26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of tax liability
(Also Part I, §§ 368, 1.368-1.)

Rev. Proc. 2018-12

SECTION 1. PURPOSE

This revenue procedure provides methods that taxpayers may use to value certain stock received by a target corporation's shareholders in a potential reorganization for purposes of determining whether the continuity of interest (COI) requirement under § 1.368-1(e) of the Income Tax Regulations is satisfied. In the circumstances described in this revenue procedure, the Internal Revenue Service (IRS) will not challenge a taxpayer's use of one of these methods to determine the value of such stock, in lieu of using the stock's actual trading price on a particular day.

SECTION 2. BACKGROUND

.01 The provisions of subchapter C, chapter 1, of the Internal Revenue Code of 1986 generally provide nonrecognition treatment for reorganizations described in § 368. The COI requirement is one of a number of requirements that a transaction must satisfy in order to qualify as a reorganization. The COI requirement prevents transactions that resemble sales from qualifying as reorganizations. Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U.S. 462 (1933). Section 1.368-1(e) of the Income Tax Regulations generally provides rules applicable to the determination of whether the COI requirement is satisfied. See generally § 1.368-1(e) for the definitions of terms used in this revenue procedure.

.02 In some reorganizations, the shareholders of a corporation (Target) transfer their Target stock to another corporation (Acquiror) in exchange for either the stock of Acquiror or, in the case of a triangular reorganization (as defined in § 1.358-6(b)(2)), the stock of the corporation in control (within the meaning of § 368(c)) of Acquiror (in either case, Issuing Corporation stock). In these reorganizations, Target shareholders may receive only Issuing Corporation stock or, in some cases, money or other property in addition to Issuing Corporation stock. In other reorganizations, Target transfers its property to Acquiror in exchange for Issuing Corporation stock (and, in some cases, money or other property), and then Target distributes the Issuing Corporation stock (and the money or other property, if any) to its shareholders in exchange for their Target stock.

.03 The COI requirement requires that, in substance, a substantial part of the value of the Target shareholders' proprietary interests (i.e., stock) in Target be preserved. Section 1.368-1(e)(1)(i); John A. Nelson Co. v. Helvering, 296 U.S. 374 (1935). A proprietary interest in Target is preserved if it is exchanged for Issuing Corporation stock. To the extent that the shareholders' proprietary interests in Target are acquired for money or other property, their proprietary interests are not preserved. Section 1.368-1(e)(1)(i). To determine whether the COI requirement is satisfied, the value of the Issuing Corporation stock the Target shareholders received is compared to the aggregate value of the consideration the Target shareholders received.

.04 Prior to 2011, the determination of whether the COI requirement is satisfied had been based on the value of the Issuing Corporation stock "as of the effective date of the reorganization" (Closing Date). Rev. Proc. 77-37, 1977-2 C.B. 568. Under this rule (Closing Date Rule), a decline in the value of the Issuing Corporation stock between the date a contract to effect a potential reorganization becomes binding (Signing Date) and the Closing Date could cause a transaction to fail the COI requirement.

.05 On December 19, 2011, the Department of the Treasury (Treasury Department) and the IRS issued final regulations (TD 9565, 76 FR 78540) including a special rule (Signing Date Rule) that applies if a binding contract to effect a potential reorganization provides for fixed consideration (as defined in § 1.368-1(e)(2)(iii)(A)) to be exchanged for the Target shareholders' proprietary interests. Section 1.368-1(e)(2)(i). If the Signing Date Rule applies, the consideration is valued as of the end of the last business day before the first date there is a binding contract (Pre-signing Date), rather than on the Closing Date. Thus, under the Signing Date Rule, a change between the Signing Date and the Closing Date in the value of the Issuing Corporation stock to be received by the Target shareholders does not affect the determination of whether the COI requirement is satisfied.

.06 The Treasury Department and the IRS published proposed regulations in 2011 (2011 Proposed Regulations) (REG-124627-11, 76 F.R. 78591 (Dec. 19, 2011)) that identified situations, other than those covered by the Signing Date Rule, in which the value of Issuing Corporation stock could be determined based on a value other than its actual trading price on the Closing Date. In one of these situations, the 2011 Proposed Regulations would have allowed the parties to use an average of the trading prices of Issuing Corporation stock over a number of days, in lieu of its actual trading price on the Closing Date, for purposes of determining whether the COI requirement is satisfied.

