was the *Sheldon* distribution contemplated, it was integral to achieve the purposes of the reorganization as a whole.

***c. Time-traveling plans.***

Plan of reorganization cases are relatively easier when all the transactions in pursuance of the plan happen at once.[80] However, economic and business realities can be much messier. Several cases have dealt with situations in which plans that were stipulated to exist were delayed or otherwise changed. In *Douglas*,[81] the Board of Tax Appeals considered a purported reorganization under the predecessor to section 368(a)(1)(C). In that transaction a corporation transferred all its assets to the acquiring corporation in exchange for stock of the acquiring corporation; the shareholders of the target corporation received 95 percent of the acquiring corporation stock as an immediate distribution from the target; and the target retained the remaining 5 percent. That retained 5 percent was distributed to the transferring corporation's shareholders over five years after the initial exchange. The delay was a result of disputed creditor claims and a nonassignable government contract that prevented prompt liquidation of the target corporation. As a result, the target corporation maintained its corporate existence for five years after the initial exchange.

The Board of Tax Appeals held that the complete liquidation of the target corporation five years after the initial exchange was under the plan of reorganization because business necessities prevented the prompt liquidation of the transferor. The court found that "the lapse of time is not decisive; and in this connection it may be noted that the act contains no limitation as to time and specifies no time within which an exchange must be made."[82] For the *Douglas* court, it was sufficient that the liquidation of the target corporation had been contemplated by the parties at the time of the reorganization, that the liquidation achieved the purposes of the plan of reorganization, and that it eventually occurred.

In *Gordon*, as well, time was not necessarily the limiting factor (although it was important); it was that the full distribution of control of Northwest was not certain. The Supreme Court stated: "This requirement that the character of the transaction be determinable does not mean that the entire divestiture must necessarily occur within a single tax year. It does, however, mean that if one transaction is to be characterized as a 'first step' there must be a binding commitment to take later steps."[83]

In *Tribune*,[84] the taxpayer owned 7.1 percent of the shares of one of its suppliers, West Tacoma Newsprint Co. (Newsprint). Newsprint was acquired by Boise Cascade Corp. in a reorganization described in section 368(a)(1)(A). Shortly thereafter, the value of the Boise Cascade shares dropped precipitously upon reports that Boise Cascade had withheld material facts about its financial condition. The taxpayer (and others) sued Boise Cascade for securities fraud, and in settlement of that litigation, the taxpayer received cash plus promised discounts on newsprint purchases over an eight-year period. The relevant question was whether the cash and discounts were boot (as the taxpayer contended) or ordinary income to the taxpayer (as the IRS asserted). The IRS maintained that the settlement proceeds were received under the later settlement agreement, and not the merger agreement that described the reorganization, and that they therefore could not be treated as being received and distributed "in pursuance of the plan of reorganization."[85]

The Ninth Circuit agreed with the taxpayer, finding that the settlement in effect represented consideration the taxpayer would have bargained for had it known the material information that Boise Cascade had concealed.[86] Thus, despite the implication in some of the case law that a plan of reorganization encompasses only the transactions known to be contemplated when the plan was

[79] *Id.* at 517.

[80] Manning, *supra* note 17, at 915.

[81] *Douglas v. Commissioner*, 37 B.T.A. 1122 (1938).

[82] *Id.* at 1128.

[83] *Gordon*, 391 U.S. at 524.

[84] *Tribune Publishing Co. v. United States*, 836 F.2d 1176 (9th Cir. 1988).

[85] *Id.* at 1178.

[86] *Id.*

conceived, the *Tribune* court was willing to relate a later, unknown transaction (the settlement) back to the time of the plan and incorporate it as a step in pursuance of the plan of reorganization.[87]

The law is unclear on the result if the definitional requirements of a reorganization are met but a contemplated transaction that would have been in pursuance of a plan of reorganization if it occurred contemporaneously with the reorganization fails to occur or fails to occur as originally contemplated. In *Bullock*,[88] a closely held company entered into legal documents to accomplish a reorganization that would have accomplished the effect of a pro rata spinoff under prior law. However, after the transfer of assets to one corporation in exchange for securities but before the distribution of those securities to the shareholders, one of the shareholders sold his stock to another, and the plan was not carried out as originally contemplated.[89] The Tax Court found that this change *in medias res* was so significant that the transaction failed to constitute a plan of reorganization because the original plan had not been carried out. The court did not discuss what would have happened if the sale had occurred before or after the plan steps had occurred.[90]

