Report No. 1516
November 18, 2025

The Honorable Scott Bessent
Secretary
Department of the Treasury
and
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable Kenneth Kies
Assistant Secretary (Tax Policy)
Department of the Treasury
and
Acting Chief Counsel
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

Re: NYSBA Tax Section Report No. 1516 - Report on Extending the "Signing Date Rule"

Dear Secretary Bessent and Assistant Secretary Kies:

Please find attached Report No. 1516 of the Tax Section of the New York State Bar Association. The Report discusses whether the "signing date rule" in Treasury Regulation § 1.368-1(e)(2), which applies for purposes of determining whether the "continuity of shareholder interest" requirement of Treasury Regulation § 1.368-1(e)(1) is satisfied, could be extended to determining whether a reverse subsidiary merger otherwise described in Section 368(a)(2)(E) of the Internal Revenue Code satisfies the control test of Section 368(a)(2)(E)(ii) (the "A2E Control Test").

The A2E Control Test requires that at least 80 percent of the voting power of all classes of voting stock and at least 80 percent of all other classes of stock of the target corporation must be acquired by the acquiror corporation in the transaction in exchange for acquiror voting stock. Taxpayers seeking to treat a part-cash/part-stock reverse subsidiary merger as a reorganization under section 368(a)(2)(E) are at risk that, due to downward movements in the acquiror's stock price during the executory period of the contract, the A2E Control Test may not be met as of the closing date. Accordingly, it may not be possible, when the plan of reorganization is adopted on the signing date, to know whether the transaction will qualify. This forces taxpayers to develop complex—but suboptimal—contractual or other mechanisms to deal with post-signing fluctuations in the value of acquiror company's stock and, in some cases, may preclude structuring a transaction in reliance on section 368(a)(2)(E).

Congress appears to have added section 368(a)(2)(E) to the Internal Revenue Code to broaden the availability of reorganization treatment to reverse subsidiary mergers. Previously such transactions could qualify only if structured so as to comply with section 368(a)(1)(B). The latter form of reorganization, however, must satisfy the stringent condition that the acquisition be *solely* for acquiror voting stock (*i.e.*, precludes any cash or other non-stock consideration). Section 368(a)(2)(E) was conventionally understood to authorize cash and non-stock consideration in reverse subsidiary mergers. These goals are frustrated by the stock price fluctuation problem above.

Prior to 2003, taxpayers faced similar problems establishing whether the "continuity of interest" requirement would be met for a reorganization. This led to the adoption of revised final regulations under Treasury Regulation § 1.368-1(e)(2) which provide that, in certain circumstances (generally, where a "binding contract" provides for "fixed consideration"), taxpayers must determine whether the "continuity of interest" requirement is satisfied based on the value of acquiror stock "on the last business day before the first date such contract is a binding contract" (*i.e.*, the "signing date rule"). However, no equivalent explicit signing date rule currently is provided in determining whether the A2E Control Test is met for a reverse subsidiary merger.

As discussed in the Report, (i) if Treasury and the Service determine that they have authority to do so, we recommend that they issue regulations extending the application of the signing date rule to the A2E Control Test, but (ii) if Treasury and the Service determine that they do not have such authority, we urge Treasury to seek such authority from Congress. In the latter case, in the interim, we suggest Treasury and the Service could, as a "backup" alternative, permit taxpayers to specifically designate in appropriate circumstances the shares of the target corporation that are being exchanged solely for acquiror stock and clarify that such economically reasonable terms of an exchange will be respected for purposes of determining whether a given transaction meets the A2E Control Test to qualify as a reorganization.

We appreciate your consideration of this Report. If you have any questions or comments, please feel free to contact us and we will be glad to assist in any way.

Respectfully submitted,

Andrew Walker
Chair

Enclosure

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Report No. 1516

New York State Bar Association Tax Section

Report on Extending the "Signing Date Rule" to certain Reverse Subsidiary Mergers

November 18, 2025

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Report No. 1516

I. Introduction

This report of the Tax Section of the New York State Bar Association[1] (the "Report") offers recommendations on whether the application of the "signing date rule," as set forth in Treas. Reg. § 1.368-1(e)(2) and which applies for purposes of determining whether the "continuity of shareholder interest" requirement of Treas. Reg. § 1.368-1(e)(1) (the "COI Requirement") is satisfied, should be extended and should apply for purposes of determining whether a reverse subsidiary merger intended to qualify as a reorganization by virtue of Section 368(a)(2)(E) of the Internal Revenue Code of 1986, as amended (the "Code"),[2] satisfies the control test of Section 368(a)(2)(E)(ii) (the "A2E Control Test").

In general, an acquisitive reorganization qualifying for tax-free treatment under Section 368 must satisfy the continuity of interest requirement.[3] Specifically, applicable Treasury Regulations provide that "[c]ontinuity of interest requires that in substance a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization."[4] Put differently, shareholders of the target corporation (the "Target") must

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[1] The principal author of this Report is Joshua Holmes. The substantial contribution of David Schizer and the invaluable assistance of Chelsea Garber are gratefully acknowledged. Helpful comments were provided by William Alexander, Andrew Carlon, Tim Devetski, Tijana Dvornic, Swift Edgar, Lawrence Garrett, Michael Mollerus, Richard Nugent, Deborah Paul, Rachel Reisberg, Michael Schler, Vikram Sharma, Alaukik Singh, Eric Sloan, Jonathan Talansky, Andrew Walker, Sara Zablotney and Libin Zhang.

[2] Except as otherwise indicated, all "Section" references herein are to the Code.

[3] Treas. Reg. § 1.368-1(e)(1).

[4] Treas. Reg. § 1.368-1(e)(1)(i).

receive, in exchange for their proprietary interests in the Target, a sufficient continuing equity interest in the acquiring corporation (the "Acquiror").

Historically, whether a merger satisfied the COI Requirement was determined on the closing date of the merger, and that determination turned on the value of the Acquiror's stock on that date. As a result, in a merger in which Target shareholders received part-cash, part-Acquiror stock as consideration, the transaction could fail to satisfy the COI Requirement, and hence fail to qualify as a reorganization, due to the vagaries of market fluctuations affecting the Acquiror's stock price between the signing date and the closing date. This can occur even in a transaction with meaningful equity cushion (as of the signing date) and even if the parties to the transaction fully intended to effect a tax-free reorganization when they signed the merger agreement and adopted the plan of reorganization.

The practice of relying solely on closing date stock values created considerable uncertainty, during the executory period of the contract, about whether a merger would qualify as a reorganization, forcing taxpayers to develop complex—but suboptimal—mechanisms to deal with post-signing fluctuations in the value of Acquiror stock.[5] However, on July 24, 2003, the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service (the "Service") announced their intention to issue guidance on "the effect of pre-closing changes of [A]cquiror

[5] For a complete catalog of these strategies, see our prior report. New York State Bar Ass'n Tax Section, Report No. 1050, *Report on Continuity of Interest and Pre-Closing Stock Value Fluctuation* (Jan. 23, 2004) [hereinafter *First COI Report*].

stock value on continuity of interest" in their 2003 - 2004 Priority Guidance Plan.[6] This project ultimately led to the adoption of revised final regulations under Treas. Reg. § 1.368-1(e)(2) (the "Final COI Regulations"), which provide that, in certain circumstances (generally, where a "binding contract" provides for "fixed consideration"),[7] taxpayers must determine whether the COI Requirement is satisfied based on the value of Acquiror stock "on the last business day before the first date such contract is a binding contract (the pre-signing date)" (the "Signing Date Rule").[8]

The A2E Control Test, which requires that at least 80 percent of the voting power of all classes of voting stock and at least 80 percent of all other classes of stock of the Target must be acquired by the Acquiror in the transaction in exchange for Acquiror voting stock, potentially raises a similar question of when to measure the value of Acquiror stock in determining whether a reverse subsidiary merger qualifies as a reorganization under Section 368(a)(2)(E). Although

[6] Press Release, Treasury Dept., 2003 – 2004 Priority Guidance Plan (July 24, 2003), https://home.treasury.gov/news/press-releases/js600.

[7] Under the regulations, "[a] contract provides for fixed consideration if it provides the number of shares of each class of stock of the issuing corporation, the amount of money, and the other property (identified either by value or by specific description), if any, to be exchanged for all the proprietary interests in the target corporation, or to be exchanged for each proprietary interest in the target corporation." Treas. Reg. § 1.368-1(e)(2)(iii)(A).

[8] For a more detailed account and discussion of the evolution of the Final COI Regulations, see our prior reports on the subject. *First COI Report*; New York State Bar Ass'n Tax Section, Report No. 1072, *Proposed Regulations Regarding Continuity of Interest and Pre-Closing Stock Value Fluctuation* (Nov. 29, 2004) [hereinafter *Second COI Report*]; New York State Bar Ass'n Tax Section, Report No. 1266, *Report on the Proposed Continuity of Interest Regulations* (May 18, 2012) [hereinafter *Third COI Report*]. This was hailed as a great step forward; in a contemporary report, we stated that the regulations proposed in 2004—including the Signing Date Rule—represented "a significant step towards quelling taxpayer uncertainty and transactional inefficiency and would be consistent with the underlying premises of the reorganization provisions of the Code . . . ." See *Second COI Report* at 3.

not entirely clear,[9] the A2E Control Test appears to measure compliance upon the closing of the merger, and, in the absence of clear guidance to the contrary, taxpayers treat it as being tested at closing. As a result, taxpayers seeking reorganization qualification for a part-cash/part-stock reverse subsidiary merger are similarly vulnerable to downward movements in the Acquiror's stock price during the executory period of the contract, making it impossible, as of the adoption of the plan of reorganization on the signing date, to know whether the transaction will so qualify—despite the intentions of the parties and for reasons outside of their control.

The current practice of using two different measurement dates for determining the value of Acquiror stock—one for determining satisfaction of the COI Requirement and one for determining whether the A2E Control Test is met—is a surprising inconsistency in the law governing reorganizations. This inconsistency creates a trap for the unwary and results in unnecessary transactional frictions; sophisticated taxpayers are forced to continue to rely on outmoded (following the adoption of the Signing Date Rule) contractual mechanisms or alternative structures to preserve reorganization treatment in the event of a post-signing drop in the value of Acquiror stock. These contractual mechanisms and structural workarounds generally add complexity and inefficiency to the negotiation and execution of merger agreements and have the potential to frustrate the non-tax business and economic objectives of the parties to an intended reorganization. Accordingly, as discussed below, (i) if Treasury and the Service determine that they have authority to do so, we recommend that they issue regulations extending

[9] See New York State Bar Ass'n Tax Section, Report No. 1164, *Report on Selected Issues in Triangular Reorganizations* (Sept. 22, 2008) [hereinafter *Triangular Reorganizations Report*] (requesting clarification).

the application of the Signing Date Rule to the A2E Control Test, allowing satisfaction of the A2E Control Test to be determined at signing, but (ii) if Treasury and the Service determine that they do not have such authority, we would urge Treasury to seek such authority from Congress though an amendment to the Code expressly delegating such authority. Moreover, if Treasury and the Service were to conclude that they lack such authority, we suggest an alternative approach, as an interim measure, that could largely achieve the same result and that is clearly consistent with existing law.

II. Scope of Report and Summary of Recommendations

This Report addresses the effect of pre-closing stock value fluctuations on a reverse subsidiary merger's satisfaction of the A2E Control Test applicable to tax-free reorganizations under Section 368(a)(2)(E). Specifically, this Report examines whether the application of the Signing Date Rule should be extended and should apply for purposes of determining whether a reverse subsidiary merger intended to qualify as a reorganization by virtue of Section 368(a)(2)(E) satisfies the A2E Control Test. Our principal recommendation is that the A2E Control Test should be measured using signing date values, provided that the requirements of the Signing Date Rule are satisfied.

III. Continuity of Interest: Background and Rationale

In general, the effect of the reorganization provisions is that no gain or loss is recognized when an exchange of qualifying property (such as stock or securities) occurs within a qualifying acquisition. The rationale is that such a transaction is seen as a continuation of the parties' prior investment in a modified form, rather than a taxable sale or exchange.[10] To qualify as a reorganization, the transaction must meet the definitional requirements for specifically identified transactions described in Section 368(a). Additionally, the transaction must meet certain nonstatutory requirements, including the COI Requirement.[11] This Part III briefly outlines the development of the COI Requirement from early judicial doctrine to present day.

A. Early Judicial Doctrine

The first reorganization provision appeared in the Revenue Act of 1918 and provided a limited tax benefit for the exchange of stock related to a corporate "reorganization, merger, or consolidation."[12] Subsequent statutory enactments in 1921, 1924 and 1926 revised and expanded the provision but offered little guidance on how to distinguish a reorganization from a taxable transaction. Thus, the key task of defining the contours of a qualifying reorganization was left largely to the courts.

The COI Requirement first emerged in 1932 in *Cortland Specialty Co. v. Commissioner*.[13] In *Cortland*, the Target transferred substantially all of its assets for cash and short-term notes.[14] The Second Circuit held that such transaction was in substance a sale rather

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[10] Treas. Reg. § 1.368-1(b) ("The purpose of the reorganization provisions of the Code is to except from the general rule certain specifically described exchanges incident to such readjustments of corporate structures made in one of the particular ways specified in the Code, as are required by business exigencies and which effect only a readjustment of continuing interest in property under modified corporate forms.").

[11] Once common law requirements, these doctrines are now incorporated in the Treasury Regulations promulgated under Section 368. See Treas. Reg. §§ 1.368-1(c), -2(g) (business purpose); Treas. Reg. § 1.368-1(d) (continuity of business enterprise); Treas. Reg. § 1.368-1(e) (continuity of interest).

[12] Revenue Act of 1918, ch. 18, § 202(b), 40 Stat. 1057, 1060 (1919).

[13] 60 F.2d 937 (2d. Cir. 1932).

