date and at all times thereafter. Taxpayers who entered into a binding agreement on or after January 28, 1998, and before August 30, 2000, may request a private letter ruling permitting them to apply the final regulations to their transaction. A private letter ruling will not be issued unless the taxpayer establishes to the satisfaction of the IRS that there is not a significant risk of different parties to the transaction taking inconsistent positions, for Federal tax purposes, with respect to the applicability of the final regulations to the transaction. The sixth sentence of paragraph (e)(1)(i) of this section, the last sentence of paragraph (e)(1)(ii) of this section, paragraph (e)(3) of this section, paragraph (e)(6) of this section, and *Example 10* of paragraph (e)(8) of this section apply to transactions occurring after December 12, 2008.

(ii) *Signing date rule*. [Reserved]. For further guidance, see §1.368–1T(e)(8)(ii).

[T.D. 6500, 25 FR 11607, Nov. 26, 1960]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting §1.368–1, see the List of CFR Sections Affected, which appears in the Finding Aids section of the printed volume and at www.fdsys.gov.

§ 1.368–1T Purpose and scope of exception of reorganization exchanges (temporary).

(a) through (e)(1) [Reserved]. For further guidance, see §1.368–1(a) through (e)(1).

(e)(2) *Measuring continuity of interest*—(i) *In general*. In determining whether a proprietary interest in the target corporation is preserved, the consideration to be exchanged for the proprietary interests in the target corporation pursuant to a contract to effect the potential reorganization shall be valued on the last business day before the first date such contract is a binding contract, if such contract provides for fixed consideration. If a portion of the consideration provided for in such a contract consists of other property identified by value, then this specified value of such other property is used for purposes of determining the extent to which a proprietary interest in the target corporation is preserved. If the contract does not provide for fixed consideration, this paragraph (e)(2)(i) is not applicable.

(ii) *Binding contract*—(A) *In general*. A binding contract is an instrument enforceable under applicable law against the parties to the instrument. The presence of a condition outside the control of the parties (including, for example, regulatory agency approval) shall not prevent an instrument from being a binding contract. Further, the fact that insubstantial terms remain to be negotiated by the parties to the contract, or that customary conditions remain to be satisfied, shall not prevent an instrument from being a binding contract.

(B) *Modifications*—(*1*) *In general*. If a term of a binding contract that relates to the amount or type of the consideration the target shareholders will receive in a potential reorganization is modified before the closing date of the potential reorganization, and the contract as modified is a binding contract, the date of the modification shall be treated as the first date there is a binding contract.

(*2*) *Modification of a transaction that preserves continuity of interest*. Notwithstanding paragraph (e)(2)(ii)(B)(*1*) of this section, a modification of a term that relates to the amount or type of consideration the target shareholders will receive in a transaction that would have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if there had been no modification will not be treated as a modification if—

(*i*) The modification has the sole effect of providing for the issuance of additional shares of issuing corporation stock to the target corporation shareholders;

(*ii*) The modification has the sole effect of decreasing the amount of money or other property to be delivered to the target corporation shareholders; or

(*iii*) The modification has the effect of decreasing the amount of money or other property to be delivered to the target corporation shareholders and providing for the issuance of additional shares of issuing corporation stock to the target corporation shareholders.

(*3*) *Modification of a transaction that does not preserve continuity of interest*. Notwithstanding paragraph (e)(2)(ii)(B)(*1*) of this section, a modification of a term that relates to the amount or type of consideration the target shareholders will receive in a transaction that would not have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if there had been no modification will not be treated as a modification if—

(*i*) The modification has the sole effect of providing for the issuance of fewer shares of issuing corporation stock to the target corporation shareholders;

(*ii*) The modification has the sole effect of increasing the amount of money or other property to be delivered to the target corporation shareholders; or

(*iii*) The modification has the effect of increasing the amount of money or other property to be delivered to the target corporation shareholders and providing for the issuance of fewer shares of issuing corporation stock to the target corporation shareholders.