.07 The Treasury Department and the IRS received comments on the 2011 Proposed Regulations to the effect that parties to potential reorganizations frequently use average trading price methods to value Issuing Corporation stock in determining the amount and/or the mix of consideration to be exchanged for Target stock. The IRS agrees that such methods often produce a more reliable estimate of the fair market value of Issuing Corporation stock than its trading price on a single date. Accordingly, the IRS has concluded that, in certain circumstances, taxpayers should be able to rely on such methods for purposes of determining whether the COI requirement is satisfied. The IRS also agrees with commenters that taxpayers should be able to rely on such methods regardless of whether the Signing Date Rule or the Closing Date Rule applies to a particular transaction.

.08 Accordingly, the IRS is prescribing in section 4 of this revenue procedure certain Safe Harbor Valuation Methods and Measuring Periods. For COI requirement purposes, if a transaction meets the requirements of either section 3.01 or 3.02 of this revenue procedure, the parties to a potential reorganization may select one of these Safe Harbor Valuation Methods and an appropriate Measuring Period, each described in section 4 of this revenue procedure, to determine the value of certain Issuing Corporation stock.

SECTION 3. TRANSACTIONS TO WHICH THIS REVENUE PROCEDURE APPLIES

Taxpayers may apply this revenue procedure to transactions that meet the requirements of either section 3.01 or 3.02 of this revenue procedure.

.01 A taxpayer may rely on this revenue procedure if the Signing Date Rule applies to the transaction and the requirements in paragraphs (1), (2), (3), (4), and (5) of this section 3.01 are satisfied:

(1) The shareholders of Target receive Issuing Corporation stock, and either money or other property or both, in exchange for their Target stock in a transaction that, apart from the COI requirement, would qualify as a reorganization described in § 368(a)(1)(A), (B), or (C), or as a reorganization described in § 368(a)(1)(G) to which § 354, or so much of § 356 as relates to § 354, applies.

(2) Shares of one or more classes of Issuing Corporation stock that are exchanged for the Target shareholders' stock are traded on a national securities

exchange registered under Section 6 of the Securities Exchange Act of 1934 (15 U.S.C. 78f) with the Securities and Exchange Commission (Exchange Traded Stock).

(3) All parties to the potential reorganization, as defined in § 368(b), treat the transaction in a consistent manner (i.e., as either qualifying or not qualifying as a reorganization).

(4) The transaction is effected pursuant to a binding contract that evidences the parties' agreement as to the following terms:

(a) The contract specifies—

(i) The Safe Harbor Valuation Method and an appropriate Measuring Period, each described in section 4 of this revenue procedure, that will be used to determine the value of each class of Exchange Traded Stock to be received by the Target shareholders.

(ii) The national securities exchange and the authoritative reporting source that will be used to determine the trading prices of each class of Exchange Traded Stock throughout the Measuring Period. The national securities exchange that will be used (specified exchange) must meet the requirements of paragraph (2) of this section 3.01. If a class of Exchange Traded Stock trades on more than one national securities exchange, the contract must specify the single exchange that will be used to value that class of Exchange Traded Stock.

(b) Pursuant to the contract, the parties will utilize the value of each class of Exchange Traded Stock determined under the selected Safe Harbor Valuation Method and Measuring Period in determining the number of shares of each class of Issuing

Corporation stock, the amount of money, and any other property (identified by specific value or by specific description) to be exchanged for all of the Target stock, or to be exchanged for each share of Target stock.

(5) The contract terms described in paragraph (4) of this section 3.01 are fulfilled at the Closing Date, in all material respects.

.02 Taxpayers may rely on this revenue procedure if the Closing Date Rule applies to the transaction and the requirements in paragraphs (1), (2), and (3) of this section 3.02 are satisfied:

(1) The requirements in paragraphs (1), (2), and (3) of section 3.01 of this revenue procedure are satisfied.

(2) The transaction is effected pursuant to a contract that is binding on the parties no later than the beginning of the first trading day of the Measuring Period (as defined in section 4.02 of this revenue procedure) selected by the parties, and evidences the parties' agreement as to the matters set forth in paragraph (4) of section 3.01 of this revenue procedure.

(3) The contract items described in paragraph (2) of this section 3.02 are fulfilled at the Closing Date, in all material respects.

SECTION 4. SAFE HARBOR VALUATION METHODS AND MEASURING PERIODS

This section 4 sets forth the Safe Harbor Valuation Methods and the Measuring Periods taxpayers may use to avail themselves of the safe harbor in section 5 of this revenue procedure in determining the value of Exchange Traded Stock. The safe harbor is available only if the transaction satisfies the requirements in section 3 of this revenue procedure, and if the method used to determine the value of the Exchange Traded Stock is a Safe Harbor Valuation Method described in section 4.01 of this revenue procedure that uses the appropriate Measuring Period described in section 4.02 of this revenue procedure.