[14] *Id.* at 938.

than a reorganization because the Target shareholders received no Acquiror equity in the exchange.[15] The court interpreted the statutory term "reorganization" as presupposing "continuance of business under modified corporate forms" and concluded that "there must be some continuity of interest on the part of the transferor corporation or its stockholders" in order to obtain nonrecognition treatment.[16] The next year, the Supreme Court decided a similar case and agreed that a continuity of interest requirement was implicit in the statute.[17] The Court concluded that, in order to qualify as a reorganization, "the seller must acquire an interest in the affairs of the purchasing company more definite than that incident to ownership of its short-term purchase-money notes."[18]

Once it was established that some equity was required, courts turned to defining how much equity was needed. In *Helvering v. Minnesota Tea Co.*,[19] the Supreme Court stated that the Target shareholders must acquire a "definite and substantial" interest in the Acquiror; some cash consideration was permissible as long as the Acquiror stock "represented a material part of the value of the transferred assets."[20] Under the "material part of the value" standard, the Court held that consideration consisting of 44 percent cash and 56 percent Acquiror stock was

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[15] *Id.* at 939 ("A sale of the assets of one corporation to another for cash without the retention of any interest by the seller in the purchaser is quite outside the objects of merger and consolidation statutes.").

[16] *Id.* at 940.

[17] See *Pinellas Ice & Cold Storage Co. v. Comm'r*, 287 U.S. 462 (1933).

[18] *Id.* at 470.

[19] 296 U.S. 378 (1935).

[20] *Id.* at 386.

acceptable.[21] Subsequent cases continued to define the permissible mix of stock and non-stock consideration.[22] These cases, taken together, suggest that courts saw continuity of interest as a touchstone of the nonrecognition treatment afforded to reorganizations.

B. COI Regulations and the Signing Date Rule

Today, the COI Requirement is enshrined in the Treasury Regulations promulgated under Section 368.[23] Echoing the early judicial reasoning, the regulations are explicit that "[t]he purpose of the continuity of interest requirement is to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations."[24]

For years, the Service adhered to a 50 percent minimum equity threshold in its ruling practice,[25] but the government eventually made clear that a 40 percent minimum equity threshold was permissible.[26] This threshold was generally measured based on the closing date values of

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[21] *Id.*

[22] See, e.g., *John A. Nelson Co. v. Helvering*, 296 U.S. 374 (1935) (38 percent stock sufficient); *Helvering v. Watts*, 296 U.S. 387 (1935) (45 percent stock sufficient); *Miller v. Comm'r*, 84 F.2d 415 (6th Cir. 1936) (25 percent stock sufficient); *Kass v. Comm'r*, 60 T.C. 218 (1973), *aff'd*, 491 F.2d 749 (3d Cir. 1974) (16 percent stock insufficient); *Yoc Heating Corp. v. Comm'r*, 61 T.C. 168 (1973) (15 percent stock insufficient); *Sw. Natural Gas Co. v. Comm'r*, 189 F.2d 332, 335 (5th Cir. 1951), *cert. denied*, 342 U.S. 860 (1951) (1 percent stock insufficient).

[23] Treas. Reg. § 1.368-1(e)(1)(i) ("Continuity of interest requires that in substance a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization. . . . [A] proprietary interest in the target corporation is not preserved if, in connection with the potential reorganization, it is acquired by the issuing corporation for consideration other than stock of the issuing corporation.").

[24] *Id.*

[25] See Rev. Proc. 77-37, 1977-2 C.B. 568.

[26] Corporate Reorganizations; Guidance on the Measurement of Continuity of Interest, 69 Fed. Reg. 48429, 48430–31 (Aug. 10, 2004); see Treas. Reg. § 1.368-1(e)(2)(v) (ex. 1).

the consideration paid by the Acquiror for the Target's assets or stock,[27] which meant that a transaction that was intended to qualify as a reorganization when the deal signed could fail the COI Requirement by the time the deal closed if the price of the Acquiror stock declined in the interim.

Starting in 2004, a series of proposed, final and temporary regulations endeavored to solve this fluctuation in value concern.[28] Treasury and the Service acknowledged the risk inherent in the closing date rule, noting that in a part-cash/ part-stock deal, "the transaction could fail to satisfy the COI requirement as a result of a decline in the value of the acquiring corporation's stock between the date the parties agree to the terms of the transaction (the signing date) and the date the transaction closes."[29] The regulations responded to this concern by defining a certain set of circumstances in which the determination of whether the COI Requirement is satisfied should be made by reference to the signing date value of Acquiror stock

[27] Rev. Proc. 77-37 (stating that the COI Requirement is satisfied based on the value of Acquiror stock "as of the effective date of the reorganization").

[28] The first version of the Signing Date Rule was proposed in 2004. See 69 Fed. Reg. at 48429. These proposed regulations were finalized in September 2005 and later replaced with temporary regulations in March 2007. See T.D. 9225, 70 Fed. Reg. 54631 (Sept. 16, 2005) (Treas. Reg. § 1.368-1(e)(2)); Temp. Treas. Reg. § 1.368-1T(e)(2), 72 Fed. Reg. 12974 (Mar. 20, 2007). Upon expiration of the 2007 temporary regulations, the Service published Notice 2010-25, which allowed taxpayers to apply the Signing Date Rule of the 2007 temporary regulations on an elective basis. Notice 2010-25, 2010-14 I.R.B. 527. Final regulations issued in December 2011 adopted the temporary regulations issued in 2007 with only minor changes. T.D. 9565, 76 Fed. Reg. 78540 (Dec. 19, 2011) (Treas. Reg. § 1.368-1(e)(2)). At the same time, in December 2011, Treasury and the Service proposed a regulation that identified situations, other than those covered by the Signing Date Rule, in which the value of Acquiror stock could be determined based on value other than its actual trading price on the closing date. 76 Fed. Reg. 78591 (Dec. 19, 2011). In 2019, Treasury and the Service withdrew these proposed regulations, stating that current law provides sufficient guidance to taxpayers with respect to the COI Requirement. 84 Fed. Reg. 12169 (Apr. 1, 2019).

[29] See 69 Fed. Reg. at 48429.

to be issued.[30] Specifically, the regulations provided that the Signing Date Rule applies in cases where a binding contract provides for fixed consideration.

The Signing Date Rule is based on the principle that because the consideration is fixed in the contract, the Target shareholders are "subject to the economic fortunes" of the Acquiror as of the signing date.[31] Several technical aspects of the regulation ensure this is the case. First, if a binding contract is modified before the closing date of the potential reorganization, the date of the modification generally is treated as the first date on which there is a binding contract (because the Target shareholders are now "locked in" to the Acquiror's stock price at the modified exchange ratio).[32] Second, a contract that provides for contingent consideration will be treated as providing for fixed consideration if it would satisfy the requirements of the Signing Date Rule without the contingent adjustment *unless* the contingent adjustments "prevent (to any extent) the target corporation shareholders from being subject to the economic benefits and burdens of ownership of the issuing corporation stock after the last business day before the first date the contract is a binding contract."[33] Third, if the Acquiror alters its capital structure between signing and closing "in a manner that materially alters the economic arrangement of the parties," the absence of a customary anti-dilution clause requiring adjustment to the

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[30] Given the purpose of the COI Requirement—to distinguish a *bona fide* reorganization from a sale—the focus on the relative value of Acquiror stock (compared to boot) and, in particular at closing, is sensible. But in circumstances where the terms of the exchange are irrevocably set at signing and the economics to the Target shareholders are effectively locked in from and after that date, the relevance of closing date values wanes.

[31] 69 Fed. Reg. at 48429.

[32] Treas. Reg. § 1.368-1(e)(2)(ii)(B)(*1*).

[33] Treas. Reg. § 1.368-1(e)(2)(iii)(C).

consideration will disqualify the contract from providing fixed consideration.[34] Each of these protections is meant to guarantee that the Target shareholders bear the ups and downs in Acquiror stock as of the time that satisfaction of the COI Requirement is determined (*i.e.*, from and after the date a binding contract is signed).[35]

Over nearly 100 years, the COI Requirement has progressed from a malleable judicial doctrine to a bright-line regulation. By promoting taxpayer certainty and looking to the mix of consideration at the time the deal was struck, the Signing Date Rule facilitates orderly business transactions intending to qualify as reorganizations.

IV. Section 368(a)(2)(E): Background and Rationale

The same logic that supports the application of the Signing Date Rule to the COI Requirement also applies to reverse subsidiary mergers. Accordingly, in this Part IV, we turn to the background and rationale behind Section 368(a)(2)(E).

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[34] Treas. Reg. § 1.368-1(e)(2)(iii)(E).

[35] Moreover, the regulations that were proposed in 2011 and withdrawn in 2019 contained even more precise and technical nuances to preserve the rationale behind the Signing Date Rule. In particular, the proposed regulations considered the application of the Signing Date Rule to contracts that provided for adjustments to the consideration if the Acquiror stock price rose above or fell below certain thresholds (*i.e.*, a "collar"). The proposed regulations extended the theory of the Signing Date Rule to such situations because, outside of the collar, the Target shareholders were "subject to the economic fortunes" of the ownership of Acquiror stock (even though such mechanisms provide some degree of price protection). For a more in-depth discussion of the technical aspects of the 2011 proposed regulations, see *Third COI Report*.

A. Forward Triangular Mergers

The text, structure and history of the triangular merger statutes reveals that they were conventionally understood to harmonize the tax treatment of similar transactions. In 1968, Congress enacted Section 368(a)(2)(D) for forward subsidiary mergers.[36]

Before this provision was added, the statute still permitted taxpayers to achieve the results of a forward subsidiary merger indirectly through the combination of two transactions—first, a statutory merger of the Target into the Acquiror and second, a subsequent contribution of the Target's assets by the Acquiror to its subsidiary.[37] But sometimes, for business or legal reasons, this two-step structure was at best cumbersome or at worst unattainable.

By adding Section 368(a)(2)(D), which expressly authorized reorganization treatment for forward subsidiary mergers, Congress enabled taxpayers to do directly what they could usually (but not always) do indirectly. At the time of enactment, the conventional understanding was that it was a liberalizing measure, and the structure of the statute confirms this reading: Congress added a new form of approved reorganization, without revoking existing forms.

This conventional understanding is echoed in the committee report. The committee saw "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

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[36] See Pub. L. No. 90-621, 82 Stat. 1310 (1968).

[37] See Section 368(a)(1)(A) (authorizing reorganization treatment for mergers); Section 351 (authorizing tax-free contributions to controlled corporations). The committee report provides background on this transactional structure. H.R. Rep. No. 90-1902, at 2 (1968).

temporarily) through a merger."[38] The report also explained the provision as a natural extension of the existing triangular B and C reorganization provisions.[39]

B. Reverse Triangular Mergers

Three years later, Congress added a provision, Section 368(a)(2)(E), authorizing reorganization treatment for reverse subsidiary mergers.[40] Once again, the text, structure and history show that this provision was conventionally understood to broaden the availability of reorganization treatment, so it would be available for reverse subsidiary mergers, as well.

Again, even before this provision was added, taxpayers could achieve reorganization treatment for reverse subsidiary mergers via a reorganization under Section 368(a)(1)(B) (a "B Reorganization").[41] Yet this form was available only if transactions satisfied a stringent condition: the acquisition had to be solely for voting stock.[42] In other words, sellers could not receive cash or any other "boot" in the transaction.

Thus, the addition of Section 368(a)(2)(E) added the ability to offer boot. As the text shows, the Acquiror must still use voting stock but, unlike in a B Reorganization, the exchange need not be "solely" for voting stock. Instead, the Acquiror must essentially use voting stock to acquire 80% of Target, but can use other consideration (including cash) to acquire the rest.

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[38] *Id.* at 3. As previously acknowledged, we realize that some judges do not consult legislative history.

[39] *Id.* ("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.").

[40] See Pub. L. No. 91-693, 84 Stat. 2077 (1971).

[41] Section 368(a)(1)(B).

[42] See, e.g., *Helvering v. Sw. Consol. Corp.*, 315 U.S. 194, 198 (1942) ("'Solely' leaves no leeway. Voting stock plus some other consideration does not meet the statutory requirement.").

Specifically, for a reverse subsidiary merger to qualify as a reorganization under Section 368(a)(2)(E), (i) the Acquiror must own stock representing Section 368(c) control[43] of the merger subsidiary before the merger, (ii) the Acquiror must acquire stock representing Section 368(c) control of the Target in exchange for Acquiror voting stock in the transaction (*i.e.*, the A2E Control Test), (iii) immediately after the merger, the Target must hold substantially all of its and the merger subsidiary's properties (the "Substantially All Requirement") and (iv) the merger must satisfy the business purpose requirement, the COI Requirement and the continuity of business enterprise test.

Like the 1968 provision on forward triangular mergers, the 1971 provision on reverse triangular mergers was conventionally understood as a liberalizing measure. As the text showed, reorganization treatment was now available for reverse mergers—not just via B Reorganizations, which could be effected "solely" for voting stock—but also via Section 368(a)(2)(E), which imposed the more lenient A2E Control Test. Again, the statutory structure is consistent with this conventional understanding: Congress retained the B Reorganization, while adding a new provision.

As with forward subsidiary mergers, this conventional understanding is echoed in the committee report. The accompanying Senate report again focused on consistent tax treatment across similar transactions. Having granted tax-free treatment to certain forward subsidiary

[43] Control for this purpose is defined as "ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation." Section 368(c).

mergers, it was only logical for Congress to grant tax-free treatment to certain reverse subsidiary mergers.[44] The report observed that a reverse subsidiary merger may be treated as tax-free under Section 368(a)(1)(B) (*i.e.*, as a B Reorganization) if the acquisition is solely for voting stock of the Acquiror, but declined to extend the "solely for stock" requirement to reverse subsidiary mergers.[45] Thus, the provision was conventionally understood to authorize boot in reverse subsidiary mergers, even though boot was not permitted in B Reorganizations.[46]

C. Advantages of the Reverse Subsidiary Merger Structure

Despite the somewhat more rigorous qualification hurdles imposed by the A2E Control Test and the Substantially All Requirement, the reverse subsidiary merger remains an important acquisition form for both tax and non-tax reasons.[47] One important tax reason for pursuing a reverse subsidiary merger is to immunize the Acquiror against the ill corporate-level tax consequences that would attend the failure of a forward subsidiary merger to qualify as a reorganization. If a reverse subsidiary merger fails to qualify as a reorganization, it is only the

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[44] S. Rep. No. 91-1533, at 3–4 (1970) ("[T]here is no reason why a merger in one direction . . . should be taxable, when the merger in the other direction . . . , under identical circumstances, is tax-free.").

