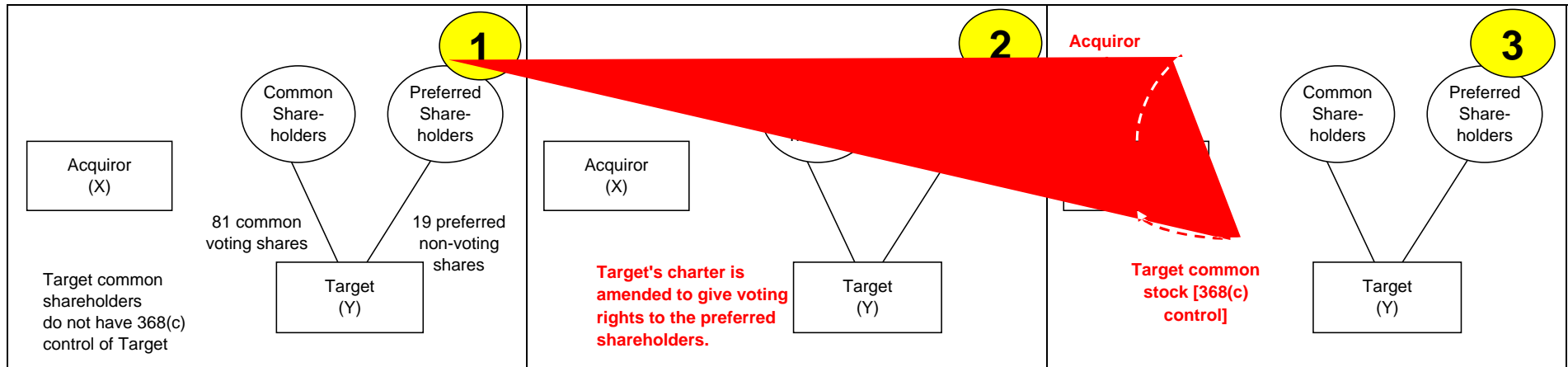


Voting Rights Added to Qualify Exchange as a B Reorganization

Initial Structure

Add Voting Rights to Preferred

Stock for Stock Exchange



Acquiror wanted to acquire the common stock of Target in a 368(a)(1)(B) reorganization, but Acquiror did not want to acquire any of the preferred stock of Target. As part of the overall plan, the charter of Target was amended to give voting rights to the preferred stock.

To qualify as a B reorganization, immediately after the acquisition Acquiror must control Target. Section 368(c) states that "control" means ownership of stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote and 80% of the total number of shares of all other classes of stock. In the above transaction, the addition of voting rights to the preferred stock caused the common stockholders to have 368(c) control of Target. Thus, the exchange qualifies as a B reorganization.

The amendment to Target's charter can be viewed as though the preferred stockholders exchanged Target non-voting preferred stock for Target voting preferred stock. However, as long as the preferred stock is not nonqualified preferred stock, then no gain or loss is recognized under section 1036. Section 1036 provides:

No gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation. . . . For purposes of this section, nonqualified preferred stock . . . shall be treated as property other than stock.

Ending Point

