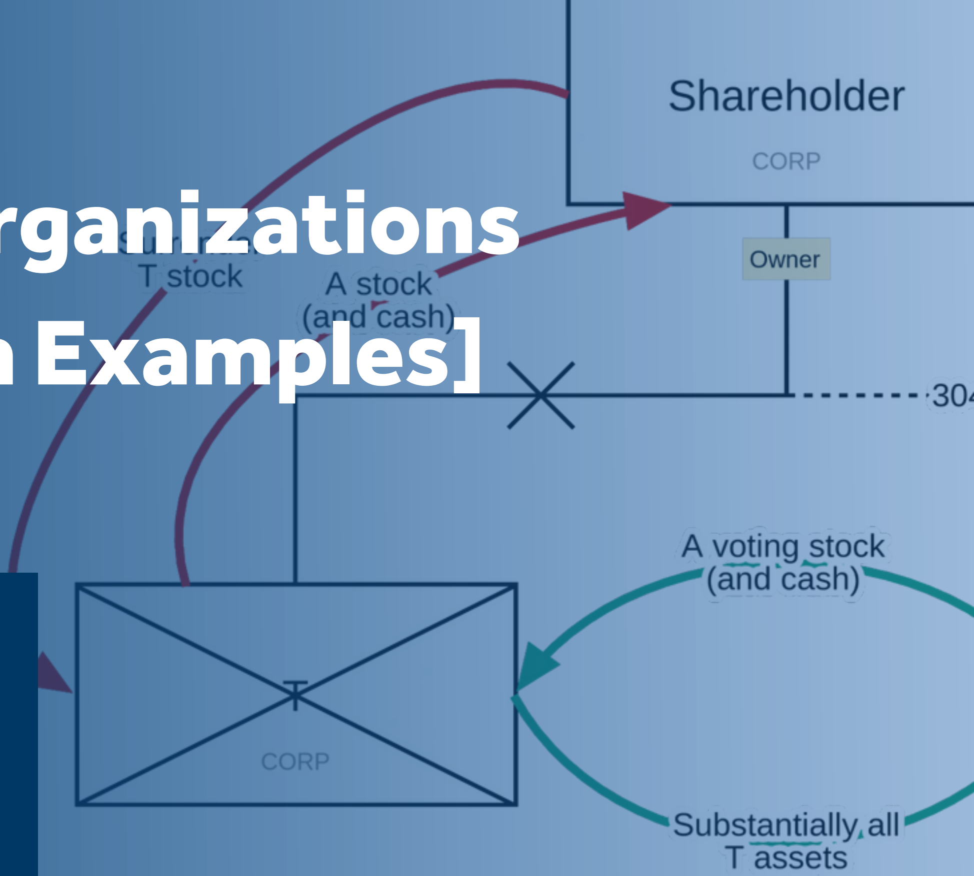
Type “D” Reorganizations [with Diagram Examples]



This article looks at what "D" Reorganizations are and provides diagram examples that you can reference. You will find a standard "D" Reorganization diagram example, and a Rev. Rul. 70-240 diagram example. In this guide, we focus specifically on non-divisive "D" reorganizations. We also reference IRC § 368(a)(1)(D), other relevant Code provisions, and provide helpful tips regarding reorganizations of this kind.

What is a Type “D” Reorganization?

Under Internal Revenue Code § 368(a)(1)(D), a Type "D" Reorganization involves the transfer of all or part of a corporation’s assets to another corporation where immediately after the transfer, the transferor (and/or one or more of its shareholders) controls the corporation to which the assets were transferred. Additionally, the stock or securities of the controlled corporation must be distributed by the transferor pursuant to a plan of reorganization in a transaction qualifying under §§ 354, 355, or 356. As a result, a Type D reorganization may be divisive or non-divisive. This article exclusively discusses non-divisive Type D reorganizations.