[45] *Id.* at 4. Prior to the enactment of Section 368(a)(2)(E), the Service had initially classified a reverse subsidiary merger as the functional equivalent of a B Reorganization, with the result that the acquisition had to be effected exclusively with voting stock of the acquiring corporation (or its parent). See Rev. Rul. 67-448, 1967-2 C.B. 144.

[46] S. Rep. No. 91-1533, at 5 (describing the 80 percent test for Section 368(c) control and explaining that "[i]f voting stock of the controlling corporation is used in the exchange to the extent described, additional stock in the surviving corporation may be acquired for cash or other property"). As noted previously, we realize that some judges do not consult legislative history.

[47] In fact, triangular mergers are considered to be "the most popular deal structure." Stephanie Hoffer and Dale A. Oesterle, *Tax-Free Reorganizations: The Evolution and Revolution of Triangular Mergers*, 108 Nw. U. L. Rev. 1083, 1096 (2014).

Target shareholders who will be subject to tax; if a forward subsidiary merger fails to qualify as a reorganization, tax is imposed at both the corporate and shareholder level.

As to non-tax reasons, at the most basic level, triangular mergers protect the Parent's assets from the Target's creditors—the liabilities remain siloed in a separate legal entity (unlike a forward merger into Parent). In addition, it is often the case that the Target is a party to a material contract, lease, governmental license or charter or royalty that contains an anti-assignment provision that would preclude structuring the acquisition as a forward asset merger qualifying as a reorganization under either Section 368(a)(1)(A) or Section 368(a)(2)(D). And although not universally true, it is frequently the case that credit agreements and indentures, although permitting the Target (as the borrower) to be a party to an acquisition, contain acceleration clauses with potentially expensive "make-whole" provisions in the event that the Target is not the survivor of the merger.

The ability to include some cash as consideration in a reverse subsidiary merger also gives this acquisition pattern certain non-tax business advantages over all-stock B Reorganizations. For an Acquiror who believes its equity currency is undervalued (perhaps due to temporary dislocations in the market), being able to pay a portion of the deal consideration in cash is more efficient and saves the Acquiror from having to issue equity at a price below what it believes is its intrinsic per share value. In addition, it is not uncommon for publicly traded companies to pay careful attention to their "earnings per share," making them particularly sensitive to the potential dilution resulting from issuing shares in an acquisition. Hence, the ability to add cash to the consideration mix can ameliorate the dilution from a proposed transaction. Finally, for a public company whose stock is traded on either the New York Stock Exchange (the "NYSE") or Nasdaq, the ability to pay a portion of the consideration in cash may allow the Acquiror to avoid having to put a potential acquisition to a vote of its shareholders. Although the Target's shareholders will always have to approve an acquisition of the Target, a vote by the Acquiror's shareholders is only required under the NYSE and Nasdaq rules if the Acquiror is issuing more than 20 percent of its stock in the transaction.[48] The incremental uncertainty attending an additional shareholder approval is almost universally viewed unfavorably as a business matter. For these reasons, it is important and useful to be able to include some cash in the consideration package without tainting the otherwise tax-free nature of the transaction.

V. Fluctuations in the Value of Acquiror Stock

A. A Canonical Example

As described in Part IV above, the reverse subsidiary merger remains an important part of the transactional tool kit for taxpayers seeking reorganization qualification in connection with continuance of business enterprises under modified corporate form. Yet, similar to the pre-Signing Date Rule application of the COI Requirement, a decline in the value of the Acquiror's stock between the signing date of a binding contract (and the adoption of a plan of reorganization) and the closing date of the transaction can arbitrarily frustrate, alternatively, the parties' tax and non-tax business goals. Consider the following example.

[48] See NYSE Listed Company Manual § 312.03(c); Nasdaq Listing Rule 5635(a).

Example 1A. Acquiror's stock price declines; no tax opinion closing condition. Acquiror and Target enter into a Signing Date Rule compliant contract pursuant to which a direct, first-tier subsidiary of Acquiror ("Merger Sub") will be merged with and into Target, with Target surviving. Pursuant to the contract, Target shareholders will receive $20 of cash plus 80 shares of Acquiror stock. At the pre-signing date, Acquiror stock is trading at $1 per share. The contract contains no provision that would readjust the merger consideration or require that the transaction be restructured in the event that the A2E Control Test would not otherwise be satisfied, nor does the contract contain a closing condition that either Target or Acquiror receive a written opinion of counsel to the effect that the transaction will qualify as a reorganization under Section 368 (a "Tax Opinion Closing Condition"). On the day before the closing of the merger, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level through the closing of the transaction.

In Example 1A, despite the parties' intent that the transaction qualify as a reorganization by virtue of Section 368(a)(2)(E), and despite the fact that it would have qualified if measured on the date that a binding contract with fixed consideration was signed, because the A2E Control Test is measured at closing, the transaction will not so qualify. As of the closing date, the total value of the consideration is $92 ($20 cash plus 80 shares worth $0.90 each). The merger fails the A2E Control test because 21.7 percent of the total consideration is boot ($20/$92), which is over the 20 percent limit. Although there are no ill corporate-level tax consequences to the transaction failing to qualify as a reorganization,[49] the Target shareholders will be taxed on the full amount of their economic gain as a result of this failure. Rather than paying tax on the lesser of the amount of gain realized and the amount of cash received (as they would have under Section 356 had the transaction qualified as a reorganization by virtue of Section 368), the Target

[49] A reverse subsidiary merger that fails to qualify as a reorganization is treated as a taxable purchase of Target's stock. See Rev. Rul. 67-448.

shareholders will be taxable under Section 1001 on both the amount of cash and the fair market value of the Acquiror stock received. Although the Target shareholders will take the Acquiror stock with a full fair market value basis (and, accordingly, could sell a portion of the Acquiror stock received in the merger at the deal price to fund the tax liability from the transaction at no additional tax cost), this is cold comfort given that the parties had planned into a largely tax-free transaction. Moreover, there may be non-tax frictions associated with liquidating a portion of the Acquiror stock received. And the Target shareholders will be forced to choose between reducing their continuing interest in the combined business of the Target and the Acquiror or finding other sources of liquidity to fund the tax.

The problem of an unanticipated (and adverse) change in the tax treatment of a potential reorganization is easily addressed through the addition of a closing condition that the Target receive a written opinion of counsel to the effect that the reverse subsidiary merger will so qualify (*i.e.*, a Tax Opinion Closing Condition).[50] Although this ensures that the Target need not close the transaction unless the receipt of the Acquiror stock will be tax-free to its shareholders, such a walkaway right in favor of the Target is certainly not desirable for, and is unlikely to be acceptable to, the Acquiror. Such a closing condition (if waivable) effectively creates an option in the hands of the Target: if the Acquiror's stock price increases between signing and closing (or is flat, in each case assuming that the A2E Control Test was satisfied at signing), then the

[50] Although the tax stakes for the Acquiror are low, given that the failure of the merger to qualify as a reorganization is devoid of consequences at the corporate level, it is not uncommon for the Acquiror to have a symmetric Tax Opinion Closing Condition.

opinion of the Target's counsel will be forthcoming. If, on the other hand, the Acquiror's stock price has declined over the same period, then the Target's counsel will be unable to give the requisite opinion, the closing condition will not be satisfied, and the Target may be entitled to terminate the contract (assuming it does not waive the condition). So, although a Tax Opinion Closing Condition brings certainty to the tax treatment of the transaction, it does so at the cost of increased uncertainty that the transaction will close at all, and in a way that is often asymmetrically favorable to the Target and its shareholders. Furthermore, if the Acquiror demands a symmetric Tax Opinion Closing Condition, closing certainty may be even more elusive.

B. Imperfect Transactional Solutions

Virtually no merger partner enters into a binding written agreement to undertake an acquisition that it does not intend to complete. There are several reasons for this. The first is reputational. Especially for a publicly traded company, who must disclose having entered into an acquisition agreement, it is important to be able to credibly commit to closing acquisitions that have been announced to the market. It is also important because, in order to be willing to invest the significant management time and resources on a potential acquisition, and to incur the costs and expenses associated with negotiating such a transaction and securing shareholder and any required regulatory approvals, the parties need to have a high degree of certainty that those efforts and expenses will not be for naught. Accordingly, closing certainty is often of paramount importance to the parties to a reorganization.

By the same token, in many deals, the tax treatment of the Target's shareholders is also a critically important element of the overall economics of any transaction.[51] Especially in a circumstance where there are large, tax-sensitive shareholders, but also more generally, the ability to promise the Target shareholders certainty about the treatment of the transaction as a reorganization can be critical to the success of the transaction and its approval by a majority of the Target shareholders. Accordingly, prior to the adoption of the Signing Date Rule, sophisticated taxpayers developed a set of tools which attempt to resolve the tensions between closing certainty (for the corporate parties to a reorganization) and tax certainty (for the Target shareholders). Those tools are now largely unnecessary for ensuring satisfaction of the COI Requirement (thanks to the Signing Date Rule), but they remain potentially relevant for ensuring satisfaction of the A2E Control Test.[52] Consider the following example.

> ***Example 1B. Acquiror's stock price declines; tax opinion closing condition; adjustment mechanism.*** Same facts as Example 1A, except that the contract contains a Tax Opinion Closing Condition. The transaction also provides that, in the event that the Tax Opinion Closing Condition cannot be satisfied, the parties agree to adjust the mix of cash and Acquiror stock (pursuant to a formula set forth in the contract) until the point where the Tax Opinion Closing Condition is just satisfied (an "<u>Adjustment Per Tax Opinion</u>"). On the day before the scheduled closing of the merger, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level through the closing of the transaction. The Adjustment Per Tax Opinion applies to permit satisfaction of the Tax Opinion

[51] It should be acknowledged that while the tax treatment of shareholders is and can be important, even critical, in some situations (*e.g.*, often with private targets, less so with public targets, absent large tax-sensitive shareholders), it often is not a critical driver of the transaction (*e.g.*, in the context of a widely held public target).

[52] Treasury and the Service specifically acknowledged that prior to its adoption of the Signing Date Rule, attempts to mitigate the fluctuation in value concern "led to complexity in structuring transactions." 69 Fed. Reg. at 48429. The fact that the Signing Date Rule does not apply in the A2E Control Test leads to similar complexity in structuring transactions. Such unnecessary complexity could be largely avoided if the Signing Date Rule were extended to the A2E Control Test.

Closing Condition. The merger closes and qualifies as a reorganization by virtue of Section 368(a)(2)(E).

On the face of it, the Adjustment Per Tax Opinion seems to deftly satisfy the parties' conflicting objectives of tax certainty and closing certainty. And although this is true, it is not without cost. Closer inspection reveals that these twin goals can only be achieved at the cost of doing some violence to the business deal as originally struck at signing. The degree of violence visited on the original economic arrangement will depend on the contractual formula implementing the Adjustment Per Tax Opinion.

Analytically, there are three ways to adjust the consideration mix to permit satisfaction of the A2E Control Test: (i) keep the number of shares of Acquiror stock fixed and reduce the amount of cash, (ii) keep the amount of cash fixed and increase the number of Acquiror shares or (iii) substitute out of cash and into Acquiror stock at some "exchange ratio."

The first of these options—the pure cash adjustment—is unlikely to be acceptable to the Target (as this would require the Target shareholders not only to take the same number of shares of Acquiror stock that are now worth less than they were at signing, but also to reduce proportionately the amount of cash they would otherwise be entitled to receive).[53] In Example 1B, if the 80 shares in the deal stay constant, the Target shareholders would have to accept $18 cash and 80 shares worth $0.90 each (for a total consideration package worth $90) rather than the deal they struck with $20 cash and 80 shares worth $1.00 each (for a total

[53] We are unaware of such a mechanism ever having been implemented in practice.

consideration package worth $100)—a 10 percent reduction in total consideration that may be untenable.

The second of these options—the pure stock adjustment—maintains the economics to the Target holders but forces the Acquiror to issue more stock in what essentially is a "down market" (with all of the attendant ills described above in Part IV). In Example 1B, if the $20 cash in the deal stays constant, the Acquiror would need to issue 88.89 shares (rather than 80 shares per the initial deal) to maintain compliance with the A2E Control Test, which would yield the same total consideration package worth $100 for Target shareholders.[54]

The third of these options—substituting out of cash and into Acquiror stock—is the one most frequently used in practice. However, even this seemingly Solomonic compromise is not without issue, because the parties still must negotiate the exchange ratio at which cash will be converted into stock. Should it be at the signing date price, so that for every $1 reduction in cash consideration, the Target shareholders are getting one share of Acquiror stock that is worth only $0.90? Or should it be at the then market price of Acquiror stock? Or could it be some other agreed-upon value? Such a provision can have important economic consequences to the parties and can make coming to an agreement difficult.

Figure 1 below illustrates the possible outcomes of the adjustment mechanism. The horizontal axis shows the number of Acquiror shares and the vertical axis shows the amount of

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[54] Note that the economics to the Target shareholders are maintained here because the original deal was struck at an 80/20 mix of stock and cash. To the extent there was equity "cushion" in the deal (*i.e.*, to the extent that the value of the Acquiror stock represented more than 80 percent of the total consideration at signing), this will not be the case. For example, if the original deal were struck with $10 cash and 90 shares of Acquiror stock worth $1 each, the value of Acquiror stock could fall by over 50 percent before the Adjustment Per Tax Opinion was implicated.