More recently, in the *Seagram* decision, the Tax Court ignored many changes in the facts — including changes in economic terms —because steps that constituted a reorganization actually occurred. It found that the changes did not alter the overall reasons and rationales for the plan.[91]

In the absence of guidance, analogous authorities could be helpful to identify principles on which to analyze the continuing existence of a plan of reorganization. For instance, under the regulations, a "non-plan" factor in the context of a section 355(e) facts and circumstances analysis is "an identifiable unexpected change in market or business conditions occurring after the acquisition that resulted in a distribution that was otherwise unexpected."[92] Rev. Rul. 2005-65, 2005-2 C.B. 684, which is a section 355(e) ruling, also seems potentially helpful. In that ruling D publicly announced that it would distribute 100 percent of its subsidiary, C. After the announcement but before the closing, X and D began to discuss an acquisition. C was distributed at the same time and in the same manner as it would have been if X had never approached D. X and D merged, with X shareholders holding more than 50 percent of D. The ruling concludes that X's acquisition of D was not part of a plan with the spinoff for purposes of section 355(e). Although these are not "plan of reorganization" authorities, similar policy principles should apply such that there should be a real and meaningful change in circumstances for a plan of reorganization to terminate before it is fully consummated.

### 3. Plan of reorganization: Key themes.

From this muddle, it is possible to extract the following themes:

1. The steps and transactions that consummate a plan of reorganization must be sufficiently contemplated and memorialized (whether or not in writing) before the transaction occurs. (There are a few exceptions, mainly concerning

[87] The Ninth Circuit in *Tribune* somehow failed to cite *Arrowsmith v. Commissioner*, 344 U.S. 6 (1952), the most commonly cited relation-back case. *Arrowsmith* is, of course, relevant to any such relation-back analysis, at least in determining character. In *Arrowsmith*, shareholders liquidated their corporation in a taxable transaction. In a later year, as successors in interest to the corporation, they were required to make a settlement payment. The Supreme Court found that the settlement payments related back to the earlier liquidation (reducing the liquidation proceeds the shareholders would have received) thus constituting a capital (rather than ordinary) loss in their hands.

[88] *Bullock v. Commissioner*, 26 T.C. 276 (1956), *aff'd per curiam*, 253 F.2d 715 (2d Cir. 1958).

[89] *Id.*, 26 T.C. at 282-293.

[90] *See* Manning, *supra* note 17, at 916.

[91] *See, Seagram*, 104 T.C. at 104. *Seagram* seems to have effectively overturned the result (which was of specious precedential value at best) in *Hewitt v. Commissioner*, 19 B.T.A. 771 (1930). In *Hewitt*, there was an adopted plan of reorganization that the court found to be a reorganization, but most shareholders, including the shareholder-petitioner in *Hewitt*, negotiated their own terms, which were different from those of the purported reorganization. The *Hewitt* shareholder was treated as engaging in a transaction that was not under the plan of reorganization and was thus taxed separately.

[92] Reg. section 1.355-7(b)(4)(iv).

changes that do not conflict with the purposes of the plan.)

2. Step transaction principles apply to determine the scope of a plan of reorganization (if any).
3. Although a plan of reorganization has a beginning and an end, there is no statutorily required period over which the transactions must occur.
4. It is possible for a transaction to be in pursuance of a plan of reorganization even if it is not required for a group of transactions to qualify for the reorganization provisions of the code. However, the transaction must be a direct and proximate result of, or integrally related to, the transactions that *are* required to constitute a reorganization and the related business purpose. Equally, just because a transaction occurs at the same time as (or even is described in the same document as) transactions that constitute a reorganization, it is not necessarily part of the plan of reorganization.

