

The F Reorganization, Explained Plainly

Before many privately held companies are sold, the seller's side goes through a short sequence of legal and tax paperwork changes — often called an "F Reorganization." This is a plain-language walkthrough of what that process is, why it happens, and what each step actually does. It uses a generic company as an example; none of the steps below change what the owners own, what the business does, or who runs it — they only change the legal wrapper around the business so a sale can close cleanly.

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Five terms worth knowing first

Corporation vs. LLC

TWO WAYS A BUSINESS CAN BE LEGALLY ORGANIZED

Both are just legal containers for the same business. A corporation issues "shares" to owners; an LLC issues "membership units." Changing from one to the other doesn't touch employees, contracts, or operations — it's a change of legal form, not a new business.

S corporation

HOW THE COMPANY IS TAXED

An S corporation doesn't pay federal income tax itself — its profit passes through and is taxed on the shareholders' own returns instead. Keeping that status intact through a restructuring like this avoids an extra layer of tax.

Tax-free reorganization

REARRANGING OWNERSHIP WITHOUT A TAX BILL

Normally, exchanging stock for stock in a new company could trigger tax as if it had been sold. The IRS has specific rules that let certain restructurings happen without that tax hit, because nothing of real economic substance changed hands. That's the point of the steps below.

IRS election (a form)

PAPERWORK THAT TELLS THE IRS HOW TO TREAT AN ENTITY

Some of these steps are simply a form filed with the IRS — not a negotiation, not a sale, just a notice that says "treat this entity this way for tax purposes going forward." It has legal significance but requires nothing further from the owners personally.

Disregarded entity

AN LLC THE IRS TREATS AS INVISIBLE

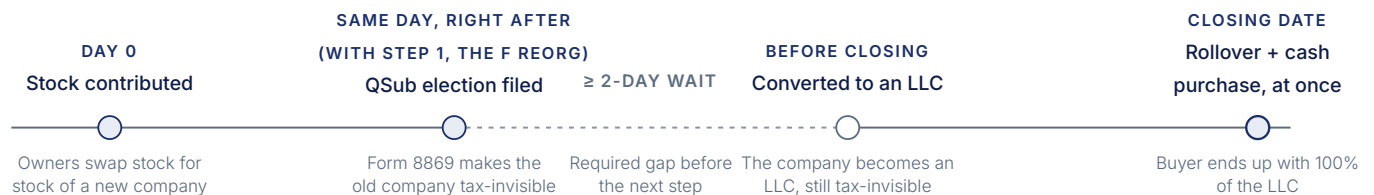
Once an LLC has a single owner and the right election is in place, the IRS ignores it as a separate taxpayer. Its income is simply reported on its owner's tax return, as if the owner held the business directly.

Rollover vs. cash

HOW SELLERS ARE OFTEN PAID AT CLOSING

In many deals, part of what a seller is owed is paid in cash. Part can instead be paid in ownership units of the buyer — that's the "rollover": the seller keeps a stake in the combined company going forward rather than cashing out entirely.

Timeline — filing to conversion to closing



Reading left to right: the contribution and QSub election happen back-to-back on Day 0 (together, the F Reorganization); a mandatory two-day-plus wait separates that from the statutory conversion into an LLC; the LLC then sits in place until Closing, when the rollover and cash purchase transfer full ownership to the buyer.

The steps, in order

0

Where things stand today

A group of shareholders owns a corporation — call it "Target Corp." It has been an S corporation, without interruption, since its original election.

1

STEP 1 The shareholders contribute their stock

The shareholders contribute all of their stock in Target Corp to a brand-new holding company — call it "New Holdco" — in exchange for 100% of the stock of that new company. Nothing is bought or sold and no cash moves. They end up owning the new company instead of the old one directly, and the new company owns the old one.

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STEP 2 An IRS form is filed

Right after that contribution, New Holdco files a one-page IRS form (Form 8869) electing to have Target Corp treated as invisible for tax purposes — a "qualified subchapter S subsidiary," or QSub. Target Corp still exists as a legal matter, but going forward the IRS taxes it and its parent as a single company. This step and Step 1 together are called an **F Reorganization**, a type of restructuring the tax code allows to happen without triggering a tax bill, specifically because the new structure is treated as a continuation of the same company — not a new one.

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A required waiting period

At least two days have to pass before the next step. This isn't a negotiation point — it's a technical requirement that keeps the reorganization and the next step (the conversion) as two clearly separate transactions in the eyes of the IRS.

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STEP 3 The company becomes an LLC