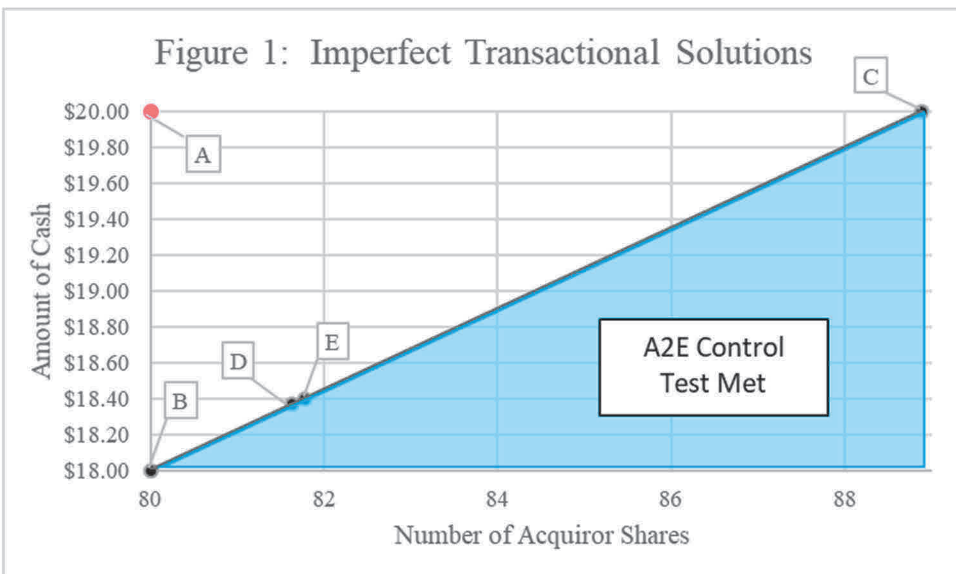
cash in the total consideration package. Point A represents the original deal that was struck—with $20 cash and 80 shares—which is outside the range of consideration permitted by the A2E Control Test (represented by the solid line, which maintains the 80/20 consideration mix, and the shaded region, to the extent parties desire to include more of an equity cushion).

Point B shows the pure cash adjustment and Point C shows the pure stock adjustment; as noted, these two endpoints help form the boundary of permissible combinations of stock and cash. Any point on the straight line connecting Point B and Point C meets the A2E Control Test, but as discussed above, exactly where the parties land along this spectrum has important economic consequences to the parties. On one hand, the Acquiror likely prefers outcomes closer to Point B, which require less cash and fewer Acquiror shares to be issued (and, accordingly, smaller deal values). The Target shareholders would prefer outcomes that are closer to Point C, with more cash and more stock (and, accordingly, greater deal values).

The parties may negotiate the appropriate exchange ratio based on the implied share price.[55] Point D is the combination of stock and cash that results from a one-to-one exchange ratio, such that for every $1 reduction in cash consideration, the Target shareholders are getting one share of Acquiror stock that is worth only $0.90. At this Point D, the Target shareholders receive roughly $18.36 cash and 81.64 Acquiror shares worth $0.90 each (for a total consideration package worth approximately $91.84). Point E is the combination of stock and

[55] In fact, the pure cash adjustment and the pure stock adjustment can be conceptualized as the limits of this adjustment mechanism, where the Acquiror price per share implied by the exchange ratio approaches infinity or zero, respectively.

cash that preserves the value from Point A, such that for every $0.90 reduction in cash consideration, the Target shareholders are getting one share of Acquiror stock that is worth $0.90. At this Point E, the Target shareholders receive roughly $18.40 cash and 81.78 Acquiror shares worth $0.90 each (for a total consideration package worth $92.00, the same as Point A). Exactly where the parties land on this line (or in the shaded region) will be the result of extensive negotiations and complex drafting, each of which adds unnecessary friction to getting the deal done. Prolonged negotiations over exchange ratio adjustments during interim periods are often driven by the current law's requirement to measure the A2E Control Test at closing. Thus, extending the Signing Date Rule to the A2E Control Test could provide the practical advantage of simplifying negotiations and deal planning.



The foregoing discussion and examples demonstrate the difficulty merger partners face in structuring and negotiating a transaction that achieves both tax and closing certainty. They also show that such certainty can only be achieved by potentially tampering with the underlying economic arrangements that the parties agreed to at signing in order to ameliorate the unintended adverse tax consequences of pre-closing drops in the Acquiror's stock price.

There is, however, an alternative that preserves the original economic terms (*i.e.*, that does not require a change in the mix of consideration) and the tax certainty of a consummated transaction—but it comes at the cost of an increased risk that the transaction will not close at all. Consider the following example.

> ***Example 1C. Acquiror's stock price declines; tax opinion closing condition; restructuring covenant.*** Same facts as Example 1A, except that the contract contains a Tax Opinion Closing Condition and also a provision (a "<u>Restructuring Covenant</u>") requiring that, in the event that the Tax Opinion Closing Condition cannot be satisfied, the parties agree to restructure the transaction as a "double dummy" pursuant to which (i) the Acquiror and Target will jointly form a new holding company ("<u>HoldCo</u>"), (ii) HoldCo will create two Merger Subs, (iii) one Merger Sub will merge with and into Acquiror (with Acquiror surviving) and (iv) the other Merger Sub will merge into Target (with Target surviving). In these mergers, the former shareholders of Acquiror and Target exchange their shares for stock in HoldCo. This structure relies on Section 351 (which places no limits on the amount of cash a property contributor can receive in an otherwise qualifying transaction) in the event that the A2E Control Test would not otherwise be satisfied. On the day before the closing of the merger, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level through the closing of the transaction.

As a result of the drop in the Acquiror's stock price, the transaction would fail the A2E Control Test (and, a fortiori, to qualify as a reorganization).[56] Accordingly, the Restructuring Covenant will change the mechanics of the acquisition as described. But now the Acquiror's shareholders, in addition to the Target's shareholders, will have to approve the transaction. If the transaction is

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[56] See *supra,* note 49.

approved by both shareholder constituencies, the parties will be entitled to rely on Section 351 for the conclusion that the HoldCo stock may be received in a tax-deferred transaction.

The foregoing examples are intended to demonstrate that measuring satisfaction of the A2E Control Test at the closing of the merger forces the parties to weigh the competing and potentially irreconcilable goals of fidelity to the original economic arrangement, tax certainty and closing certainty, and to choose only two of the three—and all because of unforeseeable movements in the Acquiror's stock price between signing and closing. In the case of a Signing Date Rule compliant contract, we believe forcing taxpayers to make this choice is inconsistent with the conventional understanding of the reorganization provisions generally, and of Section 368(a)(2)(E) specifically. As discussed above, the text, structure and conventional understanding of Section 368(a)(2)(E) show that it liberalized the requirements for reverse triangular mergers. By replacing the "solely for voting" requirement with the A2E Control Test, Congress expressly allowed Acquirors to offer boot. But this new path to reorganization treatment is cumbersome at best if the A2E Control Test is applied rigidly on the closing date. Accordingly, we believe there are good, practical policy reasons grounded in the text, structure and conventional understanding of Section 368(a)(2)(E) for extending application of the Signing Date Rule to the determination of whether a potential reverse subsidiary merger satisfies the A2E Control Test.

VI. Interpreting the Statute

The text of the A2E Control Test requires that "in the transaction, former shareholders of the surviving corporation exchanged, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation which constitutes control of such corporation."[57] In this Part VI, we examine the precise language of Section 368(a)(2)(E)(ii) using the various tools of statutory construction. Then we turn to a brief analysis of the relevant regulatory authority.

In deciding questions of statutory interpretation, a court always begins with the text of the statute itself.[58] Here, the text does not explicitly state when the A2E Control Test is to be measured. On its face, the statute simply refers to requisite amount of Target stock having been "exchanged" by Target shareholders "in the transaction."[59] Section A offers arguments for an interpretation favoring a closing date rule, while section B offers arguments for an interpretation favoring a Signing Date rule.

A. Statutory Reading Favoring a Closing Date Rule

The statute can be read to require a closing date rule, and thus to be inconsistent with our policy recommendation. The gist of this reading is that the statute seems to use "transaction" interchangeably with "exchange."[60] Such a reading equates the timing of the A2E Control Test with the moment—presumably on the closing date—when legal ownership is transferred.[61]

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[57] Section 368(a)(2)(E)(ii).

[58] *Othi v. Holder*, 734 F.3d 259, 265 (4th Cir. 2013).

[59] Section 368(a)(2)(E)(ii).

[60] See S. Rep. No. 91-1533, at 5 (1970) (equating the transaction with the effective time in describing Section 368(a)(2)(E) as permitting boot as long as "voting stock of the controlling corporation is used *in the exchange* to the extent described" (emphasis added)).

[61] Nonetheless, the concept of "closing" is itself a flexible concept. For example, there are situations in which all meaningful closing conditions have been satisfied, but a closing date is selected for convenience thereafter (and the parties generally respect the "closing date" as the "transaction" date for tax purposes rather than investigating and evaluating when they think the benefits and burdens of ownership have passed). The parties have a lot of freedom to

Under this view, a "transaction" arguably cannot exist without a closing—signed and terminated deals arguably are not "transactions" cognizable by the statute.

This narrow interpretation also seems consistent with how Treasury and the Service have historically implemented the statute. For example, the regulations promulgated under Section 368 mandate that "[t]he amount of stock constituting control is measured immediately before the transaction" and go on to observe that Target stock is "*surrendered* in the transaction."[62] Similarly, the regulations reference Parent being in control of Target "immediately after the transaction," and such control legally occurs only if and when the deal closes.[63] Again, the regulations use the term "transaction" narrowly, equating it with the time at which Target stock is surrendered. For this reason, practitioners traditionally have felt constrained to measure compliance with the A2E Control Test as of the acquisition's closing, just as they did with the COI Requirement prior to the adoption of the Signing Date Rule.[64]

We acknowledged as much in a prior report, noting that the "statute does not *appear* to permit a similar 'signing date' rule to apply" to the A2E Control Test, and that "we believe that section 368(a)(2)(E) in its current form requires compliance . . . only at closing."[65] Nevertheless,

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pick a convenient merger effective time that might not bear any relationship to the time at which the "benefits and burdens" have passed under the terms of the parties' agreement, so it is not obvious that the effective time of a merger is the only (or clearest) time for testing.

[62] Treas. Reg. § 1.368-2(j)(3)(i) (emphasis added).

[63] Treas. Reg. § 1.368-2(j)(3)(ii).

[64] Rev. Proc. 77-37 (stating that the value of the Acquiror stock should be measured "as of the effective date of the reorganization").

[65] *Triangular Reorganizations Report* at 13 (emphasis added).

we expressed some reservations about this interpretation and recommended that Treasury and the Service issue formal guidance "*clarifying* that compliance with the A2E control test is measured as of the acquisition's closing."[66] Yet although we suggested that this might be the better view, we recognized that the statute was not clear, and that it leaves the door open to other interpretations.

B. Statutory Reading Favoring a Signing Date Rule

In this section, we explore how the statutory language might be squared with a signing date rule for the A2E Control Test. We offer arguments suggesting that the text, conventional understanding, structure, legislative history and policy of Section 368(a)(2)(E) arguably support a broad interpretation of the term "transaction."

1. The Text of the Statute Supports a Signing Date Rule

Once again, we begin with the text of the statute itself.[67] There is no statutory definition of "transaction" that applies for purposes of Section 368, so a court would likely start with the plain meaning of the term.[68] Courts generally assume that the words of a statute mean what an ordinary, reasonable prudent person would understand them to mean. Although "transaction" can be construed narrowly to mean the precise moment at which the deal closes and the

[66] *Id.* (emphasis added).

[67] "We're all textualists now," as Justice Kagan famously announced. Harvard Law School, *The 2015 Scalia Lecture Series: A Dialogue with Elena Kagan on the Reading of Statutes*, YouTube, at 08:29 (Nov. 25, 2015), https://www.youtube.com/watch?v=dpEtszFT0Tg.

[68] *Bostock v. Clayton Cnty.*, 590 U.S. 644, 788 (2020).

exchange is legally consummated, as noted above, it is also possible to construe "transaction" broadly to mean the process of the whole deal from start to finish.[69]

Dictionaries can be helpful in shedding light on the conventional understanding of statutory language, and dictionary definitions support this broader interpretation. Black's Law Dictionary defines "transaction" as "[t]he act or an instance of conducting business or other dealings; esp., the formation, performance, or discharge of a contract" and "[s]omething performed or carried out; a business agreement or exchange."[70] This definition is not cabined to the closing of a deal. Instead, the definition explicitly calls out the "formation . . . of a contract" and the "business agreement" as key components of a transaction, which suggests that the signing date is as much a part of a transaction as the closing date. Indeed, the formation of a simple contract takes place when both parties sign the contract. This lends support to the claim that the statute is consistent with a signing date rule. Thus, it is not clear from the words "in the transaction" alone that the A2E Control Test must be measured at the closing date.

In addition to dictionaries, the usual meaning of "transaction" in deal documents—the context governed by the statute—arguably also lends support to a broader reading than the effective time on the closing date. For example, it is common in acquisition and merger agreements to define some notion of "transaction expenses" to include (i) fees paid to lawyers,

[69] For purposes of this discussion, we assume that the "transactions" under discussion otherwise satisfy all of the technical requirements of Section 368(a)(2)(E), as well as the business purpose, continuity of interest and continuity of business enterprise tests applicable to acquisitive reorganizations. We also assume a single transfer event (i.e., no contingent consideration) for ease of analysis – how to implement a closing date rule when there are multiple closings is beyond the scope of this Report.

[70] *Transaction*, Black's Law Dictionary (12th ed. 2024).

bankers, investment advisors, consultants, accountants and other deal professions in connection with negotiating, drafting and executing a legally binding agreement and (ii) costs incurred to obtain shareholder approval for the deal. Such "transaction expenses" are not only incurred at the time of closing; rather, they are associated with the larger process of deal-making and are commonly incurred at or prior to the signing date.

2. The Structure of the Statute Supports a Signing Date Rule

Another canon of construction is that statutory terms should be interpreted in the context of surrounding words.[71] Here, the statutory context suggests that "in the transaction" means something broader than the effective time of the merger. Section 368(a)(2)(E) refers to both "the merger" and "the transaction" in the same provision.[72] This juxtaposition suggests that Congress intended them to have different meanings—courts generally assume that Congress "intended each term to have a particular, nonsuperfluous meaning."[73] Black's Law Dictionary defines "merger" to mean "[t]he act or an instance of combining or uniting."[74] Accordingly, the term "merger" more clearly points to a specific moment in time—the time when the certificate of merger is duly filed with the applicable governmental entity (*e.g.*, the Delaware Secretary of

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[71] *Gen. Dynamics Land Sys., Inc. v. Cline*, 540 U.S. 581, 582 (2004); *Univ. of Tex. Sw. Med. Ctr. v. Nassar*, 570 U.S. 338, 356 (2013) ("Text may not be divorced from context.").