(C) *Tender offers*. For purposes of this paragraph (e)(2), a tender offer that is subject to section 14(d) of the Securities and Exchange Act of 1934 [15 U.S.C. 78n(d)(1)] and Regulation 14D (17 CFR 240.14d–1 through 240.14d–101) and is not pursuant to a binding contract, is treated as a binding contract made on the date of its announcement, notwithstanding that it may be modified by the offeror or that it is not enforceable against the offerees. If a modification (not pursuant to a binding contract) of such a tender offer is subject to the provisions of Regulation 14d–6(c) (17 CFR 240.14d–6(c)) and relates to the amount or type of the consideration received in the tender offer, then the date of the modification shall be treated as the first date there is a binding contract.

(iii) *Fixed Consideration*—(A) *In general*. 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. A contract that provides a target corporation shareholder with an election to receive a number of shares of stock of the issuing corporation and/or money and/or other property in exchange for all of the shareholder's proprietary interests in the target corporation, or each of the shareholder's proprietary interests in the target corporation, provides for fixed consideration if the determination of the number of shares of issuing corporation stock to be provided to the target corporation shareholder is determined using the value of the issuing corporation stock on the last business day before the first date there is a binding contract.

(B) *Contingent adjustments to the consideration*—(*1*) *In general*. Except as provided in paragraph (e)(2)(iii)(B)(*2*) of this section, a contract that provides for contingent adjustments to the consideration will be treated as providing for fixed consideration if it would satisfy the requirements of paragraph (e)(2)(iii)(A) of this section without the contingent adjustment provision.

(*2*) *Exceptions*. A contract will not be treated as providing for fixed consideration if the contract provides for contingent adjustments to the consideration that 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. For example, a contract will not be treated as providing for fixed consideration if the contract provides for contingent adjustments to the consideration in the event that the value of the stock of the issuing corporation, the value of the assets of the issuing corporation, or the value of any surrogate for either the value of the stock of the issuing corporation or the assets of the issuing corporation increase or decrease after the last business day before the first date there is a binding contract; or in the event the contract provides for contingent adjustments to the number of shares of the issuing corporation stock to be provided to the target corporation shareholders computed using any value of the issuing corporation shares after the last business day before the first date there is a binding contract.

(C) *Escrows.* Placing part of the consideration to be exchanged for proprietary interests in the target corporation in escrow to secure target's performance of customary pre-closing covenants or customary target representations and warranties will not prevent a contract from being treated as providing for fixed consideration.

(D) *Anti-dilution clauses.* The presence of a customary anti-dilution clause will not prevent a contract from being treated as providing for fixed consideration. However, the absence of such a clause will prevent a contract from being treated as providing for fixed consideration if the issuing corporation alters its capital structure between the first date there is an otherwise binding contract to effect the transaction and the effective date of the transaction in a manner that materially alters the economic arrangement of the parties to the binding contract. If the number of shares of the issuing corporation to be issued to the target corporation shareholders is altered pursuant to a customary anti-dilution clause, the value of the shares determined under paragraph (e)(2)(i) of this section must be adjusted accordingly.

(E) *Dissenters' rights.* The possibility that some shareholders may exercise dissenters' rights and receive consideration other than that provided for in the binding contract will not prevent the contract from being treated as providing for fixed consideration.

(F) *Fractional shares.* The fact that money may be paid in lieu of issuing fractional shares will not prevent a contract from being treated as providing for fixed consideration.

(iv) *Valuation of new issuances.* For purposes of applying paragraph (e)(2)(i) of this section, any class of stock, securities, or indebtedness that the issuing corporation issues to the target corporation shareholders pursuant to the potential reorganization and that does not exist before the first date there is a binding contract to effect the potential reorganization is deemed to have been issued on the last business day before the first date there is a binding contract to effect the potential reorganization.

