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REPORT
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STATUTORY MERGERS WITH PARENT'S STOCK

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Mr. LONG of Louisiana, from the Committee on Finance, submitted the following

REPORT

[To accompany H.R. 18942]

The Committee on Finance, to which was referred the bill (H.R 18942), relating to the income tax treatment of certain statutory mergers of corporations, having considered the same, reports favorably thereon without amendment and recommends that the bill do pass.

I. SUMMARY

This bill amends the tax laws to permit a corporation to acquire another in a tax-free statutory merger by giving in exchange for the stock of the acquired corporation the stock of the parent of the acquiring corporation (instead of the stock of the acquiring corporation itself). The bill also amends the tax laws to state the same basis rules for the properties or stock acquired with the stock of the parent corporation in a tax-free reorganization as those which apply when the acquisition is made with the stock of the acquiring corporation itself.

The Treasury Department has indicated that it does not object to the enactment of this bill.

II. STATUTORY MERGER ACQUISITIONS WITH PARENT'S STOCK

Reasons for provision.—Tax-free reorganizations under present law include transactions in which one corporation acquires substantially all the properties or substantially all the stock of another corporation, largely or wholly in exchange for its own (or its parent's) stock. These types of tax-free reorganizations take one of three basic forms: (1) statutory mergers or consolidation under State law (type "A" reorganization, defined in subparagraph (A) of sec. 368(a)(1)); (2) the

acquisition of 80 percent of the stock of another corporation solely for voting stock of the acquiring corporation or its parent (type "B" reorganization, defined in subparagraph (B) of sec. 368(a)(1)); and (3) the acquisition of substantially all the properties of another corporation solely for voting stock of the acquiring corporation or its parent (type "C" reorganization, defined in subparagraph (C) of sec. 368(a)(1)).

While in the reorganizations referred to above, the acquisitions of property or stock are usually made in exchange for stock of the acquiring corporation, in both type B and type C reorganizations, the acquisitions can be made in exchange for the stock of the parent of the acquiring corporation. This is not true, however, in the case of type A reorganizations. Present law does not permit the exchange of the stock of the parent in the case of statutory mergers into a subsidiary. Nevertheless, essentially this same result indirectly can be obtained through the combination of two transactions: The first being the acquisition, by a statutory merger, of all of the assets of a corporation by a parent, and the second being the contribution of these assets by the parent to the subsidiary.

Since the use of the stock of the parent corporation is permitted in the case of type B and C reorganizations, there does not seem to be any basis for denying the same treatment in the case of statutory mergers.

Apparently the use of a parent's stock in statutory mergers was not initially provided for because there was no special concern with the problem at the time of the adoption of the 1954 code. However, this is no longer true. The committee understands that a case has arisen in which it is desired to have an operating company merged into an operating subsidiary in exchange for the stock of the parent holding company. The committee agrees with the House that there is no reason why tax-free treatment should be denied in cases of this type where for any reason the parent cannot or, for business or legal reasons, does not want to acquire the assets (even temporarily) through a merger.

For the reasons set forth above the committee agreed with the House that it is desirable to permit the use of the stock of the parent corporation in a statutory merger in acquiring a corporation in essentially the same manner as presently is available in the case of other tax-free acquisitions.

Explanation of provision.—The bill (sec. 1) permits a corporation which is a controlled subsidiary of another corporation (i.e., the parent holds 80 percent of the voting shares and 80 percent of the total number of shares of all other classes of stock of the subsidiary) to acquire tax free all the assets of a third corporation in a statutory merger in which stock of the *parent* corporation is exchanged for the stock of the transferor corporation. The amendment (new subparagraph (D) in sec. 368(a)(2)) provides that if a parent corporation controls a subsidiary corporation (i.e., has the 80-percent control referred to above), then the acquisition of substantially all the properties of a corporation merged (in a statutory merger) into the subsidiary in exchange for the stock of the parent corporation is not to be disqualified as a type A reorganization if two conditions are met: (1) the merger insofar as the tax laws are concerned would have qualified as a type A reorganization had the merger been made into the parent instead of into the subsidiary, and

(2) no stock of the subsidiary is used in the transaction. In addition, the definition of "a party to a reorganization" is modified to include a parent corporation in the case described (by adding a new sentence to sec. 368(b)).

The amendment does not alter or modify the present requirements of "business purpose" or "continuity of enterprise." It modifies the present "continuity of interest" requirement but only in that it permits the use of the stock of the parent in making the acquisition, instead of the stock of the subsidiary.

The amendment applies whether or not the parent corporation is formed immediately before the merger, in anticipation of the merger, or after preliminary steps were taken to merge directly.

III. BASIS OF PROPERTIES OR STOCK ACQUIRED IN A REORGANIZATION WITH STOCK OF PARENT

Reasons for provisions.—Under present law if a corporation acquires properties or stock in a tax-free reorganization in exchange for its own stock, the basis of the properties or stock received remain the same as it was in the hands of the transferor corporation or shareholders. Thus, the corporation acquiring properties or stock for its own stock in a tax-free reorganization "carries over" the basis of the properties or stock which is being acquired. This is the carryover basis rule (sec. 362). However, another basis rule applicable in other cases where there are tax-free transfers is the substituted basis rule (sec. 358). Under this rule there is "substituted" for the basis of the property or stock received the basis of property or stock surrendered.