[72] Similarly, the legislative history surrounding the enactment of Section 368(a)(2)(E) uses the words "merger" and "transaction" in the same sentence, with a seemingly clear meaning that the former is a narrower construct than the latter. See S. Rep. No. 91-1533, at 3 (1970) ("[I]f a small amount of the stock of [Target] is acquired for cash before the *merger* of [Target] into [Acquiror], there often may be doubt as to whether or not the *transaction* will meet the statutory requirements of a stock-for-stock reorganization." (emphasis added)).

[73] *Bailey v. United States*, 516 U.S. 137, 146 (1995).

[74] *Merger*, Black's Law Dictionary (12th ed. 2024).

State) and the merger becomes effective under state law. This suggests that "transaction" means something broader than just a moment in time. Courts should not narrow the statute's protection by "inserting words Congress chose to omit,"[75] or by construing "transaction" and "merger" as interchangeable.

In fact, the terms "transaction" and "merger" are used multiple times throughout the statute and generally imply that "transaction" is broader than "merger." Section 368(a)(2)(E) begins by referring to a "transaction otherwise qualifying under paragraph (1)(A)." As Section 368(a)(1)(A) refers to mergers and consolidations, this reference suggests that transaction means the same thing as merger, but other references to "transaction," together with step transaction authorities, suggest the opposite. The opening language of Section 368(a)(2)(E) says that stock of the controlling corporation may be "used in the transaction," implying that "transaction" is broader than "merger" in that the transaction includes the exchange of target shares for merger consideration, an exchange that arguably is not part of the merger itself. Further, the Substantially All Requirement requires the surviving corporation to own its and the merger subsidiary's properties "after the transaction."[76] Here, the reference to transaction seems to encompass a step transaction point. Dispositions of assets by the surviving corporation as part of the plan would be pertinent to the analysis of the Substantially All Requirement. The reference to "transaction" supports that point, whereas, had the Substantially All Requirement

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[75] *Lomax v. Ortiz-Marquez*, 140 S. Ct. 1721, 1725 (2020).

[76] Section 368(a)(2)(E)(i).

said "after the merger," it would have suggested that the test applies right after the merger, rather than after all the steps in the plan.

In summary, the text of the statute does not explicitly state when the A2E Control Test is to be measured. While, the text can be read to support a closing date rule, it also can be read to support a signing date rule.

3. The Conventional Understanding of the Statute Supports a Signing Date Rule

Arguably, the conventional understanding of the statute when it was enacted also lends support to a signing date rule. As described in Part IV, Section 368(a)(2)(E) was understood as a liberalizing effort to spare reverse subsidiary mergers from the "no boot in B" prohibition. Adding Section 368(a)(2)(E) enabled taxpayers to use reverse subsidiary mergers without relying on B Reorganizations, and thus to include up to 20 percent cash or other property as consideration.

Yet this conventional understanding—allowing boot in reverse triangular mergers—is frustrated by measuring the A2E Control Test at closing. A closing date rule renders it impossible, as of the date of signing and adoption of the plan of reorganization, to know whether a proposed part-cash/part-stock reverse subsidiary merger will qualify for reorganization treatment, despite the intentions of the parties.[77] As a result of this uncertainty, the

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[77] There is precedent in other areas of the tax law for placing emphasis on the facts that existed when the parties struck a deal. See, e.g., Rev. Rul. 75-468; 1975-2 C.B. 115 (holding that a redemption premium was not excessive because it "was not bargained for nor was it intended[] at the time the exchange ratio was agreed upon"); see also *First COI Report* (discussing Rev. Rul. 75-468 and other examples). In the context of this Report, focusing on the intent of the parties' counsels in favor of extending the Signing Date Rule.

overwhelming majority of reverse subsidiary mergers intending to qualify under Section 368(a)(2)(E) deals are all-stock transactions.[78] It is not feasible to achieve the result and relief that Congress was understood to have provided under Section 368(a)(2)(E) (absent the contractual complexities described in Part V.B).

As a result, there is tension between this closing-date constraint and what the statute was conventionally understood to achieve when it was enacted. This tension is all the more acute because the relevant statute *extended* the reorganization provisions. In 1968, and again in 1971, Congress granted nonrecognition treatment to *more* types of transactions, not fewer, as noted above.[79] This conventional understanding—that Congress was systematically expanding the reorganization provisions—offers courts another ground to read the statute as consistent with a Signing Date Rule.

4. The Legislative History Supports a Signing Date Rule

This conventional understanding is echoed in the legislative history[80] (although we realize that some judges do not consult legislative history). The Senate report states the following:

> Although the reverse merger does not qualify as a tax-free statutory merger, it may, in appropriate circumstances, be treated as tax-free as a stock-for-stock

[78] According to Intelligize, which tracks transactions of $1 million or more involving at least one public company, there were approximately 91 completed reverse subsidiary mergers that were intended to qualify as a "reorganization" under Section 368(a) of the Code within the last 12 months. Of those 91 deals, only 4 involved some cash consideration, and none of those 4 had a Tax Opinion Closing Condition.

[79] See, e.g., *supra* Part IV.A.

[80] Cf. *Sierra Club v. United States Army Corps of Eng'rs*, 909 F.3d 635, 645 (4th Cir. 2018); *Stanley v. City of Sanford*, No. 23-997, slip op. at 23 (U.S. June 20, 2025) (Jackson J., dissenting) ("Too often, this Court closes its eyes to context, enactment history, and the legislature's goals when assessing statutory meaning.").

> reorganization (subparagraph (B)). However, in order to qualify as a tax-free stock-for-stock reorganization it is necessary that the acquisition be solely for voting stock and that no stock be acquired for cash or other consideration. Thus, if a small amount of the stock of [Target] is acquired for cash before the merger of [Target] into [Acquiror], there often may be doubt as to whether or not the transaction will meet the statutory requirements of a stock-for-stock reorganization. The committee . . . sees no reason why in cases of this type the acquisition needs to be made solely for stock.[81]

Thus, the legislative history confirms that Congress intended to allow up to 20 percent cash or other property to be used in a tax-free reverse subsidiary merger and, more generally, to expand the scope of the reorganization provisions. To facilitate these purposes, courts should construe "transaction" to allow for the extension of the Signing Date Rule.[82] A closing date rule renders it impossible for taxpayers to take advantage of the liberalized approach that the statute was conventionally understood to offer, because parties to a potential reorganization (and their respective legal counsel who are expected to opine on the intended tax treatment) cannot predict future stock values and thus cannot comfortably conclude that the transaction will qualify for nonrecognition treatment.

5. Policy Considerations Also Support a Signing Date Rule

Finally, interpreting "transaction" broadly to allow for the extension of the signing date rule to the A2E Control Test is good policy. Indeed, although we think the question of how to interpret the statute is unclear—and, as noted above, there is a strong case for reading it as

[81] S. Rep. No. 91-1533, at 3–4 (1970).

[82] See *Stanley*, slip op. at 23 n.12 (Jackson J., dissenting) ("[I]t is imperative that we interpret statutes consistent with all relevant indicia of what *Congress* wanted, as best we can ascertain its intend. A methodology that includes consideration of Congress's aims does exactly that—and no more.").

requiring a closing date rule—the better answer, as matter of policy, is not. A signing date rule clearly is better policy, as we emphasize above.

Flexibility to apply a signing date rule would more effectively prevent tax considerations from interfering with efficient transactions. From its inception, the reorganization rule was described by economists as "perhaps the most important provision" in the Code.[83] Congressional committees critiqued early versions of the provision: "Probably no part of the present income-tax law has been productive of so much uncertainty and litigation or has more seriously interfered with those business readjustments which are peculiarly necessary under existing conditions."[84] In advocating for a more expansive definition of reorganization, lawmakers observed that a more inclusive bill would "not only permit business to go forward with the readjustments required by existing conditions, but [would] also considerably increase the revenue." Thus, there has always been a sense that the reorganization provision is intended to facilitate realignment of business interests in an efficient manner. Extending the Signing Date Rule to the A2E Control Test would allow corporations to take advantage of the many benefits of the structure without tax impediments to doing so.[85] The uncertainty inherent in measuring the A2E Control Test based on stock values at closing frustrates Congressional intent and introduces tax frictions to economically valuable deals.

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[83] Hearings on H.R. 8245 Before the S. Comm. on Fin., 67th Cong. 29 (1921) (statement of Treasury Department economist T.S. Adams).

[84] S. Rep. No. 67-275 (1921); H.R. Rep. No. 67-350 (1921).

[85] See *supra,* Part IV.B.

A signing date rule also promotes tax neutrality. As discussed in Part IV above, the conventional understanding of the reorganization rules is that they are supposed to harmonize the tax treatment of similar transactions. In extending the tax-free treatment afforded a direct statutory merger to a forward subsidiary merger, Congress was understood to acknowledge that the latter could be achieved by the former, coupled with a subsequent tax-free drop down. The principle was that economically similar transactions should be taxed in a similar manner. In reaching the conclusion that the tax-free treatment of a direct statutory merger should also be afforded to a forward subsidiary merger, Congress effectively looked past the structural differences of the two transactions to see their fundamental similarities. A similar logic applied in extending the tax-free treatment afforded to forward subsidiary mergers under Section 368(a)(2)(D) to reverse subsidiary mergers under Section 368(a)(2)(E). We believe that this principle, namely, that like transactions should be taxed alike (and the natural corollary that dissimilar transactions should be taxed differently only if their differences are tax-relevant), provides support for the conclusion that the Signing Date Rule should be extended to the determination of whether the A2E Control Test has been satisfied.

The examples in this Part VI are intended to illustrate this point. To begin with, consider the following example.

> ***Example 2A. Private Target, public Acquiror, simultaneous sign and close; 91 days to register Acquiror stock issued in the merger; Acquiror's stock price declines 90 days after closing.*** Publicly traded Acquiror and private Target enter into a Signing Date Rule compliant contract pursuant to which Merger Sub will be merged with and into Target, with Target surviving. At the pre-signing date, Acquiror stock is trading at $1 per share. Pursuant to the contract, which provides for a simultaneous signing and closing, Target shareholders will receive $20 of

cash plus 80 shares of Acquiror stock. The transaction satisfied the A2E Control Test and otherwise qualifies as a reorganization by virtue of Section 368(a)(2)(E). For securities law purposes, the Acquiror stock is treated as issued in a "private placement" and cannot be transferred until registered. The merger agreement contains a covenant requiring Acquiror to register the shares issued in the transaction as soon as reasonably practicable. Acquiror files a registration statement that is declared effective (making the registered shares transferrable) 91 days after closing. The day before the registration statement is declared effective, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level.

Contrast Example 2A with the following.

Example 2B. Private Target, public Acquiror; 91 days to closing to obtain required regulatory approval; Acquiror's stock price declines 90 days after signing and one day before closing. Publicly traded Acquiror and private Target enter into a Signing Date Rule compliant contract pursuant to which Merger Sub will be merged with and into Target, with Target surviving. At the pre-signing date, Acquiror stock is trading at $1 per share. Pursuant to the contract, Target shareholders will receive $20 of cash plus 80 shares of Acquiror stock. Because Target is in a regulated industry, the transaction is subject to governmental approval. The day before regulatory approval is obtained, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level through the closing of the transaction. If measured at closing, the A2E Control Test will not be satisfied, and the transaction will not qualify as a reorganization.

These two examples are more alike than they are different. In each case, the A2E Control Test would be met if measured at signing. And in each case, the Target shareholders bear the economic benefits and burdens of fluctuations in the Acquiror's stock price from and after the date of signing. Indeed, in each case, the Target shareholders cannot dispose of the Acquiror stock received in the transaction until 91 days after the date of signing. Yet the first transaction, in which there is no executory period, would be afforded reorganization qualification (because the A2E Control Test is clearly satisfied, as signing and closing occur simultaneously), while the latter would be treated as a fully taxable sale (because the intervening changes in the Acquiror's stock price which occur during the delay between signing and closing and are outside the parties' control cause the A2E Control Test to be failed). That these economically similar transactions would be taxed in diametrically opposed ways seems an incongruous and inapposite elevation of form over substance. This incongruity suggests that the taxation of these two transactions should be conformed, which would be achieved if the A2E Control Test were tested at signing in the case of a transaction governed by a Signing Date Rule compliant contract.

VII. Regulatory Authority and *Loper Bright*

To sum up, as this Report has argued, from a policy perspective, it is clearly better to determine whether the A2E Control Test is satisfied at signing. Nonetheless, as we have acknowledged, the statutory basis to do so is unclear. In a prior report, we suggested that the statute appeared to support a closing date rule, but as discussed above, the statute arguably can also be read to support a signing date rule.

In this Section, we analyze in more detail whether Treasury has regulatory authority to adopt a signing date rule in light of the recent decision in *Loper Bright*,[86] which ended the doctrine of *Chevron* deference.[87] This doctrine had required courts to defer to federal agencies' reasonable interpretations of ambiguous statutes that they administer.

[86] See *Loper Bright Enterprises v. Raimondo*, 603 U.S. 369, 400 (2024) ("[S]tatutes, no matter how impenetrable, do—in fact, must—have a single, best meaning."); see also New York State Bar Ass'n Tax Section, Report No. 1508, *Comment on Tax Implications of* Loper Bright (Mar. 7, 2025) [hereinafter *Loper Bright Report*].

[87] *Chevron U.S.A. Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

Under *Loper Bright,* courts do not defer to an agency interpretation simply because a statute is ambiguous. Rather, courts generally are supposed to find "the best reading" of the relevant statute. Yet *Loper Bright* still authorizes two forms of deference.

First, courts should defer to agency interpretations when Congress has constitutionally delegated an issue, and the agency has acted reasonably within the bounds of this delegation:

> When the best reading of a statute is that it delegates discretionary authority to an agency, the role of the reviewing court under the APA is, as always, to independently interpret the statute and effectuate the will of Congress. The court fulfills that role by recognizing constitutional delegations, fixing the boundaries of the delegate authority, and ensuring the agency has engaged in 'reasoned decision making' within those boundaries.[88]

Second, *Loper Bright* indicates that, even without a delegation, another, more limited form of deference applies: *Skidmore* deference. Under *Skidmore*, agency interpretations, rulings and opinions are "not controlling upon the courts by reason of their authority."[89] Still, such rulings, interpretations and opinions "do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance."[90] In other words, *Skidmore* "give[s] [the agency] power to persuade, if lacking power to control."[91]

In light of *Loper Bright*, Treasury has four potential ways to promulgate a signing rule under regulations, and we briefly consider them in turn: (1) the best reading, (2) a delegation, (3) *Skidmore* deference and (4) a new grant of regulatory authority from Congress.