(v) *Examples.* For purposes of the examples in this paragraph (e)(2)(v), P is the issuing corporation, T is the target corporation, S is a wholly owned subsidiary of P, all corporations have only one class of stock outstanding, A is an individual, no transactions other than those described occur, and the transactions are not otherwise subject to recharacterization. The following examples illustrate the application of this paragraph (e)(2):

Example 1. Application of signing date rule. On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. Pursuant to the contract, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. Twenty of the P shares, however, will be placed in escrow to secure customary target representations and warranties. The P stock is listed on an established market. On January 2 of Year 1, the value of the P stock is $1 per share. On June 1 of Year 1, T merges with and into P pursuant to the terms of the contract. On that date, the value of the P stock is $.25 per share. None of the stock placed in escrow is returned to P. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for $40 of P stock and $60 of cash, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

Example 2. Treatment of forfeited escrowed stock. (i) *Escrowed stock.* The facts are the same as in Example 1 except that T's breach of a representation results in the escrowed consideration being returned to P. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. Pursuant to paragraph (e)(1)(i) of §1.368–1, for continuity of interest purposes, the T stock is exchanged for $20 of P stock and $60 of cash, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

(ii) *Escrowed stock and cash.* The facts are the same as in paragraph (i) of this *Example 2* except that the consideration placed in escrow consists solely of eight of the P shares and $12 of the cash. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. Pursuant to paragraph (e)(1)(i) of §1.368–1, for continuity of interest purposes, the T stock is exchanged for $32 of P stock and $48 of cash, and the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

Example 3. Redemption of stock received pursuant to binding contract. The facts are the same as in *Example 1* except that A owns 50 percent of the outstanding stock of T immediately prior to the merger and receives 10 P shares and $30 in the merger and an additional 10 P shares upon the release of the stock placed in escrow. In connection with the merger, A and S agree that, immediately after the merger, S will purchase any P shares that A acquires in the merger for $1 per share. Shortly after the merger, S purchases A's P shares for $20. Because the contract provides for the number of shares of P and the amount of money to be exchanged for all of the proprietary interests in T, under this paragraph (e)(2), there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. In addition, S is a person related to P under paragraph (e)(4)(i)(A) of §1.368–1. Accordingly, A is treated as exchanging his T shares for $50 of cash. Because, for continuity of interest purposes, the T stock is exchanged for $20 of P stock and $80 of cash, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

Example 4. Modification of binding contract—continuity not preserved. The facts are the same as in *Example 1* except that on April 1 of Year 1, the parties modify their contract. Pursuant to the modified contract, which is a binding contract, the T shareholders will receive 50 P shares (an additional 10 shares) and $75 of cash (an additional $15 of cash) in exchange for all of the outstanding T stock. On March 31 of Year 1, the value of the P stock is $.50 per share. Under this paragraph (e)(2), although there was a binding contract providing for fixed consideration as of January 3 of Year 1, terms of that contract relating to the consideration to be provided to the target shareholders were modified on April 1 of Year 1. The execution of the transaction without modification would have resulted in the preservation of a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation if there had been no modification. However, because the modified contract provides for additional P stock and cash to be exchanged for all the proprietary interests in T, the exception in paragraph (e)(2)(ii)(B)(*2*) of this section does not apply to preserve the original signing date. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on March 31 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for $25 of P stock and $75 of cash, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

Example 5. Modification of binding contract disregarded—continuity preserved. The facts are the same as in *Example 4* except that, pursuant to the modified contract, which is a binding contract, the T shareholders will receive 60 P shares (an additional 20 shares as compared to the original contract) and $60 of cash in exchange for all of the outstanding T stock. In addition, on March 31 of Year 1, the value of the P stock is $.40 per share. Under this paragraph (e)(2), although there was a binding contract providing for fixed consideration as of January 3 of Year 1, terms of that contract relating to the consideration to be provided to the target shareholders were modified on April 1 of Year 1. Nonetheless, the modification has the sole effect of providing for the issuance of additional P shares to the T shareholders. In addition, the execution of the terms of the contract without regard to the modification would have resulted in the preservation of a substantial part of the value of the T shareholders' proprietary interest in T because, for continuity of interest purposes, the T stock would have been exchanged for $40 of P stock and $60 of cash. Pursuant to paragraph (e)(2)(ii)(B)(*2*) of this section, the modification is not treated as a modification for purposes of paragraph (e)(2)(ii)(B)(*1*) of this section. Accordingly, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for $60 of P stock and $60 of cash, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore the transaction satisfies the continuity of interest requirement.