## IV. Changing Plans in the Divisive Context

Thus far, this report has identified two broad principles. First, the purpose of divisive D reorganizations is to permit shareholders to divide their real ownership in a corporate venture into smaller corporate ventures without tax, with the framework being a partial liquidation of D. Second, the plan of reorganization concepts are to be applied in a manner that puts heavy weight on the contemporaneous intent of the parties and the purposes of divisive D reorganizations. Those principles can be applied to more complex scenarios involving (1) the period over which distributions under section 361 must be made to be under a plan; (2) contingent or unknown payments between D and C that still relate to a divisive D reorganization; and (3) retained stock issues. However, these broad principles, and whatever flexibility they imply, should be applied in the context of the intended unyielding bounds of a divisive D reorganization.

The IRS seems to have a renewed focus on these concepts as well, demonstrated by the fact that it recently tipped its hand regarding the application of plan of reorganization principles in Rev. Proc. 2018-53, 2018-43 IRB 667. Rev. Proc. 2018-53 provides guidelines for the IRS's ruling policy on the tax treatment of C stock, securities, and cash (section 361 consideration) received by D in a divisive D reorganization and purportedly distributed under section 361. The revenue procedure requires D to submit (or explain why it cannot submit) specific standard representations in connection with a ruling request for such a transaction. Many of these standard representations appear to be related to the plan of reorganization concepts discussed earlier and generally appear to be consistent with the theory that this report has developed from existing case law.[93]

### A. Section 361 Distributions

#### 1. In general.

In connection with a divisive D reorganization, it is common for C to borrow cash in an amount less than D's basis in C under new loan agreements and to distribute the proceeds to D, which D uses to repay or repurchase outstanding D debt. Also or alternatively, D may receive C securities in partial exchange for the assets contributed to C, which D uses to retire D debt. D may use C stock to retire D debt. Or, finally, D may distribute other C property to D shareholders. Each of these potential uses of C property appears to be blessed by section 361, provided the use is "in pursuance of," "pursuant to," or "in connection with" a plan of reorganization.

Some of the standard representations in Rev. Proc. 2018-53 address concerns about the bona fides of D debt. Standard representation 1 requires D to represent that it is the obligor in substance of the debt that will be assumed or satisfied in connection with the divisive D

[93] This exercise in line-drawing on the IRS's part at times is more restrictive than the case law would warrant in applying the plan of reorganization concept. In this way, the revenue procedure hews closer to the more rigid interpretations of the concept, likely for administrative convenience.

reorganization. Standard representation 2 requires D to represent that no holder of the debt that will be assumed or satisfied is related to either D or C under section 267(b) or section 707(b)(1). That is, when the D debt satisfied is debt to a related person, it is hard to conclude that anything at all has happened to D's balance sheet — no proceeds have left D's orbit. The discussion below assumes that the D debt being repaid is real D debt, and not D debt artificially incurred in anticipation of the divisive D reorganization.[94]

As discussed earlier, for a use of property received from C in a divisive D reorganization to be in pursuance of a plan of reorganization, the use should (1) be reasonably anticipated and contemplated when the steps that constitute the reorganization described in the plan of reorganization occur and (2) be reasonably related to the purposes of the divisive D reorganization in question. To be reasonably anticipated for this purpose, it would appear that it is sufficient for D's board of directors to identify the use of proceeds and to memorialize the reason for the distribution in its resolutions. For retirement of D debt — although this is almost too obvious to mention — the retirement should be real, not illusory. This means that D should not have plans to immediately re-borrow an amount equal to the satisfied debt or otherwise functionally retain the proceeds.[95] This is not to say that D can never re-borrow at all. That is, D should have the flexibility to incur additional debt to fund future and unknown investments and activities. The code's reorganization provisions should be interpreted in a manner to encourage the creation of business investments (for example, capital expenditures and business combinations), not to impede them.

There was a time the IRS was willing to rule that newly incurred D debt issued solely to facilitate a swap of that debt for C stock or securities in connection with a divisive D reorganization qualified under section 361.[96] Logically, to be in pursuance of a plan of reorganization, any transfer of cash to D creditors should really be made for true D obligations that are contemplated when the plan for the transactions that create the definitional reorganization is developed.[97] Not everyone agrees with this proposition. Some argue that any D debt incurred at any time should suffice, based on a plain reading of the statutory language.[98]

