



Federal Tax **ADVISORY** ■

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Downstream Reorganizations

[LTR 201721014](#) ruled that a holding company can reorganize into a partly owned subsidiary by swapping old shares for new shares of the subsidiary and then liquidating. The technique is an old one, but tends to be forgotten because it looks so odd.

Facts

Holdco owned some percentage, let's assume 40%, of Opco. It also owned two small operating subsidiaries. Opco redeemed Holdco's shares in exchange for new voting common Opco stock, and then Holdco liquidated. As a result, Holdco's shareholders received the stock of Opco and the two small subsidiaries.

If instead Holdco had liquidated and distributed the Opco shares to its shareholders, Holdco would have recognized its gain in the Opco shares and the shareholders would have recognized their gain in the Holdco stock. The plan followed avoided all tax but on the inside and outside gain resulting from the distribution of the two small subsidiaries' stock.

Downstream reorganizations

The technique is just a variation on the downstream merger, which could have reached the same result. But Holdco would have had to distribute the stock of its two small subs before merging. Perhaps there were business reasons why Opco could not merge with Holdco.

Petrie Stores

This transaction occurred in the 1990s when Petrie Stores held a large block of Toys "R" Us. Petrie engaged in essentially the same steps pursuant to a letter ruling approving the desired tax results. At the time, a ruling

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was thought necessary. The ruling probably was not necessary in 2017, but the taxpayer received it anyway as a sort of comfort ruling.

Other applications

The transaction works both if Holdco controls Opco and if it does not. The attractiveness of the transaction depends on the relative size of the other assets of Holdco and the amount of gain in those assets and gain in the stock of Holdco. Unfortunately, the transaction cannot be used for an outbound reorganization.

For more information, please contact [Jack Cummings](#) at 919.862.2302.

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