Example 6. New issuance. The facts are the same as in *Example 1*, except that, instead of cash, the T shareholders will receive a new class of P securities that will be publicly traded. In the aggregate, the securities will have a stated principal amount of $60 and bear interest at the average LIBOR (London Interbank Offered Rates) during the 10 days prior to the potential reorganization. If the T shareholders had been issued the P securities on January 2 of Year 1, the P securities would have had a value of $60 (determined by reference to the value of comparable publicly traded securities). Whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock and the P securities to be issued to the T shareholders on January 2 of Year 1. Under paragraph (e)(2)(iv) of this section, for purposes of valuing the new P securities, they will be treated as having been issued on January 2 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for $40 of P stock and $60 of other property, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

Example 7. Fixed consideration—continuity not preserved. On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. Pursuant to the contract, 60 shares of the T stock will be exchanged for $80 of cash and 40 shares of the T stock will be exchanged for 20 shares of P stock. On January 2 of Year 1, the value of the P stock is $1 per share. On June 1 of Year 1, T merges with and into P pursuant to the terms of the contract. This contract provides for fixed consideration and therefore whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. However, applying the signing date rule, the P stock represents only 20 percent of the value of the total consideration to be received by the T shareholders. Accordingly, based on the economic realities of the exchange, the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

Example 8. Anti-dilution clause. (i) *Absence of anti-dilution clause.* On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. Pursuant to the contract, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. The contract does not contain a customary anti-dilution provision. The P stock is listed on an established market. On January 2 of Year 1, the value of the P stock is $1 per share. On April 10 of Year 1, P issues its stock to effect a stock split; each shareholder of P receives an additional share of P for each P share that it holds. On April 11 of Year 1, the value of the P stock is $.50 per share. Because P altered its capital structure between January 3 and June 1 of Year 1 in a manner that materially alters the economic arrangement of the parties, under paragraph (e)(2)(iii)(D) of this section, the contract is not treated as a binding contract that provides for fixed consideration. Accordingly, whether the transaction satisfies the continuity of interest requirement cannot be determined by reference to the value of the P stock on January 2 of Year 1.

(ii) *Adjustment for anti-dilution clause.* The facts are the same as in paragraph (i) of this *Example 8* except that the contract contains a customary anti-dilution provision, and the T shareholders receive 80 P shares and $60 of cash in exchange for all of the outstanding stock of T. Under paragraph (e)(2)(iii)(D) of this section, the contract is treated as a binding contract that provides for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is generally determined by reference to the value of the P stock on January 2 of Year 1. However, under paragraph (e)(2)(iii)(D) of this section, the value of the P stock on January 2 of Year 1 must be adjusted to take the stock split into account. For continuity of interest purposes, the T stock is exchanged for $40 of P stock (($1÷2) × 80) and $60 of cash. Therefore, the transaction satisfies the continuity of interest requirement.

Example 9. Shareholder election. On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. On January 2 of Year 1, the value of the P stock and the T stock is $1 per share. Pursuant to the contract, at the shareholders' election, each share of T will be exchanged for cash of $1, or alternatively, P stock. The contract provides that the determination of the number of shares of P stock to be exchanged for a share of T stock is made using the value of the P stock on the last business day before the first date there is a binding contract (i.e., $1 per share). Accordingly, the contract provides for fixed consideration, and the determination of whether the transaction satisfies the continuity of interest requirement is based on the number of shares of P stock the T shareholders receive in the exchange and by reference to the value of the P stock on January 2 of Year 1.