The IRS appears to have adopted a narrower approach for its new advance ruling policy,[99] limiting the D debt that may be retired to debt that exists at the earliest of (1) the day the ruling request is filed, (2) the day the transaction is publicly announced, or (3) the day that D's board of directors approves the transaction. Ultimately, of those options, the board approval concept seems most appropriate. To be part of a plan, a distribution of proceeds must be contemplated before the reorganization and authorized by a board when the board resolutions authorizing the transaction are approved. If a board reconsiders an earlier proposed transaction and authorizes changes before carrying out the actual separation,

[94] There is ample discussion in the literature regarding whether particular transactions under section 361 should be treated as equivalent or substantially equivalent to sales by D. *See*, *e.g.*, Dantzler, *supra* note 20, at 686-693; Paul, *supra* note 18; Sheffield, *supra* note 19; and Wessel et al., *supra* note 5, at 63-64. Although these questions are always important to consider, to isolate the effect of the plan of reorganization requirement, the following discussion assumes that the sole question is whether these payments are made in pursuance of, or in connection with, the plan of reorganization including the divisive D reorganization.

[95] Rev. Proc. 2018-53, standard representation 7, requires D to represent that it will not replace the debt that will be assumed or satisfied with a "previously committed borrowing, other than borrowing in the ordinary course of business pursuant to a revolving credit agreement or similar arrangement."

[96] *See* Paul, *supra* note 18, at 104-105.

[97] Rev. Proc. 2018-53, standard representation 5, similar to previous practice, requires D to represent that the adjusted issue price of its debt that will be satisfied does not exceed the historic average of the total adjusted issue price of its third-party debt and third-party debt of other members of its separate affiliated group that is not evidenced by contingent payment debt instruments. The historic average is determined "based on the debt outstanding as of the close of the eight fiscal quarters that ended or will end immediately before the date of approval of" the distribution under section 355 by the D board of directors.

[98] *See* Wessel et al., *supra* note 5, at 95-96. Their analysis does not discuss the application of plan of reorganization principles in this context. Because the plan of reorganization concept is limiting, a very broad reading of section 361 is probably incorrect. However, as discussed *infra*, for contingent and unknown payments from C to D that are found to be made in pursuance of a plan of reorganization, there are better arguments under existing authorities that those proceeds could be distributed to any D creditor existing at the time of receipt of the contingent payment.

[99] Rev. Proc. 2018-53, standard representation 4, requires D to represent that it incurred the debt to be satisfied both before the ruling request is submitted and at least 60 days before the earliest of (1) the date of the first public announcement of the transaction; (2) the date that D enters into a binding agreement for the transaction; or (3) the date the D board of directors approves the transaction (the cutoff date). The revenue procedure allows D to use section 361 consideration to repay debt incurred after the cutoff date if D establishes that the effect is to allocate historic D debt between D and C or to exchange historic D debt for C stock.

that earlier proposal should be deemed to be abandoned and thus irrelevant.

For D's distribution to shareholders and creditors of proceeds received from C to further the purposes of the reorganization, the proceeds should be used in a manner consistent with the theory of the divisive D reorganization. That is, those proceeds should cause a realignment of the corporate capital structures and balance sheets of D and C as stand-alone entities.[100] D may not retain C property for unlimited periods, effectively putting the property on D's balance sheet to enable a later distribution to be in pursuance of the reorganization. There must be a relatively firm and fixed plan for the distribution to occur (for example, a board resolution authorizing only such a use), whether the distribution occurs immediately upon the distribution of control of C or later.

At least one commentator has posited that D's repayment of its own debt with a noncontrolling amount of C stock is a harder policy case even if in pursuance of a plan of reorganization, and that it more closely resembles a sale of C stock.[101] The objection is that absent the divisive D reorganization, the use of C stock to repay D debt would certainly be taxable, and the "exchange goes beyond the readjustment of corporate structures that occurs when existing assets and liabilities are allocated between [D] and [C]."[102] And yet, in the acquisitive context (for instance, in a reorganization described in section 368(a)(1)(C) or (G)), creditors must be paid, so using the reorganization proceeds, including C stock, to satisfy the transferor's obligations as part of the plan of reorganization on a tax-favored basis is plainly correct as a policy matter.

In the simplest of cases, these standards are easily met. D's board of directors identifies and authorizes permitted uses of cash, which clearly further a contraction in D's balance sheet and occur relatively contemporaneously with the other transactions qualifying for reorganization status. But the simplest of cases seems also to be the rarest of cases. Reality often intervenes to present a more complex fact pattern.

