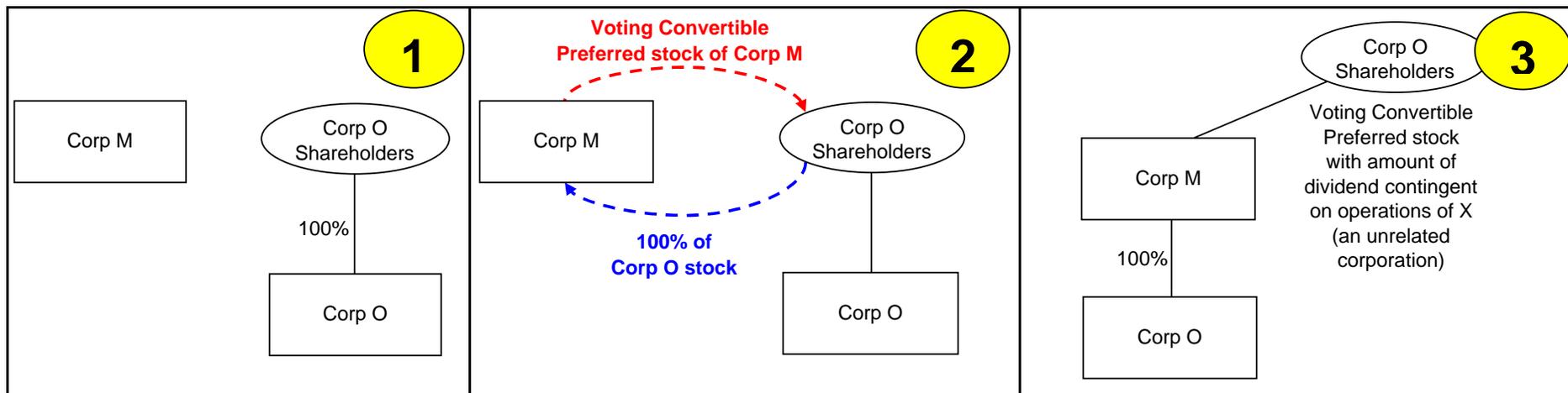


Contingent Dividends on Convertible Preferred Stock in a B Reorganization

Initial Structure

B Reorganization

Ending Point



M corporation acquired all the outstanding stock of O corporation solely in exchange for authorized but previously unissued voting convertible preferred stock of M. This M preferred stock is convertible into common stock of M at any time within ten years from the date of issuance. The M convertible preferred stock will pay cumulative annual dividends of \$6 per share. In addition to the \$6 dividend, for a period of ten years after the date of issuance, holders of the convertible preferred stock may receive an additional annual dividend of up to \$1.50 per share. This possible additional dividend is designed to insure that M will pay as large a dividend as would have been paid if the O shareholders had accepted a competing offer from X, an unrelated corporation. The additional dividend will be paid only if the dividend paid by X on a specified number of its shares exceeds the normal M dividend on the convertible preferred stock received in the reorganization by the former O shareholders and only in an amount necessary to equalize the M and X dividends.

The additional dividend right will be extinguished if the shareholder converts his M convertible preferred stock into M common stock. However, the additional dividend right will not be extinguished if the shareholder otherwise disposes of his M convertible preferred stock but will remain an attribute of the stock to be enjoyed by the new holder of the stock. Section 368(a)(1)(B) provides, in part, that the term "reorganization" means the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock in another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation whether or not such acquiring corporation had control immediately before the acquisition).

In order to be considered an attribute of stock, a right to dividends must be inseparable from the other rights inherent in the stock and not be personal to the shareholders. Since in the instant case, the right to receive additional dividends is a right inherent in the M convertible preferred stock and is not personal to the former O shareholder, such right is an attribute of the M convertible preferred stock and does not constitute other property received by the former O shareholders in exchange for their O stock. Accordingly, the acquisition by M of the stock of O is a reorganization within the meaning of section 368(a)(1)(B). No gain or loss is recognized to the former shareholders of O upon the exchange under section 354(a).