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[88] *Id.* at 395 (cleaned up).

[89] *Skidmore v. Swift*, 323 U.S. 134, 140 (1944).

[90] *Id.*

[91] *Id.*

A. Best Reading

In principle, Treasury would have authority to adopt a signing date rule in regulations if this is the "best reading" of Section 368(a)(2)(E). As we explained above, there is not a clear answer to this question. The statute does not define the relevant terms. In a prior report, we said that the "statute does not appear to permit a similar 'signing date' rule to apply," but we indicated that the issue was unclear. In this report, we have reiterated the statutory argument to focus on the closing date, and we also have offered arguments for the opposite interpretation—that is, to conclude that the best reading of the statute is a signing date rule.

A challenge in resolving this question is that more guidance is needed on what the Supreme Court means by "the best reading," including which interpretation to adopt when various canons of construction support different interpretations.[92] As a result, we do not offer a view here on whether a signing date rule is "the best interpretation."[93]

B. Delegation

Another potential justification for regulations implementing a signing date rule is a delegation. Where there is an express grant of authority, the standard is whether the agency has engaged in reasoned decision-making within the bounds of its delegated authority. This is a

[92] It is unclear whether the same *Loper Bright* concern applies to the Signing Date Rule as it exists today. As discussed in Part III, the COI Requirement is a creature of the regulations that evolved from judicial doctrine. It is not obvious how *Loper Bright* applies to regulations like the COI Requirement that are grounded in a judicial decision rather than a specific statute. *See Loper Bright Report* at 54–55 ("[T]hese regulations are less likely to implement a delegation from Congress because they are anchored in a judicial decision interpreting a statute (the Code, or a particular section of it) rather than a purported grant of regulatory authority.").

[93] *See infra,* Part VIII for an alternative proposal that likely comports with either interpretation of the statute.

decidedly lower standard of review than the default standard under *Loper Bright*, where courts are directed to determine the best reading of the statute.[94]

If Treasury were to adopt regulations extending the Signing Date Rule to the A2E Control Test, it would presumably be acting under its authority to "prescribe all needful rules and regulations for the enforcement of this title."[95] Section 7805(a) is often referred to as a "general authority" provision, in contrast to a specific authority in a Code section to promulgate regulations to either define a term in the statutory text or to prescribe the law.[96]

Another open question under *Loper Bright,* which we discussed in our recent report on this landmark opinion, is when Treasury can rely on Section 7805 as a delegation.[97] A significant volume of existing regulations have invoked it as authority—including the Signing Date Rule under the continuity of interest regulations.[98]

This is understandable because the language of Section 7805 is extremely broad.[99] As a result, the Court has treated Section 7805 as an expansive delegation, but the relevant cases long

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[94] *Id.* at 400 ("It therefore makes no sense to speak of a 'permissible' interpretation that is not the one the court, after applying all relevant interpretive tools, concludes is best. In the business of statutory interpretation, if it is not the best, it is not permissible.").

[95] Section 7805(a).

[96] There are hundreds of code provisions with more specific regulatory authority. *See* John F. Coverdale, *Court Review of Tax Regulations and Revenue Rulings in the Chevron Era*, 64 Geo. Wash. L. Rev. 35, 52 (1995) (finding more than 1,000 grants); Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727, 1735 & nn.37–38 (2007) (citing one search that found 293 such grants of authority and another that found over 550).

[97] *Loper Bright Report*.

[98] The Signing Date Rule as it exists today was promulgated under the same authority. See T.D. 9565, 76 Fed. Reg. 78540, 78541 (Dec. 19, 2011).

[99] *Loper Bright Report*, at 27-28.

predate *Loper Bright*. For example, in *Bob Jones*, the Court offered a very robust reading of this provision:

> [E]ver since the inception of the tax code, Congress has seen fit to vest in those administering the tax laws very broad authority to interpret those laws. In an area as complex as the tax system, the agency Congress vests with administrative responsibility must be able to exercise its authority to meet changing conditions and new problems. Indeed as early as 1918, Congress expressly authorized the Commissioner 'to make all needful rules and regulations for the enforcement' of the tax laws. Revenue Act of 1918, ch. 18, § 1309, 40 Stat. 1057, 1143 (1919). The same provision, so essential to efficient and fair administration of the tax laws, has appeared in tax codes ever since, see I.R.C. § 7805(a) (1976); and this Court has long recognized the primary authority of the IRS and its predecessors in construing the Internal Revenue Code . . . .[100]

Yet it remains to be seen whether the Supreme Court will continue to interpret Section 7805 in such an expansive fashion. As we noted in our recent report on *Loper Bright*, that broad interpretation might survive, with the Court treating Section 7805 as, in effect, a special canon of construction for tax regulations, directing courts to defer to Treasury regulations on any tax-related issue to the greatest extent constitutionally permissible. If so, more specific delegations in tax may be unnecessary.[101] Under this reading of Section 7805, Treasury clearly would have authority to issue regulations adopting a signing date rule under the A2E Control Test.

Alternatively, instead of treating Section 7805 as an all-purpose delegation under *Loper Bright*, the Court might adopt a narrowing construction.[102] For example, the Court might focus

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[100] *Bob Jones Univ. v. United States*, 461 U.S. 574 (596) (1983); see also Mayo Found. for Med. Educ. & Rsch. v. United States, 562 U.S. 44, 56–57 (2010).

[101] For a more in-depth discussion of whether Section 7805 qualifies as a delegation under *Loper Bright*, see *Loper Bright Report* at 27–32.

[102] *Loper Bright Report* at 29–30.

on the word "needful" to conclude that Section 7805 is available only for regulations that are necessary, not just ones that are advisable.[103] Under this standard, a case can still be made for a signing date rule because, as noted above, a closing date rule undermines the ability of Section 368(a)(2)(E) to deliver the result it was conventionally understood to offer when it was enacted: liberalizing the reorganization rules to permit boot in a reverse triangular merger.

Another narrowing construction might also still support a signing date rule: the notion that Section 7805 provides added authority when rules change.[104] This reading emphasizes Section 7805(a)'s reference to "all rules and regulations as may be necessary *by reason of any alteration of law*." Again, a signing date rule would improve the effectiveness of a change in the law—the adoption of Section 368(a)(2)(E)—although, admittedly, this change was enacted over fifty years ago.

Other narrowing constructions could render Section 7805 inadequate as authority for a signing date rule under the A2E Control Test. For example, if courts focus on the term "enforcement," and therefore deem Section 7805 to be available only for "housekeeping rules,"[105] the provision arguably cannot authorize a substantive provision like the one we recommend here.

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[103] *Id.* at 29.

[104] *Id.*

[105] *Id.* at 29.

Hopefully, the Court will offer guidance about how to determine whether a delegation is adequate under *Loper Bright*. But without this guidance, it is difficult to offer a definitive judgment about whether Section 7805 provides adequate authority for a signing date rule.

C. *Skidmore* Deference

In implementing a signing date rule for the A2E Control Test, Treasury can also invoke its deep institutional expertise administering the tax system. In *Loper Bright*, the Court acknowledged that an agency's expertise can be persuasive to courts—even when its expert opinion is not binding—as judges seek to determine the best interpretation of the statute.

As we noted in our report on *Loper Bright*, the Court signaled that this "*Skidmore* deference" was especially likely when agencies draw on their unique expertise about facts, as opposed to legal interpretation.[106]

> [A]lthough an agency's interpretation of a statute "cannot bind a court," it may be especially informative "to the extent it rests of factual premises within [the agency's] expertise" . . . Such expertise has always been one of the factors which may give an Executive Branch interpretation particular "power to persuade, if lacking power to control."[107]

Arguably, that is the case here. Treasury is drawing on its knowledge of the functioning of markets, which it has acquired in reviewing the tax treatment of countless transactions over the century since the reorganization rules were first added to the Code. Specifically, in proposing a signing date rule, Treasury would be relying on its granular appreciation of the

[106] *Id.* at 54.

[107] *Loper Bright*, 144 S. Ct. at 2267 (quoting Bureau of Alcohol, Tobacco and Firearms v. FLRA, 464 U.S. 89, 98 n. 8 (1984) and *Skidmore*, 323 U.S. at 140)

impact of post-signing changes in stock price. This knowledge of the relevant facts has enabled Treasury to understand the impossibility of anticipating at *signing* whether requirements such as continuity of interest and control will still be satisfied at *closing*. This insight about the market enables Treasury to appreciate why, without a signing date rule, Section 368(a)(2)(E) cannot discharge the function it was conventionally understood to serve when it was enacted.

In addition, Treasury also has the expertise to understand when a particular result is available indirectly, such that it ought also to be available directly. As discussed further in Part VIII, there is an alternative path that is consistent with the Code and achieves the desired result of tax certainty at signing.

D. New Grant of Regulatory Authority

If Treasury concludes that a regulation implementing a signing date rule is not adequately supported by the three sources of regulatory authority discussed above—the best interpretation, a delegation, and *Skidmore*—another option is to seek an express grant of authority in the Code. Congress could provide specific authority by amending Section 368(a)(2)(E) to authorize regulations addressing fluctuations in Parent stock value between the signing and closing dates for purposes of applying the A2E Control Test or, alternatively, add a provision to Section 368 granting such regulatory authority more generally as to reorganizations.[108] This is consistent with our prior recommendation that Congress amend the statute to authorize regulations

[108] As we noted in our prior *Triangular Reorganizations Report*, there is precedent for this type of approach in the Code. Cf. Section 1504(a)(5)(F) (authorizing Treasury to promulgate regulations in determining affiliated group status that disregard changes in voting power to the extent disproportionate to related changes in value).

addressing fluctuations in parent stock value between the signing and closing dates for purposes of applying the A2E Control Test.[109]

VIII. A Backup Proposal: Reliance on Specific Identification

If Treasury and the Service were to conclude that they do not have authority to issue regulations extending the application of the Signing Date Rule to the A2E Control Test, there is an alternative approach that could be adopted without an amendment to the Code. In this Part VIII, we outline a path that relies on specific identification to achieve the functional equivalent of the Signing Date Rule in the context of the A2E Control Test.

Pending a Congressional grant of authority to adopt a Signing Date Rule, Treasury could issue regulations under Section 368 allowing that, where the terms of the exchange specifically identify particular Target shares as being exchanged for particular consideration, and such terms are "economically reasonable," such terms will be respected for purposes of the A2E Control Test, notwithstanding any shift in values between signing and closing.[110] Stated another way, under this approach, the satisfaction of the A2E Control Test in principle would be determined as of the closing date using the fair market value of acquiror stock as of the closing date; however, if (1) under the contractual terms agreed to at signing, designated target shares (presumably, shares constituting less than a controlling interest in the target corporation) were specifically

[109] See *Triangular Reorganizations Report* at 14.

[110] See former Prop. Treas. Reg. § 1.368-1(a) (adding the following sentence to the end of existing 1.368-1(a) stating "For purposes of determining whether a transaction qualifies as a reorganization under section 368(a), to the extent the terms of the exchange specify that a particular property is received in exchange for a particular property, such terms shall control provided such terms are economically reasonable.").

identified as being exchanged solely for cash and/or other property and the remaining Target shares (*i.e.*, the control block) were specifically identified as being exchanged for solely for acquiror stock, and (2) those exchanges, in each case, represented a "value-for-value" arms-length exchange at the time this was agreed (*i.e.*, were economically reasonable), then (3) this specific identification would be respected for purposes of the A2E Control Test. Consequently, even if the value of acquirer shares had declined by the time of closing, the exchange of the control block shares would not be recharacterized (contrary to the contractual terms) as having in part been exchanged for cash or other property (to reflect the differential value as of closing they receive as compared to the shares designated as exchanged for cash or other property) and the designated shares constituting control would be respected as having been exchanged solely for stock.

Section A, below, briefly describes the specific identification rules in the current regulations under Sections 356 and 358, on which our alternative proposal is modelled. Section B explains how the logic of those regulations could be extended to the determination of whether a transaction qualifies as a reorganization (and thus would apply to the A2E Control Test). Section C provides further illustrative examples.

A. Terms of the Exchange Control for Purposes of Shareholder-Level Gain and Basis Calculations

The tax implications to a shareholder who receives money or other property (*i.e.*, "boot") as part of an otherwise tax-free reorganization are addressed in Sections 356 and 358. These provisions generally require a shareholder to recognize an amount of gain equal to the lesser of the gain realized and the boot received (*i.e.*, "boot within gain") and provide for carryover basis with certain adjustments to preserve the unrecognized gain. The current regulations contain rules for allocating the different types of consideration received to the shares of stock and securities surrendered for purposes of determining gain under Section 356 and determining basis in nonrecognition property under Section 358.

Specifically, the current regulations provide that for purposes of computing gain recognition under Section 356, "to the extent the terms of the exchange specify the other property or money that is received in exchange for a particular share of stock or security surrendered or a particular class of stock or securities surrendered, such terms shall control provided such terms are economically reasonable."[111] The same "terms of the exchange" control for purposes of applying the basis rules in Section 358.[112] To the extent the terms of the exchange do not dictate a specific allocation, a pro rata portion of the consideration—stock, securities and boot—is treated as received in exchange for each share of stock and security surrendered based on their relative fair market values.[113] The examples provided in the

[111] Treas. Reg. § 1.356-1(b).

[112] Treas. Reg. § 1.358-2(a)(2)(ii). This specific identification, or "tracing," approach was permitted even prior to the promulgation of these regulations. See, e.g., *Bloch v. Comm'r*, 148 F.2d 452, 455 (9th Cir. 1945) ("[I]f one group of shares with its cost known, is traceable into another group of shares, and the latter group is sold, the cost of the former group will be taken as the cost of the latter group. No closer identity is required, and, of course, the result is exactly and not merely approximately correct."); *Osrow v. Comm'r*, 49 T.C. 333 (1968) (upon a recapitalization, where certificates were specifically earmarked, new stock received for old stock took old stock's basis, and new stock received for debt took debt's basis).