.01 Safe Harbor Valuation Methods.

To avail themselves of the safe harbor provided in section 5 of this revenue procedure, taxpayers may use any of the Safe Harbor Valuation Methods set forth in paragraphs (1), (2), and (3) of this section 4.01 to determine the value of Exchange Traded Stock.

(1) Average of the Daily Volume Weighted Average Prices. For each class of Exchange Traded Stock, taxpayers may use the average of the daily volume weighted average prices of a share of that class of Exchange Traded Stock, on the specified exchange, as determined on each day of the Measuring Period (see section 4.02 of this revenue procedure).

(2) Average of the Average High-Low Daily Prices. For each class of Exchange Traded Stock, taxpayers may use the average of the daily average high-low trading prices of a share of that class of Exchange Traded Stock, on the specified exchange, as determined on each day of the Measuring Period.

(3) Average of the Daily Closing Prices. For each class of Exchange Traded Stock, taxpayers may use the average of the daily closing prices of a share of that class of Exchange Traded Stock, on the specified exchange, as determined on each day of the Measuring Period.

.02 Measuring Period.

A Measuring Period is a number of consecutive trading days, based on the trading days of the specified exchange, used in connection with a Safe Harbor Valuation Method described in section 4.01 of this revenue procedure. The Measuring Period used to determine the value of a share of each class of Exchange Traded Stock must include at least five but not more than 35 consecutive trading days.

The Measuring Period must end no later than the Closing Date, if the Closing Date is a trading day on the specified exchange. If the Closing Date is not a trading day, the Measuring Period must end no later than the last trading day before the Closing Date. If the Signing Date Rule applies to the transaction, the Measuring Period must end no earlier than three trading days before the Pre-signing Date. If the Closing Date Rule applies to the transaction, the Measuring Period must end no earlier than three trading days before the Closing Date.

SECTION 5. SAFE HARBOR

If the applicable requirements in section 3 of this revenue procedure are satisfied, the IRS will not challenge the position that, for purposes of determining whether the COI requirement is satisfied, the value of Exchange Traded Stock is determined under the Safe Harbor Valuation Method and Measuring Period selected by the parties. The safe harbor is available regardless of whether the value of Exchange Traded Stock, as determined under the Safe Harbor Valuation Method and the Measuring Period selected by the parties, satisfies the COI requirement.

SECTION 6. SCOPE AND EFFECT OF REVENUE PROCEDURE

.01 Exclusivity.

The safe harbor set forth in section 5 of this revenue procedure is available solely for purposes of determining whether the COI requirement is satisfied. Further, the safe harbor may be applied only to transactions that satisfy the requirements of section 3 of this revenue procedure and only to determine the value of Exchange Traded Stock under a Safe Harbor Valuation Method described in section 4.01 of this revenue procedure using the appropriate Measuring Period described in section 4.02 of this revenue procedure. No inference should be drawn regarding the application of any federal tax principles outside the scope of this revenue procedure.

.02 Effect of Safe Harbor Not Applying.

If the safe harbor does not apply, this revenue procedure has no effect on the federal tax treatment of the transaction. In such cases, the determination of whether a transaction satisfies the COI requirement will be made under general federal tax principles without regard to the provisions of this revenue procedure.

.03 Private Letter Rulings.

Subject to the provisions of Rev. Proc. 2018-1, 2018-1 I.R.B. 1, and Rev. Proc. 2018-3, 2018-1 I.R.B. 130, the IRS will entertain requests for rulings and determination letters regarding transactions and legal issues to which the safe harbor does not apply and regarding the applicability of the safe harbor.

SECTION 7. EFFECT ON OTHER DOCUMENTS

This revenue procedure further amplifies Rev. Proc. 77-37, 1977-2 C.B. 568, as amplified by Rev. Proc. 86-42, 1986-2 C.B. 722, and Rev. Proc. 89-50, 1989-35 I.R.B.

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SECTION 8. EFFECTIVE DATE

This revenue procedure is effective with respect to transactions with an effective date on or after January 23, 2018.

SECTION 9. DRAFTING INFORMATION

The principal author of this revenue procedure is Jean Broderick of the Office of Associate Chief Counsel (Corporate). For further information regarding this revenue procedure, contact Ms. Broderick at (202) 317-6848 (not a toll-free call).