Example 10. Contingent adjustment based on the value of the issuing corporation stock—continuity not preserved. On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. On January 2 of Year 1, the value of the P stock is $1 per share. Pursuant to the contract, if the value of the P stock does not decrease after January 2 of Year 1, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. Furthermore, the contract provides that the T shareholders will receive $.16 of additional P shares and $.24 for every $.01 decrease in the value of one share of P stock after January 2 of Year 1. On June 1 of Year 1, T merges with and into P pursuant to the terms of the contract. On that date, the value of the P stock is $.40 per share. Pursuant to the terms of the contract, the consideration is adjusted so that the T shareholders receive 24 more P shares ((60 × $.16)/$.40) and $14.40 more cash (60 × $.24) than they would absent an adjustment. Accordingly, at closing the T shareholders receive 64 P shares and $74.40 of cash. Because the contract provides that additional P shares and cash will be delivered to the T shareholders if the value of the stock of P decreases after January 2 of Year 1, under paragraph (e)(2)(iii)(B)(*2*) of this section, the contract is not treated as providing for fixed consideration, and therefore whether the transaction satisfies the continuity of interest requirement cannot be determined by reference to the value of the P stock on January 2 of Year 1. For continuity of interest purposes, the T stock is exchanged for $25.60 of P stock (64 × $.40) and $74.40 of cash and the transaction does not preserve a substantial part of the value of the proprietary interest in T. Therefore, the transaction does not satisfy the continuity of interest requirement.

Example 11. Contingent adjustment to boot based on the value of the target corporation stock—continuity not preserved. On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. On January 2 of Year 1, T has 100 shares outstanding, and each T share is worth $1. On January 2 of Year 1, each P share is worth $1. Pursuant to the contract, if the value of the T stock does not increase after January 3 of Year 1, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. Furthermore, the contract provides that the T shareholders will receive $1 of additional cash for every $.01 increase in the value of one share of T stock after January 3 of Year 1. On June 1 of Year 1, the value of the T stock is $1.40 per share and the value of the P stock is $.75 per share. Pursuant to the terms of the contract, the consideration is adjusted so that the T shareholders receive $40 more cash (40 × $1) than they would absent an adjustment. Accordingly, at closing the T shareholders receive 40 P shares and $100 of cash. Because the contract provides the number of shares of P stock and the amount of money to be exchanged for all the proprietary interests in T, and the contingent adjustment to the cash consideration is not based on changes in the value of the P stock, P assets, or any surrogate thereof, after January 2 of Year 1, there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. For continuity of interest purposes, the T stock is exchanged for $40 of P stock (40 × $1) and $100 of cash. Therefore, the transaction does not satisfy the continuity of interest requirement.

Example 12. Contingent adjustment to stock based on the value of the target corporation stock—continuity preserved. On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 1 of Year 1. On that date T has 100 shares outstanding, and each T share is worth $1. On January 2 of Year 1, each P share is worth $1. Pursuant to the contract, if the value of the T stock does not decrease after January 3 of Year 1, the T shareholders will receive 40 P shares and $60 of cash in exchange for all of the outstanding stock of T. Furthermore, the contract provides that the T shareholders will receive $.40 less P stock and $.60 less cash for every $.01 decrease in the value of one share of T stock after January 3 of Year 1. The contract also provides that the number of P shares by which the consideration will be reduced as a result of this adjustment will be determined based on the value of the P stock on January 2 of Year 1. On June 1 of Year 1, T merges with and into P pursuant to the terms of the contract. On that date, the value of the T stock is $.70 per share and the value of the P stock is $.75 per share. Pursuant to the terms of the contract, the consideration is adjusted so that the T shareholders receive 12 fewer P shares ((30 × $.40)/$1) and $18 less cash (30 × $.60) than they would absent an adjustment. Accordingly, at closing the T shareholders receive 28 P shares and $42 of cash. Because the contract provides for the number of shares of P stock and the amount of money to be exchanged for all of the proprietary interests in T, the contract does not provide for contingent adjustments to the consideration based on a change in value of the P stock, P assets, or any surrogate thereof, after January 2 of Year 1, and the adjustment to the number of P shares the T shareholders receive is determined based on the value of the P shares on January 2 of Year 1, there is a binding contract providing for fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock on January 2 of Year 1. For continuity of interest purposes, the T stock is exchanged for $28 of P stock (28 × $1) and $42 of cash. Therefore, the transaction satisfies the continuity of interest requirement.