While under present law the carryover basis rule specifically applies to properties or stock acquired by the issuance of stock of the *acquiring* corporation in the case of type A, B, and C reorganizations, no mention is made of the basis rule to apply in these types of reorganizations where the properties or stock are acquired with the stock of the parent corporation (or with treasury stock of the acquiring corporation). The committee agrees with the House that the same basis rules should apply where the properties or stock are acquired with the parent's stock (or with treasury stock of the acquiring corporation) as where they are obtained by the issuance of new stock of the acquiring corporation and that this should be specified in the tax laws.

Explanation of provision.—For the reasons given above the bill amends present law in two respects to provide that the carryover basis rule is to apply in the case of type A, B, and C reorganizations where the properties or stock are acquired with the stock of the parent of the acquiring corporation (or with treasury stock of the acquiring corporation).

The first of these amendments (sec. 2(a) of the bill) amends the provision of present law providing the substituted basis rule (sec. 358) to expand the exception in present law which provides that this substituted basis rule does not apply to property acquired by a corporation in exchange for its stock of securities. The bill expands the statutory language under this exception to the substituted basis rule to cover cases where the acquisition is made with the stock of the parent of the acquiring corporation (or with treasury stock of the acquiring corporation).

The second of these amendments (sec. 2(b) of the bill) amends the provision of present law providing the carryover basis rule (sec. 362). Presently this section provides that this carryover basis rule is not to apply if the property acquired consists of stock or securities in a corporation, a party to the organization (as in a type B reorganization) unless the acquisition was made with stock or securities of the transferee as consideration in whole or part for the transfer. The bill amends the statutory version of this "unless" clause to make it applicable to those cases where the acquisition is made with the stock of the parent of the acquiring corporation (or with treasury stock of the acquiring corporation).

Both of these amendments also apply when the stock of the parent corporation used in the acquisition was originally purchased (whether before or after the date of enactment of this provision) by the subsidiary.

These amendments are effective with respect to plans of reorganization adopted after the date of enactment of this bill. In neither case, however, does the committee intend any inference to be drawn as to the law in effect before the enactment of this bill. In both cases it is intended that prior law be interpreted as if this bill had not been enacted.

IV. CHANGES IN EXISTING LAW

In compliance with subsection (4) of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman):

INTERNAL REVENUE CODE OF 1954

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SEC. 358. BASIS TO DISTRIBUTEES.

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(e) EXCEPTION.—This section shall not apply to property acquired by a corporation by the [issuance] *exchange* of its stock or securities (*or the stock or securities of a corporation which is in control of the acquiring corporation*) as consideration in whole or in part for the transfer of the property to it.

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SEC. 362. BASIS TO CORPORATIONS.

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(b) TRANSFERS TO CORPORATIONS.—If property was acquired by a corporation in connection with a reorganization to which this part applies, then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain recognized to the transferor on such transfer. This subsection shall not apply if the property acquired consists of stock or securities in a corporation a party to the reorganization, unless acquired by the [issuance] *exchange* of stock or securities of the transferee (*or of a corporation*

which is in control of the transferee) as the consideration in whole or in part for the transfer.

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SEC. 368. DEFINITIONS RELATING TO CORPORATE REORGANIZATIONS.

(a) REORGANIZATION.—

(1) IN GENERAL.—For purposes of parts I and II and this part, the term "reorganization" means—

(A) a statutory merger or consolidation;

(B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);

(C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether, the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under sections 354, 355, or 356;

(E) a recapitalization; or

(F) a mere change in identity, form, or place of organization, however effected.

(2) SPECIAL RULES RELATING TO PARAGRAPH (1).—

(A) REORGANIZATIONS DESCRIBED IN BOTH PARAGRAPH (1)(C) AND PARAGRAPH (1)(D).—If a transaction is described in both paragraph (1)(C) and paragraph (1)(D), then, for purposes of this subchapter, such transactions shall be treated as described only in paragraph (1)(D).

(B) ADDITIONAL CONSIDERATION IN CERTAIN PARAGRAPH (1)(C) CASES.—If—

(i) one corporation acquires substantially all of the properties of another corporation,

(ii) the acquisition would qualify under paragraph (1)(C) but for the fact that the acquiring corporation exchanges money or other property in addition to voting stock, and

(iii) the acquiring corporation acquires, solely for voting stock described in paragraph (1)(C), property of the other corporation having a fair market value which is at least

80 percent of the fair market value of all of the property of the other corporation.

then such acquisition shall (subject to subparagraph (A) of this paragraph) be treated as qualifying under paragraph (1)(C). Solely for the purpose of determining whether clause (iii) of the preceding sentence applies, the amount of any liability assumed by the acquiring corporation, and the amount of any liability to which any property acquired by the acquiring corporation is subject, shall be treated as money paid for the property.

(C) TRANSFERS OF ASSETS OR STOCK TO SUBSIDIARIES IN CERTAIN PARAGRAPH (1)(A), (1)(B), AND (1)(C) CASES.—A transaction otherwise qualifying under paragraph (1)(A), (1)(B), or (1)(C) shall not be disqualified by reason of the fact that part or all of the assets or stock which were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets or stock.

(D) *STATUTORY MERGER USING STOCK OF CONTROLLING CORPORATION.—The acquisition by one corporation, in exchange for stock of a corporation (referred to in this subparagraph as "controlling corporation") which is in control of the acquiring corporation, of substantially all of the properties of another corporation which in the transaction is merged into the acquiring corporation shall not disqualify a transaction under paragraph (1)(A) if (i) such transaction would have qualified under paragraph (1)(A) if the merger had been into the controlling corporation, and (ii) no stock of the acquiring corporation is used in the transaction.*

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