Reg. 1.368-2(b)(1)(iii), Example 3

S Corp with QSub Merger into Disregarded Entity

**Initial Structure**

- Corp Y (Acquiror) (Combining Entity) 100%
- LLC X (Disregarded Entity)
- Corp Z (S Corp) (Target) 100%
- Corp U (Q Sub)

**Merger**

- Corp Y (Acquiror) (Combining Entity)
- Corp Z (S Corp) (Target)
- LLC X (Disregarded Entity)
- Corp U (Q Sub)

**Ending Point**

- Corp Y (Acquiror) (Combining Entity)
- LLC X (Disregarded Entity)
- Corp U

△ means flow-thru for U.S. tax purposes
□ means "S" corporation

Under State W law, Corp Z (an S corporation) merges into LLC X. Pursuant to such law, the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z become the assets and liabilities of X and Z's separate legal existence ceases for all purposes. In the merger, the Z shareholders exchange their stock of Z for stock of Y.

The deemed formation by Z of U pursuant to Reg. 1.1361-5(b)(1) (as a consequence of the termination of U's QSub election) is disregarded for Federal income tax purposes. The transaction is treated as a transfer of the assets of U to X, followed by X's transfer of these assets to U in exchange for stock of U. See Reg. 1.1361-5(b)(3) Example 9. The transaction will qualify as a statutory merger or consolidation for purposes of section 368(a)(1)(A) because the transaction is effected pursuant to State W law and the following events occur simultaneously at the effective time of the transaction: all of the assets and liabilities of Z and U, the sole members of the transferor unit, become the assets and liabilities of one or more members of the transferee unit that is comprised of Y, the combining entity of the transferee unit, and X, and Z ceases its separate legal existence for all purposes. Moreover, the deemed transfer of the assets of U in exchange for U stock does not cause the transaction to fail to qualify as a statutory merger or consolidation. See section 368(a)(2)(C).

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