**2. Delays.**

The case law is clear: There is no particular time limit within which a transaction must occur to be in pursuance of a plan of reorganization. But in the cases in which the courts permitted a significant lapse of time to occur, true business exigencies required that the transferring corporation retain the transaction proceeds so that they could be distributed in pursuance of the plan of reorganization.[103] The mere convenience of the taxpayer is insufficient.

In a sense, there is some congruence with the standard under section 332 for tax-free liquidations. In general, a complete liquidation must be completed within one tax year.[104] However, the code and the Treasury regulations acknowledge that a complex endeavor like a liquidation cannot always occur within a tax year, so they permit a series of distributions over three years also to qualify for favored treatment if specified requirements are met.[105] Section 361 is more flexible, and there is no statutory time requirement for the distribution of section 361 proceeds.

The plan of reorganization requirement in this context is key — there must be real business exigencies to delay any planned distribution to shareholders or creditors.[106] But there is an additional, more difficult question: Can a distribution to shareholders be a final contingency? That is, can D plan to distribute C

[100] But what if neither D nor, if applicable, C were efficiently leveraged before the transaction such that there was excess debt capacity at both D and C? In that case, the C cash received by D is surplus cash and theoretically should be returned to shareholders.

[101] *See* Sheffield, *supra* note 19, at 124-125.

[102] *Id.* at 125.

[103] *See, e.g.*, *Douglas*, 37 B.T.A. 1122. In issuing rulings regarding section 361 payments to creditors, the IRS does appear to put a premium on speed. In Rev. Proc. 2018-53, standard representation 6, D must represent that "one or more substantial business reasons" justify any delay of more than 30 days in satisfying debt with section 361 consideration, and further that any such delay will not extend beyond 180 days. Although the specific time limit itself is the IRS's own policy (and is different from previous policy reflected in prior rulings allowing 12 to 18 months), the requirement that any delay be substantiated by substantial business reasons is wholly consistent with existing authorities.

[104] Section 332(b) and reg. section 1.332-3.

[105] Section 332(b) and reg. section 1.332-4.

[106] It is relatively easy to imagine exigencies in the debt context. D may be unable to quickly force its creditors to take early payment in cash or in C stock at all. Imagining what those exigencies might be in a dividend case is admittedly more difficult. It is easier to imagine true restrictions on the ability to conduct share repurchases because market activity could cause D's share price to rise.

proceeds in repayment of its debt but then plan to distribute any excess to shareholders (after some set elapsed time) in a manner such that the later distribution to shareholders is in pursuance of a plan of reorganization? Can D's board of directors resolve that C proceeds can be used at any time for any permitted section 361 purpose, as long as the proceeds are distributed by a specified time?

The first alternative seems consistent with the weight of authority. At some point, if D's creditors do not wish to be repaid, D should view the C proceeds as excess and deliver them to D's shareholders, reducing D's equity. The second question is at first glance harder, because there really are only two possible uses of C proceeds, and a resolution that permits D to choose either of them is almost tantamount to having no intention at all. However, the plan of reorganization cases hold that contemporaneously developed plans in the alternative are acceptable, as long as one of the planned actions eventually happens. If to be in pursuance of a plan of reorganization, a transaction need only further the purposes of that reorganization, the focus should be on whether the transaction — optional or not — furthers the purposes of the reorganization.

Note that a delay, even if justified, runs the risk that the plan of reorganization will be cut short by unexpected intervening events that render the planned uses of C proceeds either moot or no longer supporting the purposes of a plan of reorganization. Leaving aside any other considerations, if D wishes to receive the C proceeds without tax, it is best served by distributing those proceeds as quickly as practicable.

### 3. Contingent or unknown amounts.

More difficult to analyze are common payments made between D and C under indemnity or similar agreements (including under relatively common arrangements such as tax-sharing agreements). They are definitionally contingent and may occur years after the divisive D reorganization. There is some authority on the treatment of indemnity payments in connection with section 381 transactions. Under Rev. Rul. 83-73, 1983-1 C.B. 84, in a reorganization under section 368(a)(1)(A), shareholders of the target corporation made a cash indemnity payment to the acquirer. The IRS ruled that the payment related back to the time before the merger under *Arrowsmith* principles,[107] and it was treated as a tax-free contribution to the capital of the target.