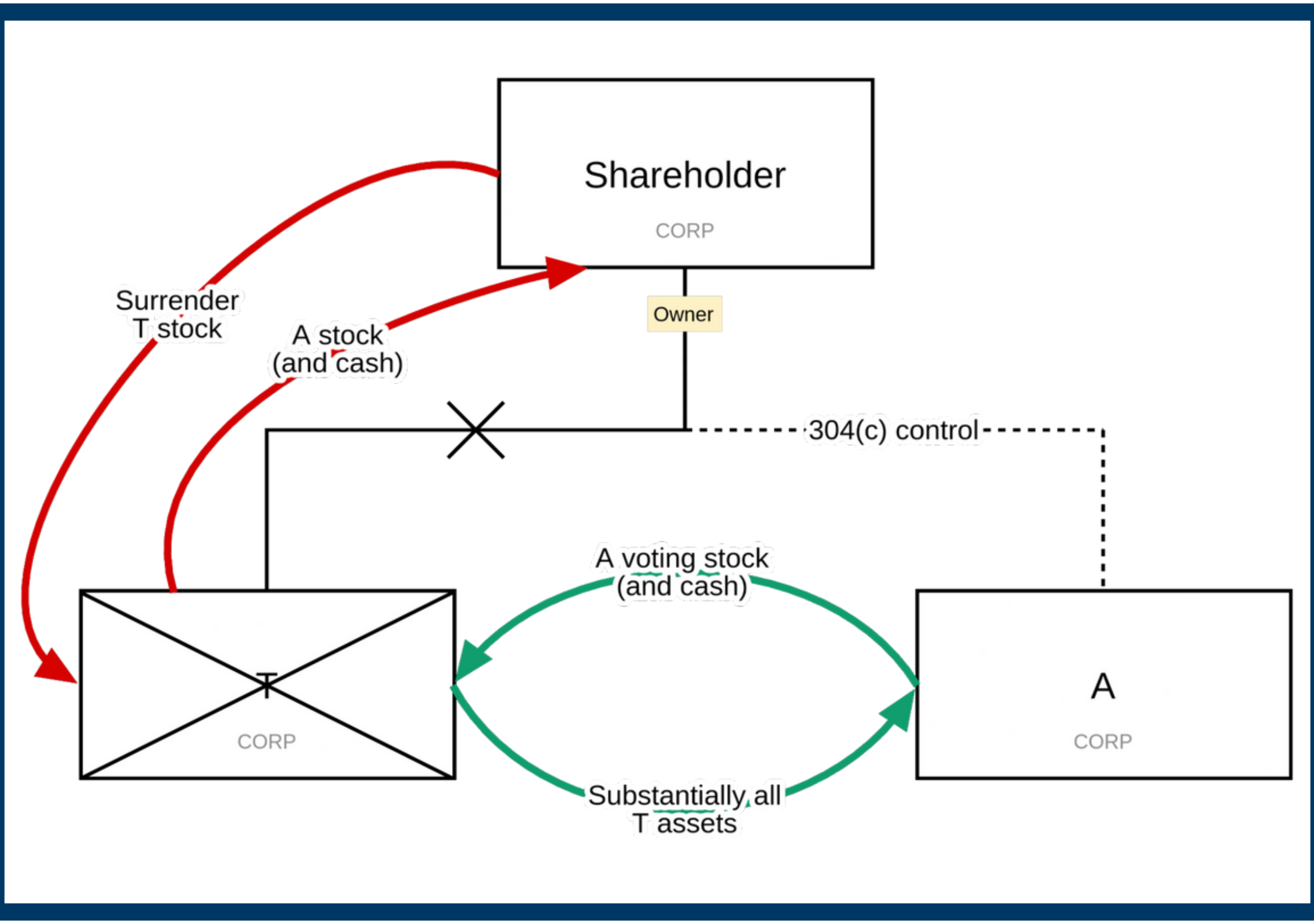
In a non-divisive “D” reorganization, “substantially all” of the assets of the transferor are transferred to a corporation that is controlled by the transferor immediately after the transfer. Stock or securities of the controlled corporation must then be distributed in a transaction that qualifies under § 354 or § 356. For a distribution to qualify under §§ 368(a)(1)(D) and 354, the transferor must distribute all of its properties, which, in effect, results in its complete liquidation. See § 354(b)(1)(B). Additionally, the transferor must transfer “substantially all” of its assets (although the use of the term “substantially all of the assets" has been interpreted more flexibly than the similar term “substantially all of the properties” in a “C” reorganization). Moreover, § 356 applies to recognize gain where an exchange fails to meet the requirements of § 354 solely because property received in exchange consists not only of property permitted by § 354 received without recognition of gain, but also of other property or money.