[113] Note that the item-by-item approach to allocating boot under Section 356 differs from the allocation in Section 351 exchanges. In Section 351 exchanges, the IRS does not permit the transferor to designate specific property to be exchanged for particular stock and securities. Rev. Rul. 85-164, 1985-2 C.B. 117; Rev. Rul. 68-55, 1968-1 C.B. 140; however, that ruling was focused on specific policy concerns (namely, preventing using specific designation to "cherry pick" specific property based on its character as capital or ordinary or for basis recovery purposes) and not

regulations illustrate the potential benefits to the taxpayer of using specific allocation over the pro rata approach.

Ignoring for illustrative purposes whether the transactions below otherwise qualify as reorganizations under section 368(a), and the impact of fluctuations in the value of Acquiror stock between signing and closing, consider the following examples:

> ***Example 3A. Private Target, public Acquiror; 91 days to obtain required regulatory approval; Acquiror's stock price does not fluctuate.*** X directly owns all of the stock of Target, which consists of 80 shares Class A stock (acquired at \$0.25 each) and 20 shares of Class B stock (acquired at \$0.50 each). Each Target share is worth \$1. Acquiror and Target enter into a contract pursuant to which Merger Sub will be merged with and into Target, with Target surviving. At the pre-signing date and at all times through closing, Acquiror stock is trading at \$1 per share. In the merger, X surrenders all of X's Target stock for 80 shares of Acquiror stock and \$20 cash. The terms of the exchange do not specify that shares of Acquiror stock or cash are received in exchange for particular shares of Class A stock or Class B stock of Target.

Because the terms of the exchange do not specify that the cash is received in exchange for shares of Class A or Class B stock of Target, a pro rata portion of the cash is treated as received in exchange for each share of Class A stock and each Class B stock based on the fair market value of the surrendered shares. Therefore, X is treated as receiving shares of Acquiror stock with a fair market value of \$64 and \$16 of cash in exchange for its shares of Class A stock and Acquiror stock with a fair market value of \$16 and \$4 of cash in exchange for its shares of Class B stock. X realizes a gain of \$60 on the exchange of shares of Class A stock, \$16 of which is recognized, and X realizes a gain of \$10 on the exchange of shares of Class B stock, \$4 of

on whether the transaction generally qualified as a section 351 transaction. On the other hand, specific allocation may be respected for installment sale purposes. See Rev. Rul. 68-13, 1968-1 C.B. 195.

which is recognized. Following the merger, X has 64 shares of Acquiror stock with a basis of $0.25 each and 16 shares of Acquiror stock with a basis of $0.50 each.[114]

Now consider a slight variation:

> ***Example 3B. Private Target, public Acquiror; 91 days to obtain required regulatory approval; Acquiror's stock price does not fluctuate.*** Same as Example 3A, except the terms of the exchange specify that X receives 80 shares of Acquiror stock in exchange for X's share of Class A stock of Target and $20 of cash in exchange for X's shares of Class B stock of Target.

Because the terms of the exchange specify which particular shares are exchanged for what particular consideration, and such terms are economically reasonable, those terms control. X realizes a gain of $60 on the exchange of shares of Class A stock, none of which is recognized, and X realizes a gain of $10 on the exchange of shares of Class B stock, all of which is recognized. Following the merger, X has 80 shares of Acquiror stock with a basis of $0.25 each.[115] Compared to Example 3A, when X is able to allocate boot solely to the high-basis Class B shares, X recognizes less gain as a result of the merger. (Note that if, contrary to the Example's assumption, Acquiror' stock value had declined by closing, while this would affect the amount of gain realized, albeit not recognized, with respect to the Class A stock, it would not affect the gain recognized with respect to the Class B stock. In other words, X is not required to reallocate some of the cash consideration to the Class A Stock because the value of consideration actually received with respect each Class is no longer in proportion to the relative value of the Class A and Class B stock at the time the deal was signed).

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[114] See Treas. Reg. § 1.356-1(d) (ex. 3); Treas. Reg. § 1.358-2(c) (ex. 4).

[115] See Treas. Reg. § 1.356-1(d) (ex. 4); Treas. Reg. § 1.358-2(c) (ex. 5).

This position is consistent with the conclusions reached in Revenue Ruling 74-515.[116] There, a shareholder surrenders (i) common stock of Target in exchange for common stock of Acquiror and (ii) preferred stock of Target in exchange for cash. The ruling concludes that, for purposes of computing gain recognized under section 356 in the context of an exchange the terms of which provided for the exchange of common stock for common stock and preferred stock for cash, the terms of the exchange governed. Additionally, while the cited examples from the current regulations contemplate allocating consideration to different classes of stock, there is nothing in the current regulations suggesting that consideration cannot be allocated to different blocks of shares within the same class.[117] In fact, the regulations allow the terms of the exchange to specify "money that is received in exchange for *a particular share of stock* or security surrendered *or a particular class of stock* or securities surrendered."[118] Moreover, the

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[116] See Rev. Rul. 74-515, 1974-2 C.B. 118; T.D. 9244, 71 Fed. Reg. 4264, 4265–66 (Jan. 26, 2006) (citing the same ruling in the preamble to the final regulations under sections 356 and 358); see also *Armstrong v. Comm'r*, 31 B.T.A. 418 (1934) (holding that, where a merger agreement specified that one class of the stockholder's stock would be redeemed for cash and that the second class of stock would be exchanged for cash and stock of a corporation that was a party to the reorganization, the two classes of stock must be treated separately and that the cash received by the stockholder in redemption of the first class of stock could not be allocated to the second class); PLR 201120012 (respecting form of transaction in merger agreement where cash payment would be made in full to satisfy debt, and issuance of warrants would be respected as made in full to retire common stock held by shareholder); PLR 201120013 (same); PLR 201527003 (finding certain corporate resolutions specifying the mix of stocks and securities to be distributed with respect to each share of distributing corporation's stock in a §355 distribution to be reasonable for purposes of Reg. §1.358-2(a)(2)(v)). For a discussion of other contexts in which the IRS has respected a specific allocation of particular consideration to specific assets exchanged in a single transaction, see New York State Bar Ass'n Tax Section, Report No. 1316, *Report on Proposed Regulations Regarding Allocation of Consideration and Allocation and Recovery of Basis in Transactions Involving Corporate Stock or Securities* at 89–92 (Feb. 6, 2015).

[117] Indeed, the examples do not specify that Class A and Class B stock are economically different; under the given facts, they may be different only in name.

[118] Treas. Reg. § 1.356-1(b) (emphasis added).

regulations explicitly contemplate a tracing approach within a particular class of stock for different blocks acquired at different times.[119]

Thus, it seems that the result in each of Examples 3A and 3B would be the same if Class A and Class B were economically identical, or if X held all of Target stock consisting of two separate blocks of a single class of stock rather than two separate classes of Target stock. In fact, the former proposed regulations included an example that allows a shareholder to specifically allocate boot to high basis shares even though the Target only had one class of stock outstanding.[120] The example was added to explain that shareholder elections constituted "terms of the exchange" under the existing regulations. The example did not purport to alter existing law with respect to whether shareholders could allocate boot to different blocks of shares within the same class; thus, the fact that these regulations were subsequently withdrawn has little bearing on the result explicated by that particular example.[121]

Of relevance to the discussion below, the statute and the current regulations do not provide specific guidance on what it means for terms of an exchange to be "economically

[119] Treas. Reg. § 1.358-2(c) (ex. 5) (example with different blocks of Class A stock).

[120] See former Prop. Treas. Reg. § 1.358-2(i) (ex. 14); 74 Fed. Reg. 3509 (Jan. 21, 2009), *withdrawn*, 84 Fed. Reg. 11,686 (Mar. 28, 2019).

[121] 74 Fed. Reg. at 3513 ("Commentators questioned how shareholder elections factor into the terms of the exchange. These proposed regulations include two new examples illustrating the effect of such elections."). Notably, the current regulations were interpreted this way before the 2009 proposed regulations came out. See, e.g., New York State Bar Ass'n Tax Section, Report No. 1137, *Report on Final Regulations Regarding Allocation of Basis under Section 358 and Related Matters* at 29 (Dec. 13, 2007) [hereinafter *Prior 358 Report*] ("Section 356, as interpreted by Regulations Section 1.356-1(b), permits a shareholder, in certain circumstances, to realize gain and receive boot, yet avoid recognition of any gain by allocating nonrecognition property to surrendered stock and securities in which there is gain and allocating boot to surrendered stock and securities in which there is a loss (or at least no gain).").

reasonable." One example in the regulations simply concludes that the terms of the exchange are economically reasonable, and the only stated fact that is relevant to this conclusion is the equivalence in values of the consideration for each exchange "on the date of the exchange."[122] However, it also seems equally appropriate to determine whether the *terms* of an exchange are "economically reasonable" as of the date the terms of the exchange (*i.e.*, the binding contract that constitutes the plan of reorganization) are agreed (*i.e.*, on the signing date). It would be peculiar to conclude that the agreed terms (assuming these were reasonable at the time they were agreed based on what was known to the parties at the time) become unreasonable due to subsequent events the parties do not control. Indeed, an example in the now-withdrawn regulations seemed to contemplate terms of an exchange being economically reasonable based on signing date values.[123]

While the current regulations under sections 356 and 358 do little to illuminate the meaning of "economically reasonable," prior COI regulations used the same "economically reasonable" language.[124] Specifically, the prior regulations stated that a contract provided for fixed consideration if it provides "[t]he percentage of the number of shares of each class of proprietary interests in the target corporation, or the percentage (by value) of the proprietary interests in the target corporation, to be exchanged for stock of the issuing corporation, provided

[122] See Treas. Reg. § 1.356-1(d) (exs. 3–4); Treas. Reg. § 1.358-2(c) (exs. 4–5).

[123] See former Prop. Treas. Reg. § 1.358-2(i) (ex. 14); 74 Fed. Reg. 3509 (Jan. 21, 2009), *withdrawn*, 84 Fed. Reg. 11,686 (Mar. 28, 2019).

[124] Those regulations also contained an example of an "economically unreasonable" exchange, where the exchanges were not value-for-value based on fair market value as of the day prior to the signing date. See T.D. 9225, 70 Fed. Reg. 54631, 54636 (Sept. 16, 2005) (Treas. Reg. § 1.368-1(e)(2)(v) (ex. 7)).

that the proprietary interests in the target corporation to be exchanged for stock of the issuing corporation and the proprietary interests in the target corporation to be exchanged for consideration other than stock of the issuing corporation each represents an *economically reasonable exchange as of the last business day before the first date there is a binding contract to effect the potential reorganization*."[125] The time to determine whether an economically reasonable exchange was made, sensibly, was determined as of pre-signing date.[126]

Thus, it is difficult to see why an allocation would fail to be reasonable if it were negotiated at arm's length and agreed based on fair market value at the time. Importantly, none of the regulatory provisions cited above impose a non-tax "business purpose" requirement for a specific allocation to be respected. Given the ubiquity of the "business purpose" test, it seems implausible that the regulations would not have mentioned "business purpose" directly if they intended the requirement that terms be economically reasonable to mean and include such a "business purpose" requirement. (The above assumes value fluctuations that are outside of the parties' control; arrangements designed to manipulate values would raise separate concerns.)

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[125] Former Treas. Reg. § 1.368-1(e)(2)(iii)(A)(3).

[126] While the Final COI Regulations did not retain this exact "economically reasonable" language, they do retain the idea of respecting a specific identification of shares for specific consideration in the exchange. See Treas. Reg. § 1.368-1(e)(2)(iii)(A) ("A contract provides for fixed consideration if it provides the number of shares of each class of stock of the issuing corporation, the amount of money, and the other property (*identified either by value or by specific description*), if any, to be exchanged for all the proprietary interests in the target corporation, or to be exchanged for each proprietary interest in the target corporation." (emphasis added)).

B. Terms of the Exchange Could Also Control for Purposes of Reorganization Qualification

The regulations are clear that economically reasonable terms of the exchange are to be respected "[f]or purposes of computing the gain, if any, recognized pursuant to section 356" and "for purposes of applying the rules of [section 358]." However, the regulations are not explicit as to whether such terms of the exchange control for any other purpose, including the determination of whether the transaction qualifies as a reorganization under Section 368. We recognized as much in a prior report on the subject, in which we stated the following:

> We recommend that the IRS and Treasury clarify how consideration is allocated for purposes of qualification under Section 368. The allocation method provided in the Final Regulations for Sections 356 and 358 is based on the actual terms of the exchange, so absent a specific requirement to the contrary, taxpayers will likely feel compelled to allocate in the same manner for qualification under Section 368 where nonrecognition treatment is important, because to do otherwise would be to disavow their chosen form. . . . Therefore, we recommend that the IRS and Treasury consider a rule that, for purposes of qualification of a transaction as a reorganization under Section 368 . . . , respects the allocation of consideration specified in the terms of an exchange where such allocation is economically reasonable, with a default rule allocating consideration pro rata absent an economically reasonable allocation specified in the terms of the exchange.[127]

Seemingly in response to this concern, the regulations that were proposed in 2009 included "cross-references in the regulations under sections 368 and 1001 to *clarify* that, to the extent the terms of the exchange specify that a particular property is received in exchange for a particular property, such terms shall control for purposes of determining whether a transaction

[127] *Prior 358 Report* at 28–29.

qualifies as a reorganization provided such terms are economically reasonable."[128] Again, although these regulations were subsequently withdrawn, the fact that this particular provision was added as a clarification suggests that it was consistent with existing law (and *a fortiori*, is not inconsistent with the statute itself), notwithstanding the subsequent withdrawal of the proposed regulations.

We believe the same approach that would apply under the regulations for purposes of section 356 and 358 if a transaction qualifies as a reorganization reasonably could be extended to determine whether the transaction qualifies as a reorganization in the first instance.

C. Illustrative Examples – Private Target

The examples below, the initial examples involving a privately-held Target,[129] are intended to demonstrate that differences in the allocation of aggregate consideration among Target shareholders can potentially change whether a reverse subsidiary merger fails the A2E Control Test (assuming that a Signing Date Rule is not otherwise applicable).