(e)(3) through (7) [Reserved]. For further guidance, see §1.368–1(e)(3) through (7).

(8) *Effective dates.* (i) [Reserved]. For further guidance, see §1.368–1(e)(8)(i).

(ii) *Signing date rule.* Paragraph (e)(2) of this section applies to transactions occurring pursuant to binding contracts entered into after September 16, 2005. For transactions occurring pursuant to binding contracts entered into after September 16, 2005, and on or before March 20, 2007, the parties to the transaction may elect to apply the provisions of §1.368–1(e)(2) as contained in 26 CFR part 1, revised April 1, 2006, instead of the provisions of this paragraph (e)(2). However, the target corporation, the issuing corporation, the controlling corporation of the acquiring corporation if stock thereof is provided as consideration in the transaction, and any direct or indirect transferee of transferred basis property from any of the foregoing, may not elect to apply the provisions of §1.368–1(e)(2) as contained in 26 CFR part 1, revised April 1, 2006, unless all such taxpayers elect to apply the provisions of such regulations. This election requirement will be satisfied if none of the specified parties adopts inconsistent treatment. The applicability of this section expires on or before March 19, 2010.

[T.D. 9316, 72 FR 12977, Mar. 20, 2007]

§ 1.368–2 Definition of terms.

(a) The application of the term *reorganization* is to be strictly limited to the specific transactions set forth in section 368(a). The term does not embrace the mere purchase by one corporation of the properties of another corporation. The preceding sentence applies to transactions occurring after January 28, 1998, except that it does not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times thereafter. If the properties are transferred for cash and deferred payment obligations of the transferee evidenced by short-term notes, the transaction is a sale and not an exchange in which gain or loss is not recognized.

(b)(1)(i) *Definitions.* For purposes of this paragraph (b)(1), the following terms shall have the following meanings:

(A) *Disregarded entity.* A disregarded entity is a business entity (as defined in §301.7701–2(a) of this chapter) that is disregarded as an entity separate from its owner for Federal income tax purposes. Examples of disregarded entities include a domestic single member limited liability company that does not elect to be classified as a corporation for Federal income tax purposes, a corporation (as defined in §301.7701–2(b) of this chapter) that is a qualified REIT subsidiary (within the meaning of section 856(i)(2)), and a corporation that is a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)).

(B) *Combining entity.* A combining entity is a business entity that is a corporation (as defined in §301.7701–2(b) of this chapter) that is not a disregarded entity.

(C) *Combining unit.* A combining unit is composed solely of a combining entity and all disregarded entities, if any, the assets of which are treated as owned by such combining entity for Federal income tax purposes.

(ii) *Statutory merger or consolidation generally.* For purposes of section 368(a)(1)(A), a statutory merger or consolidation is a transaction effected pursuant to the statute or statutes necessary to effect the merger or consolidation, in which transaction, as a result of the operation of such statute or statutes, the following events occur simultaneously at the effective time of the transaction—

(A) All of the assets (other than those distributed in the transaction) and liabilities (except to the extent such liabilities are satisfied or discharged in the transaction or are nonrecourse liabilities to which assets distributed in the transaction are subject) of each member of one or more combining units (each a transferor unit) become the assets and liabilities of one