Revenue Ruling 2002-85

Copyright © 2007 Andrew Mitchel LLC
International Tax Services
www.andrewmitchel.com

D Reorganization with a Drop

Initial Structure | **Target Asset Transfer & Liquidation** | **Drop**

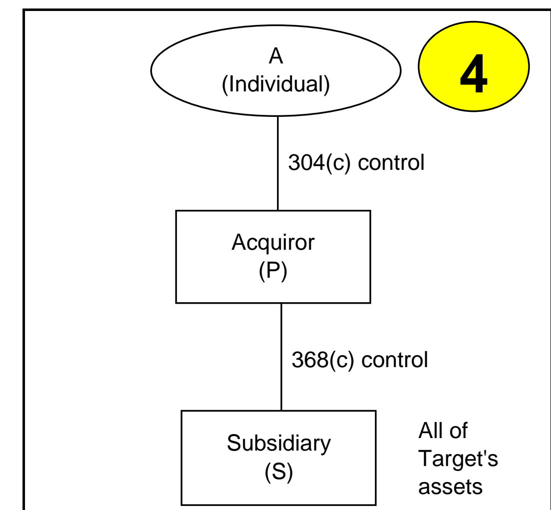
1
A (Individual)
100%
100%
Acquiror (P)
Target (T)
Cash
Operating Assets
368(c) control
Subsidiary (S)

2
A (Individual)
b
Acquiror Stock & Cash
Surrender 100% of Target Stock
Acquiror Stock & Cash
Acquiror (P)
a
Target (T)
All of Target 's Assets
Subsidiary (S)

3
A (Individual)
304(c) control
Acquiror (P)
All of Target's Assets
Subsidiary (S)

Nonrecognition Operative Provisions: (a) Acquiror - section 1032, Target - section 361(a) (b) Shareholders - section 354(a)(1), Target - section 361(c)

Ending Point



In Revenue Ruling 2002-85, the IRS held that a D reorganization followed by a drop qualified as a reorganization, despite the fact that section 368(a)(2)(C) specifically allows drops for certain reorganizations but not for D rerorganizations. 368(a)(2)(C) provides that "a transaction otherwise qualifying under paragraph (1)(A), (1)(B), or (1)(C) shall not be disqualified by reason of the fact that part or all of the assets or stock which were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets or stock. A similar rule shall apply to [certain G reorgs]."

No where is section 368(a)(1)(D) mentioned in this very specific statute. This statute was amended in 1964 to add B reorgs and in 1980 to add certain G reorgs. However, Congress has never added D reorgs. The IRS's interpretation of the statute is not consistent with the statutory construction maxim "expressio unius est exclusio alterius" [the expression of one thing is the exclusion of another]. It would appear that the ruling is an attempt to prevent tax avoidance. Otherwise individual taxpayers could bailout earnings at capital gain rates by simply having Acquiror drop the Target assets into a subsidiary, thereby busting the D reorg. The good news is that this ruling will allow taxpayers that want reorg treatment to prevail.

HUNDREDS of additional charts at www.andrewmitchel.com