For the purposes of a non-divisive “D” reorganization, “control” is determined under § 304(c) as possession of at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock, applying the attribution rules of § 318(a) with some modifications.

Notwithstanding the requirement in § 368(a)(1)(D) that stock or securities of the controlled corporation must be distributed, the IRS has issued guidance permitting transactions to qualify as a Type D reorganization where issuance of stock or securities would be a meaningless gesture because the same person or persons own all the stock of the transferor and controlled corporations. These are referred to as “all-cash D” reorganizations.

See Type "D" Reorganization Diagram example on next page. ⟶

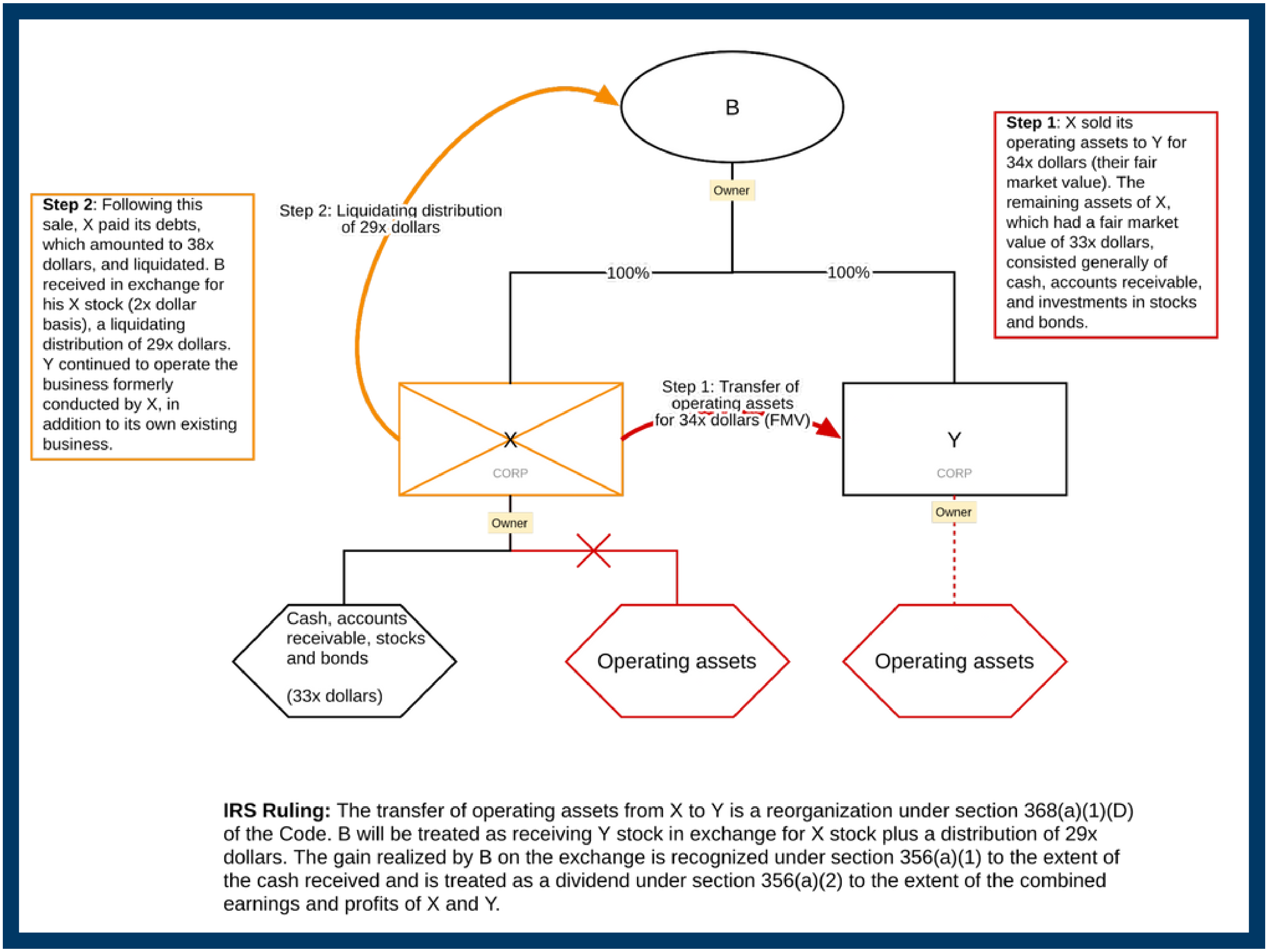
Type "D" Reorganization Diagram Example



This diagram illustrates a basic non-divisive "D" reorganization involving the acquisition of "substantially all" of the assets of a target corporation (T) (see green arrows), followed by a § 354 distribution pursuant to a plan of reorganization (see red arrows).

See Rev. Rul. 70-240 (All-cash "D" reorganization) example on next page. ⟶

Rev. Rul. 70-240 (All-cash "D" reorganization) Example



This example illustrates Revenue Ruling 70-240, which treats a sale of operating assets followed by a liquidation as a non-divisive "D" reorganization because B (the shareholder) already owned all of the stock of Y.

In 2009, the IRS and Treasury issued final all-cash "D" regulations providing that a transaction in which no stock of the transferee corporation is issued and distributed can nevertheless qualify as a non-divisive “D” reorganization where the same shareholders own all the stock of the transferor and controlled corporation in identical proportions.

The arrows signify the transfer of stock or assets. Easily included labels distinguish entities, relationships, and actions. The color scheme and text boxes also provide a convenient way to depict the actions and visually identify the consequences of each action.

Type “D” Reorganization Best Practices