> ***Example 3C. Private Target, public Acquiror; single class of stock; 91 days to obtain required regulatory approval; Acquiror's stock price declines 90 days after signing and one day before closing.*** X directly owns all of the stock of Target. Acquiror and Target enter into a Signing Date Rule compliant contract pursuant to which Merger Sub will be merged with and into Target, with Target surviving. At the pre-signing date, Acquiror stock is trading at $1 per share. Pursuant to the contract, in the merger, each share of Target stock will be

[128] 74 Fed. Reg. at 3515 (emphasis added); see former Prop. Treas. Reg. § 1.368-1(a).

[129] When Treasury and the Service finalized the current regulations under Sections 356 and 358, they noted that the issue of designating which type of consideration is received in exchange for particular shares of stock or securities was "likely to arise only in cases in which the target corporation is closely held," reasoning that in such cases "the shareholders will likely have the ability to control the terms of the exchange". T.D. 9244, 71 Fed. Reg. 4264 (Jan. 26, 2006).

> converted into the right to receive 0.8 shares of Acquiror stock and $0.20 of cash. Between signing and closing, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level through the closing of the transaction.

As of the closing date, the total value of the consideration is $92, and more than 20 percent of the total consideration is boot.[130] Thus, if measured at closing, the A2E Control Test will not be satisfied. (Indeed, even absent the decline in value, if a "share" is the relevant cognizable unit of property for federal income tax purposes, no Target share has been exchanged solely for Acquiror stock regardless).

Contrast this with an example involving unrelated separate taxpayers:

> ***Example 3D. Private Target, public Acquiror; specific identification; 91 days to obtain required regulatory approval; Acquiror's stock price declines 90 days after signing and one day before closing.*** Financial sponsor owns 20 shares of Target; Founder owns 80 shares of Target. Same facts as Example 3C, except that pursuant to the contract, in the merger, Founder will receive 80 shares of Acquiror stock and Financial sponsor will receive $20. Between signing and closing, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level through the closing of the transaction.

In this example, there are two separate, but unrelated taxpayers, who own the same class of Target stock, but there is a business rationale for treating them differently (perhaps the financial sponsor is insisting on an exit, and the Acquiror wants to provide appropriate incentives to the Founder by having her roll her stake into Acquiror stock). This example, although also stylized, presents a very strong case for respecting the allocation of consideration specified at signing and seems to fit the statute well. However, to the extent the appeal of allowing specific

[130] Total consideration is $20 cash plus 80 shares worth $0.90 each, or $92 total value. Of that, 21.7 percent ($20/$92) is boot.

identification may seem more intuitive than in the Examples below, it is because there is an independent "business purpose" for the different allocation of consideration. On the other hand, as discussed above, there is no indication in other contexts that business purpose is a condition for respecting specific identification.[131]

Now consider the following slight variation on the earlier Example 3C:

> ***Example 3E. Private Target, public Acquiror; single class of stock; different (but affiliated) taxpayers; 91 days to obtain required regulatory approval; Acquiror's stock price declines 90 days after signing and one day before closing.*** X, X1, X2 and Target are corporations. X directly owns all of the stock of X1 and X2. X1 owns 80 shares of Target. X2 owns 20 shares of Target. Acquiror and Target enter into a Signing Date Rule compliant contract pursuant to which Merger Sub will be merged with and into Target, with Target surviving. At the pre-signing date, Acquiror stock is trading at $1 per share. Pursuant to the contract, in the merger, each share of Target stock will be converted into the right to receive 0.8 shares of Acquiror stock and $0.20 of cash. Between signing and closing, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level through the closing of the transaction.

Again, it seems clear that, if measured at closing, the A2E Control Test will not be satisfied.

However, consider what result would be reached if instead the contract provided that X2 was to exchange its stock in Target solely for cash and X1 was to exchange its Target stock solely for Acquiror stock.

> ***Example 3F. Private Target, public Acquiror; specific identification; single class of stock; 91 days to obtain required regulatory approval; Acquiror's stock price declines 90 days after signing and one day before closing.*** Same facts as Example 3D, except that pursuant to the contract, in the merger, X1 will receive

[131] See, supra, text following n. 126.

> 80 shares of Acquiror stock and X2 will receive $20. Between signing and closing, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level through the closing of the transaction.

If the specific allocation here is respected (as we think it should be, given the exchanging parties are separate taxpayers), it appears that the A2E Control Test will be satisfied, and the transaction will qualify as a reorganization by virtue of Section 368(a)(2)(E). Yet, this transaction seems economically indistinguishable from the transaction in Example 3D and there is no apparent policy reason why one should qualify as a reorganization while the other is taxable.

The statutory language of A2E Control Test itself seems to allow for specific identification. The statute requires that "in the transaction, former shareholders of the surviving corporation exchanged, for *an amount of voting stock* of the controlling corporation, an amount of stock in the surviving corporation which constitutes control of such corporation."[132] The legislative history says that "[i]f voting stock of the controlling corporation is used in the exchange to the extent described, additional stock in the surviving corporation may be acquired for cash or other property (whether or not from the shareholders who received voting stock)."[133] These sentences assume it to be clear what stock is acquired for voting stock and that other stock may be acquired for boot—which is exactly the specific identification approach.

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[132] Section 368(a)(2)(E)(ii) (emphasis added).

[133] S. Rep. No. 91-1533, at 5.

However, taking the above analysis to its logical conclusion, what if there is a single Target shareholder who exchanges separate blocks of the same class of Target shares (*i.e.*, cognizable separate "units" of property for tax purposes that are economically indistinguishable)?

> ***Example 3G. Private Target, public Acquiror; specific identification; single class of stock; 91 days to obtain required regulatory approval; Acquiror's stock price declines 90 days after signing and one day before closing.*** Same as Example 3C, except that pursuant to the contract, in the merger, 20 specifically identified shares of Target stock will be converted into the right to receive $20 of cash (in the aggregate), and 80 specifically identified shares of Target stock will be converted into the right to receive 80 shares of Acquiror stock. Between signing and closing, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level through the closing of the transaction.

It seems clear that, assuming "economic reasonableness" is determined as of the signing date when the terms of the exchange are agreed (and the fact that, as of the signing date, the per share consideration is the same across share is strong evidence of "economic reasonableness"), for purposes of determining X's gain or loss on the transaction, Treas. Reg. §§ 1.356-1(b) and 1.358-2(a)(2)(ii) will give effect to the specific identification set forth in the contract. As discussed previously, it is less clear whether that specific identification will be respected for any other purpose, including for determining satisfaction of the A2E Control Test. Yet, although the specific identification rules, by their terms, apply only for limited purposes, it seems incongruous to apply these rules for purposes of determining the shareholder-level basis consequences of the transaction, but not to determine whether the transaction satisfies the A2E Control Test and thus qualifies as a reorganization (*i.e.*, the shareholder-level gain or loss recognition consequences of the transaction).

It could fairly be argued that, because X is the sole shareholder of the Target, the allocation of different types of consideration according to specific identification contained in the contract is artificial. That is, in substance this was an "all for all" exchange of $20 of cash and 80 shares of Acquiror stock where proration is the order of the day and, accordingly, there is no room to argue that the Acquiror acquired two different blocks of shares at two slightly different per share prices: 20 Target shares for $20 of cash and 80 Target shares for 80 shares of Acquiror stock worth $72 in the aggregate. Yet, even if one has sympathy for this line of reasoning, there are other adjacent circumstances where this logic is likely to have less sway (and Treasury and the Service have already acquiesced to this treatment at the shareholder level).[134] What if the 20 shares receiving cash and the 80 shares receiving Acquiror stock were themselves of different classes potentially with identical economic and voting rights (that, is, were not only distinct "units" of property for tax purposes but had distinct terms)? And what if, in the case of a transfer of any such shares during the executory period of the contract, the transferee would be stuck with the contractually specified consideration? Would these facts support giving effect to the specific identification for purposes of determining satisfaction of the A2E Control Test? We believe the answer to this question is yes. The separate Target shares are distinct units of property for tax purposes, and there is no reason under the logic that supports specific identification in the "easier" cases above, as for policy reasons specific to section 368(a)(2), to preclude specific identification on these facts.

[134] See *supra,* Part VIII.A.

D. Illustrative Examples – Public Target

The specific identification approach outlined in this Part VIII could perhaps also extend to "public" deals, providing enough flexibility to qualify as a Section 368(a)(2)(E) reorganization (*e.g.*, by adopting an identification requirement in connection with a cash-stock election mechanism). However, we acknowledge this raises additional issues not present in the case of a private Target. In a prior report, we observed:

> It is not clear precisely what must be in the terms of the exchange in order for them to govern the allocation. The Preamble to the Final Regulations explains that taxpayers are not expected to be able to control the terms of the exchange except where the target in the reorganization is closely held. It is apparent that a shareholder is more likely to be able to control the terms of an exchange if that shareholder owns a substantial part of a closely held corporation rather than a miniscule fraction of a publicly traded corporation. It is less clear, however, that a reorganization involving a publicly-traded corporation is not conducive to designated allocations if those with control over the terms of the exchange are inclined to create one, or if individual shareholders are permitted to supply certain terms of the exchange that pertain solely to them. Nor is it readily apparent why shareholders in a public transaction should be afforded less flexibility than their private transaction counterparts regarding allocations of boot or shares of stock or securities of more than one class received, so long as such allocations are economically reasonable.[135]

However, we see no reason why, assuming specific identification is permitted in the private target context, that in principle it should not be available for a public target. Consider the following examples:

> ***Example 4A. Public Target, public Acquiror; specific identification; 91 days to obtain required regulatory approval; Acquiror's stock price declines 90 days after signing and one day before closing.*** At signing, Target has only Class A common shares outstanding. The merger agreement specifies that the Acquiror is acquiring 80 percent of the Target shares held by each shareholder for Acquiror

[135] *Prior 358 Report* at 16.

stock and 20 percent of the Target shares held by each shareholder for boot. Between signing and closing, the Acquiror's stock price drops by 10 percent to \$0.90 per share and remains at that level through the closing of the transaction.

Based on signing date values, the specific allocation is economically reasonable. We recognize, however, that to achieve the intended result in Example 4A may require further mechanics requiring each shareholder to identify the specific shares being exchanged for cash and stock as part of the exchange process, which could be complex in practice. Consider an economically equivalent variation:

Example 4B. Public Target, public Acquiror; specific identification; 91 days to obtain required regulatory approval; Acquiror's stock price declines 90 days after signing and one day before closing. At signing, Target has only Class A common shares outstanding. The merger agreement specifies that the Acquiror is acquiring 80 percent of the Target shares held by each shareholder for Acquiror stock and 20 percent of the Target shares held by each shareholder for boot. Before the merger closes, Target declares a stock dividend entitling each holder of Target stock to receive one Class B common share (having identical economic and voting rights as Class A shares) for every 4 shares of Class A stock then held. In the merger, the Class A shares are converted into the right to receive 0.8 shares of Acquiror stock (valued at \$1/share on the signing date), and the Class B shares are converted into the right to receive \$0.20 of cash. Between signing and closing, the Acquiror's stock price drops by 10 percent to \$0.90 per share and remains at that level through the closing of the transaction.

Again, based on signing date values, the specific allocation is economically reasonable. However, the transaction does implicate step transaction principles. Consider yet another economically equivalent variation:

Example 4C. Public Target, public Acquiror; specific identification; 91 days to obtain required regulatory approval; Acquiror's stock price declines 90 days after signing and one day before closing. Same as Example 4A, except the merger agreement provides that four-fifths of each share of Target stock will be converted into the right to receive 0.8 shares of Acquiror stock (valued at \$1/share on the signing date) and one-fifth of each share will be converted into the right to receive $0.20 of cash. Between signing and closing, the Acquiror's stock price drops by 10 percent to $0.90 per share and remains at that level through the closing of the transaction.

Based on signing date values, each of these specific allocations is economically reasonable. It seems that Example 4A may need further mechanics requiring each shareholder to identify the specific shares being exchanged for cash and stock as part of the exchange process. It is possible that 4B collapses to 4C under step transaction principles (but maybe not if there is a period of time where the two classes trade separately). Regardless, it seems that Example 4C fundamentally reaches the same result achieved by the parties in the earlier Example 3G and Example 4A while raising no obvious policy difference.

We acknowledge that specific designation with respect to fractional shares may strike some as extending the specific identification construct beyond its natural bounds. It would involve designating in an exchange a fractional amount of the smallest "unit of property" that is cognizable as a tax matter (one share). If so, and assuming Treasury and the IRS otherwise conclude they did not have the authority to adopt an express rule applying the A2E Control Test as of the signing date, that might limit the universe of public transactions for which our alternative approach could achieve the intended outcome; and it would be necessary to seek a legislative amendment. On the other hand, we think there are compelling policy reasons to adopt a regime that does not frustrate the understood purpose of section 368(a)(2)(E) by making qualification contingent on unpredictable and uncontrolled fluctuations in shares value between signing and closing and as far as is possible reach the same result in all economically equivalent reorganization transactions, private or public.

IX. Conclusion

Historically, both the COI Requirement and the A2E Control Test were measured at closing, making reorganizations vulnerable to fluctuations in stock price between signing and closing. In 2004, Treasury introduced the Signing Date Rule for the COI Requirement, allowing the Acquiror stock value to be measured as of signing under certain circumstances, but did not extend the Signing Date Rule to the A2E Control Test. As a result, taxpayers can face the paradox of satisfying the COI Requirement at signing but failing the A2E Control Test at closing due to market changes, despite their intent to qualify for reorganization treatment.

This Report recommends that the Signing Date Rule be extended to the A2E Control Test, which would promote certainty in tax-free reorganizations, reduce reliance on inefficient and complicated contractual solutions and prevent unintended tax consequences arising from volatility beyond the parties' control. Treasury and the Service should resolve the misalignment between the COI Requirement and the A2E Control Test by adopting a uniform rule. If Treasury and the Service determine that they currently lack the statutory authority to do this by regulation, we would urge Treasury to seek such authority from Congress though an amendment to the Code expressly delegating such authority. Alternatively, Treasury could implement the backup proposal without a statutory amendment to clarify that economically reasonable terms of an exchange will be respected for purposes of determining whether a given transaction qualifies as a reorganization.