*Tribune* is consistent with these principles and further suggests that the payments may relate back for purposes of determining whether they are made under the plan of reorganization. When the possibility of indemnity or similar payments is clearly specified and contemplated in the documents carrying out the divisive D reorganization and is not otherwise completely severable from the reorganization,[108] those payments from C to D are best thought of as being in pursuance of the plan of reorganization. But the plan of reorganization penumbra for these payments remains hazy.

For instance, one could argue that C's payments to D of its share of regular consolidated taxes due (whether known or discovered as a result of a later audit) under the terms of a tax allocation agreement entered into at the time of the divisive reorganization should logically be treated as ordinary course payments because they relate to an obligation C would have paid to D in the ordinary course.[109] But if the parties' course of conduct regarding tax payments wasn't regular or if there are contingent or special payments, the law does not clearly provide for this result. In contrast, an indemnity obligation that creates the economic effect of C assuming a D contingent liability (for example, an environmental claim against D) logically should be treated differently.

If a contingent payment ultimately is treated as made in pursuance of the plan of reorganization, it is unclear what D must do with those proceeds to qualify for section 361 nonrecognition treatment. If the payment relates to a loss or obligation that D is required to pay to a third party (including a taxing authority or other governmental entity), perhaps the problem solves itself (and this should be the case even if D is required by law or a court order to make payment to the third party before receipt of the indemnity payment from C).

[107] *See Arrowsmith*, 344 U.S. 6.

[108] *E.g.*, the regular dividends paid by C to D in LTR 200737017.

[109] This is particularly true if C and D were party to a tax-sharing agreement before the transaction.

But if there is no third-party liability associated with the payment for whatever reason when it is made,[110] does that payment simply constitute taxable boot in D's hands? Is D even able to remedy the situation by distributing those proceeds to its creditors or shareholders? The better answer is that D should be able to distribute the proceeds, at least to its shareholders. But for the best results, D's board of directors, when it approves D's distribution of C, should resolve to distribute any such windfalls to shareholders.

Although it may be relatively hard to conclude that D should be able to pay off D debt that was not in existence or even contemplated at the time of the divisive D reorganization, if D receives an unexpected windfall from C in connection with the transactions that accomplish a separation of D and C, those proceeds would seem to be in the nature of excess earnings received from C in connection with the reorganization, which D's board of directors can contemplate to distribute to its shareholders through a dividend or share repurchase in a manner consistent with plan of reorganization.

This is true even if the item giving rise to the payment is completely unknown, under theories relying on *Tribune*. *Tribune* also may support an argument that D should be able to pay off its debt that exists when the unknown payment is received. That is, if D had known that it was entitled to the payment, it would have reduced its debt load more than it actually did (or never needed to incur the liabilities now on its balance sheet), so that payment should be treated as in pursuance of the plan.[111] This theory, however, should probably be limited to the truly unknown, rather than payments between D and C that are known and expected at the time of the transaction. These theories do not extend the duration of the plan of reorganization indefinitely. Rather, they should apply only when the payment clearly relates back to the reorganization under other applicable tax principles.

At the Corporate Tax session of the American Bar Association Section of Taxation meeting in Atlanta on October 6, 2018, Robert Wellen, IRS associate chief counsel (corporate), addressed this point from the agency's perspective: He indicated that the IRS issued Rev. Proc. 2018-53 without addressing contingent liabilities because it wished to issue guidance on other section 361 issues more quickly.[112] Wellen suggested that the IRS is still considering guidance on this subject. Any such guidance should look to the relation-back doctrines and take a practical approach to D's required use of proceeds.

### B. Retained Stock

Questions surrounding retained stock pose different and even trickier plan of reorganization questions. As discussed earlier, a separate plan concept applies to determine whether the retention is permitted in the first place. To retain stock, the taxpayer must clearly demonstrate that the retention is not part of plan, a principal purpose of which is the avoidance of tax.[113] Thus, to retain stock at all, D must have a relatively clear plan formulated regarding the transaction so that the retention can be vetted. D may, but need not if it has sufficient justification, distribute the retained C stock to shareholders or creditors.[114] D may also sell the retained C stock for cash in a taxable transaction and retain that cash for its own purposes.