In structuring a Type D reorganization, practitioners should be aware that the acquiror is not required to issue actual stock (and the target is thus not required to distribute stock). The Treasury regulations provide that where no stock or securities are issued by the acquiror (i.e., the recipient of the assets), the transaction may still qualify as a “D” reorganization where the same shareholders own all of the stock of the transferor and transferee corporations in identical proportions before and after the transaction. This is illustrated in Rev. Rul. 70-240. Where the value of the consideration received in the transaction is equal to the fair market value of the transferor’s assets, the transferee will be *deemed* to issue a nominal share of stock in addition to actual consideration exchanged. The nominal share of stock is then deemed to be distributed by the transferor through the chain(s) of ownership to reflect actual ownership of the transferor and transferee corporations. This concept is illustrated in the regulations through a series of examples that involve the deemed issuance of nominal shares where no actual shares were issued in exchange for the assets. Similarly, Rev. Rul. 70-240 above also illustrates an application of the “meaningless gesture” doctrine, where the transfer of assets (without an accompanying exchange of transferee stock) was treated as if the shareholder received transferee stock in exchange for transferor stock.

Blue J’s diagramming tool provides a convenient way to **collaborate on a shared diagram** with colleagues to visually represent any transaction, including a “D” reorganization. We host example diagrams in our Blue J Folios, which may be easily edited to depict any transaction–or build your own. Blue J Folios provide a starting point for your research, with an outline that summarizes the topic and contains references from the Code and Treasury Regulations, common leading authorities on each topic, and a visualization of certain authorities using our Diagramming tool.

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