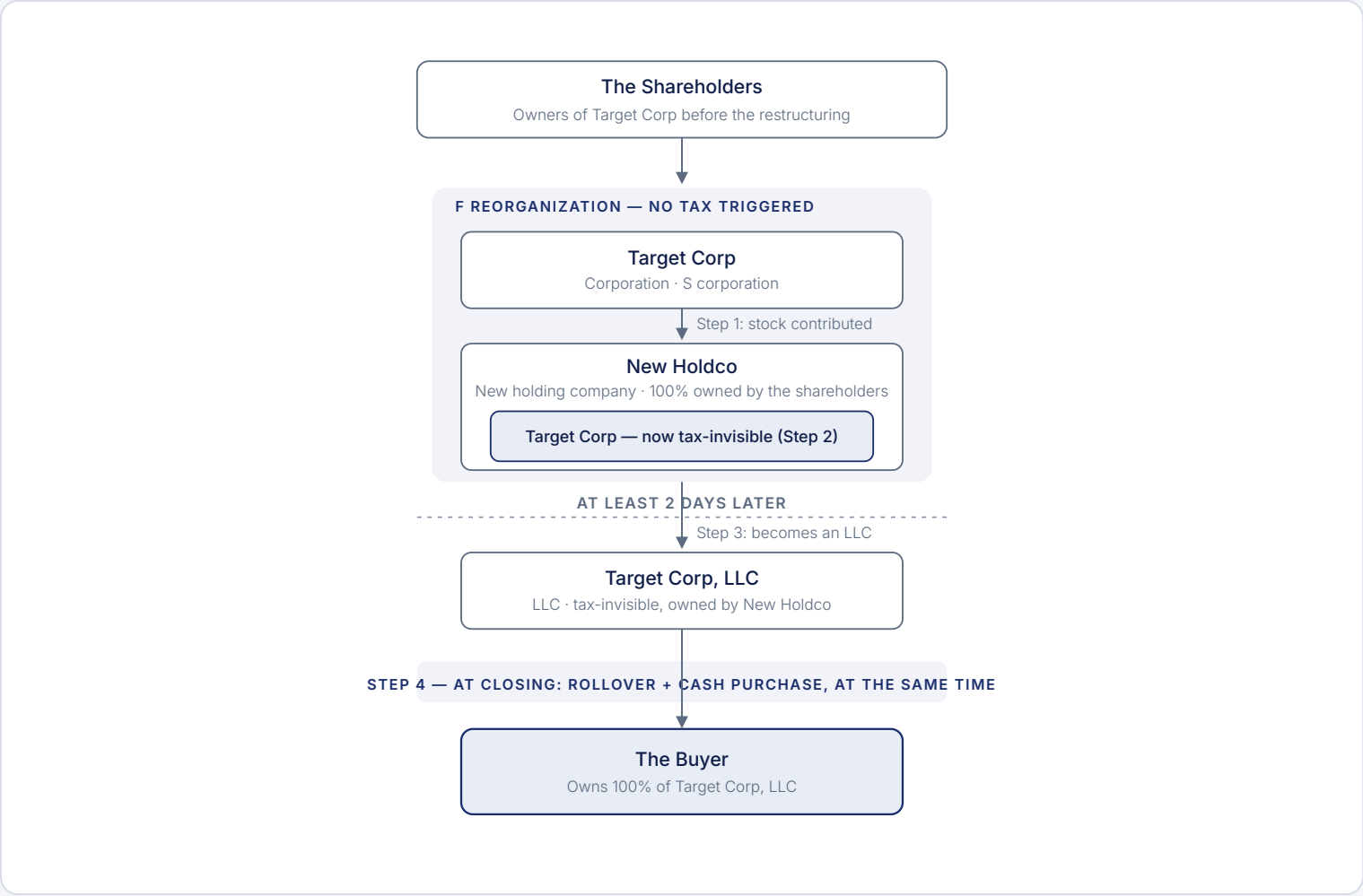
Target Corp then converts — by a routine state-law filing — from a corporation into an LLC: "Target Corp, LLC." This is not a sale, a liquidation, or a new company standing up. It is the same continuous business, changing its legal form the same way a corporation might change its name. Because the IRS was already treating it as invisible (Step 2), the new LLC is automatically invisible for tax purposes too.

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STEP 4 Closing — paid two ways at once

At Closing, two things happen simultaneously. First, New Holdco contributes part of its LLC ownership to the Buyer in exchange for ownership units in the Buyer's company — this is the rollover, the sellers' continuing stake in the business going forward. Second, the Buyer purchases the rest of the LLC ownership from New Holdco for cash. Between the two, the Buyer ends up owning 100% of the LLC, and the sellers end up with a mix of cash and an ongoing ownership position.

The structure, step by step



Stock is contributed to a new holding company and an IRS election is filed (together, the F Reorganization); a mandatory two-day wait follows; the subsidiary becomes an LLC; and at Closing ownership splits between rollover units in the buyer's company and a cash payment.

Why go through all of this? It preserves the S corporation tax status the company has always had, so the restructuring itself doesn't create a tax bill for the sellers. By the time of Closing, the business sits inside a single, simply-owned LLC — the clean structure buyers in deals like this typically expect to acquire. None of these steps change how the business operates, who runs it, or what it's worth.

Plain-English glossary

F Reorganization	A restructuring the tax code specifically allows to happen without a tax bill, because the resulting company is treated as a continuation of the old one — not a new taxpayer.
S corporation	A company that doesn't pay federal income tax itself; its profit is taxed on the shareholders' own returns instead.
QSub election	A form (IRS Form 8869) that tells the IRS to treat a subsidiary company as invisible for tax purposes, even though it still legally exists.
Statutory conversion	A state filing that changes a corporation into an LLC (or the reverse) without dissolving it or restarting the business — the same company, in a new legal form.
Disregarded entity	A single-owner LLC the IRS ignores as a separate taxpayer; its income is reported directly on its owner's tax return.
Rollover	The part of a payout received as ownership units in the buyer's company instead of cash, giving the seller a continuing stake in the business going forward.
Purchased interests	The part of the seller's LLC ownership sold to the buyer for cash at Closing. Together with the rollover portion, it adds up to 100% of the ownership.
Holdback	A portion of the purchase price withheld at Closing and paid out later, once the final numbers are confirmed.

Semper adde valorem — always add value in everything you do.

Published by Crassus Partners as a general educational resource on the F Reorganization structure commonly used to prepare privately held companies for sale. The example above uses a generic company and does not describe any specific transaction. See the disclaimer above.