On one level, exactly the same analysis applies to whether any later transaction concerning retained C stock is in pursuance of the plan of reorganization. However, retained stock raises tricky issues. For instance, the IRS's ruling policy is that D must dispose of the C stock as quickly as possible after the divisive D reorganization in a manner consistent with the business purpose for

[110] *E.g.*, as a result of an "equalization in value" payment.

[111] Although how to administer such a standard, except for a result-oriented judicial ruling, is puzzling.

[112] Emily L. Foster, "Guidance on Leveraged Spinoff Rulings Designed for Flexibility," *Tax Notes*, Oct. 15, 2018, p. 386.

[113] Section 355(a)(1)(D)(ii).

[114] *See* Rev. Rul. 75-321; and Rev. Rul. 75-469, 1975-2 C.B. 126. *See also* discussion *supra* at notes 7 and 8.

the spinoff, but in any event within five years.[115] Five years is a long time. What happens if circumstances change? For instance, what if, before the final disposition of the retained stock of C, D unexpectedly becomes a takeover target? This could change or make impossible D's previously planned uses of C stock (although perhaps arguments analogous to the theory of Rev. Rul. 2005-65 could be used if the C stock is still used in the same manner as planned).[116]

Under existing case law it does not appear that the status of the reorganization itself would be harmed by such a change in plan. Assuming *Gordon* is correct that there is a single distribution for section 355 purposes that must involve the distribution of control of C, that distribution will have occurred and be complete. However, the intervening change in facts could well cause any further disposition of C stock to lose its character as in pursuance of the plan of reorganization, because it could lose its crucial relevance to the purposes of the reorganization.

If the purposes of the reorganization no longer exist or are no longer relevant, the plan of reorganization ends, and a later disposition may well not be in pursuance of that reorganization. If the actual steps required to qualify a divisive D reorganization are complete, the logic of *Bullock* does not require that an intervening event that causes a change in the circumstances of retained stock to somehow cause a reexamination of the divisive D reorganization as a whole. Certainly, if an intervening event occurs between the contribution of assets to C and the distribution of control of C, that event could definitely implicate the qualification of the reorganization. However, once the reorganization steps are complete, the inquiry regarding the retained stock is whether it is being disposed of in pursuance of or in connection with the plan of reorganization. It is not itself a qualifying step.

## V. Conclusion

Back to my resolutions and my closet. If my yearly plans for organization tried to qualify as plans of reorganization, I would be even less successful than I already am at purging old boots. But it wouldn't necessarily be my fault. The plan of reorganization concept is fragile and perilous, and understanding whether an action is or is not under that plan, particularly in the divisive context, is more of a metaphysical inquiry than a certainty.

Acknowledging that certainty is impossible, taxpayers will be on firmest ground when their transactions under section 361 are firmly established in pre-transaction board resolutions and occur quickly. But life doesn't always go as planned, and the plan of reorganization requirement, narrow as it is, should be interpreted in the divisive context in a sensible manner that furthers taxpayers' ability to carry out the business purposes of otherwise bona fide reorganizations.

The plan of reorganization requirement should be evaluated on multiple levels. First, the step transaction lens should be applied to set the penumbra of the transactions purporting to constitute a reorganization. This is consistent with the first sentence of the plan of reorganization definition in the Treasury regulations and will permit analysis of whether the planned transactions actually represent a reorganization. In the divisive context, this penumbra should be heavily informed by the business purposes of the transaction.

Second, identified transactions within the penumbra developed under the first step (whether or not required to qualify the transaction as a technical reorganization) should be analyzed to determine whether they are in pursuance of the plan and its business purposes, or represent something different and separate. Third, any contingent or unknown payments should be analyzed under the relation-back doctrine represented by *Arrowsmith* and related authorities to determine whether they relate to the transactions that occur within the reorganization penumbra, and, if so, whether those payments represent payments in pursuance of the plan of reorganization under the second step. ■

[115] Rev. Proc. 96-30, Appendix B.

[116] This may even be true if the economic consequences are somewhat different from what was anticipated.