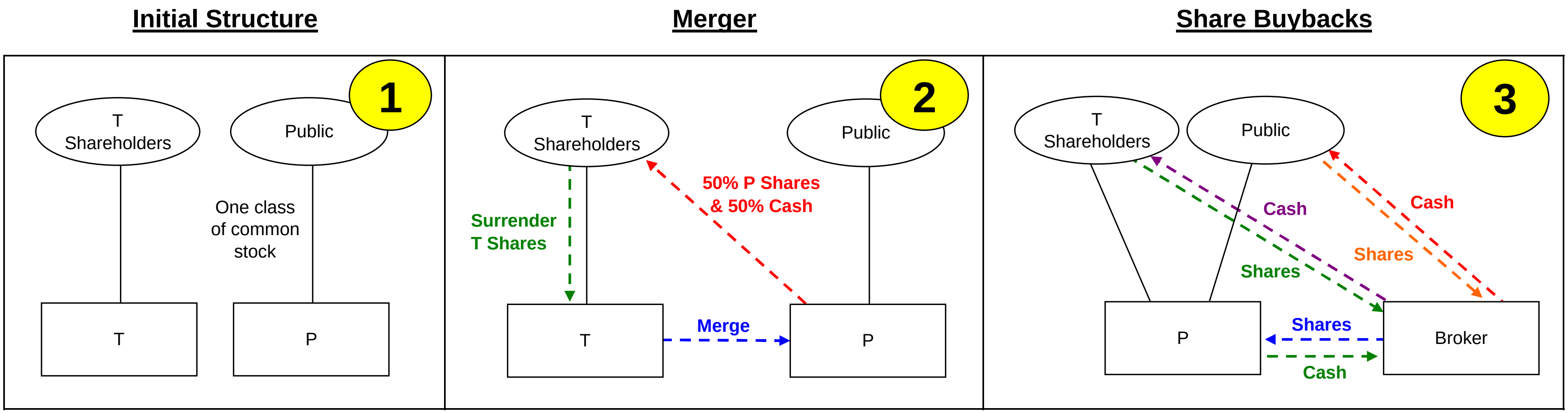
Revenue Ruling 99-58

Continuity of Interest With Stock Repurchases



T merges into P, a corporation whose stock is widely held, and is publicly and actively traded. P has one class of common stock authorized and outstanding. In the merger, T shareholders receive 50 percent common stock of P and 50 percent cash. Viewed in isolation, the exchange would satisfy the continuity of interest requirement of Reg. 1.368-1(e). However, in an effort to prevent dilution resulting from the issuance of P shares in the merger, P's pre-existing stock repurchase program is modified to enable P to reacquire a number of its shares equal to the number issued in the acquisition of T. The number of shares repurchased will not exceed the total number of P shares issued and outstanding prior to the merger. The repurchases are made following the merger, on the open market, through a broker for the prevailing market price. P's intention to repurchase shares was announced prior to the T merger, but the repurchase program was not a matter negotiated with T or the T shareholders. There was not an understanding between the T shareholders and P that the T shareholders' ownership of P stock would be transitory. Because of the mechanics of an open market purchase, P does not know the identity of a seller of P stock, nor does a former T shareholder who receives P stock in the merger and subsequently sells it know whether P is the buyer. Without regard to the repurchase program, a market exists for the newly-issued P stock held by the former T shareholders. During the time P undertakes its repurchase program, there are sales of P stock on the open market, which may include sales of P shares by former T shareholders.

Requisite to a reorganization is a continuity of interest as described in Reg. 1.368-1(e). Reg. 1.368-1(b). The general 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." Reg. 1.368-1(e)(1)(i). To achieve this purpose, the regulation provides that a proprietary interest in the target corporation is not preserved to the extent that, "in connection with the potential reorganization,. . . stock of the issuing corporation furnished in exchange for a proprietary interest in the target corporation in the potential reorganization is redeemed." Id. However, for purposes of the continuity requirement, "a mere disposition of stock of the issuing corporation received in the potential reorganization to persons not related. . . to the issuing corporation is disregarded." Id. The regulation provides that all facts and circumstances will be considered in determining whether, in substance, a proprietary interest in the target corporation is preserved. Under the facts of the ruling, continuity of interest was satisfied. There was not an understanding between the T shareholders and P that the T shareholders' ownership of the P shares would be transitory. Further, because of the mechanics of an open market repurchase, the repurchase program does not favor participation by the former T shareholders.