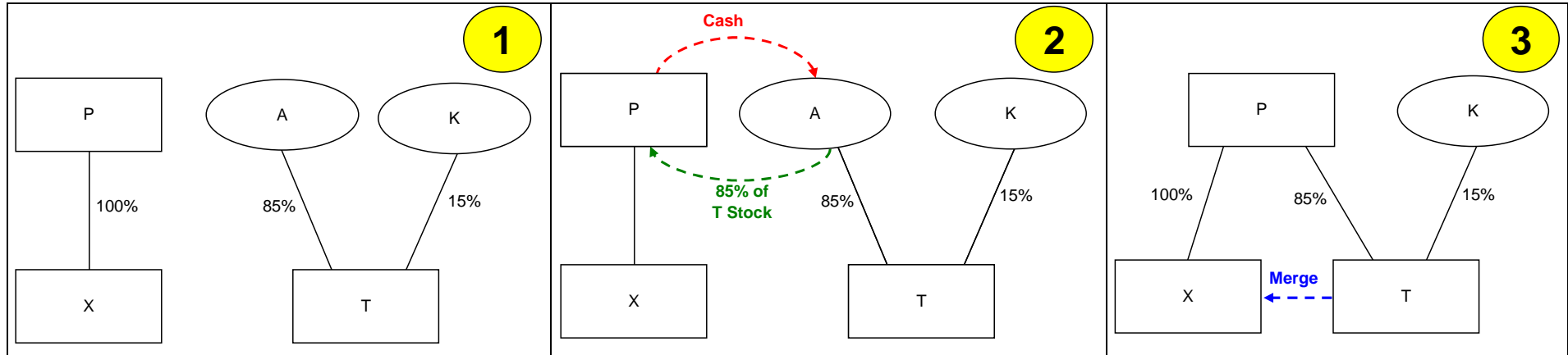


Initial Structure

QSP

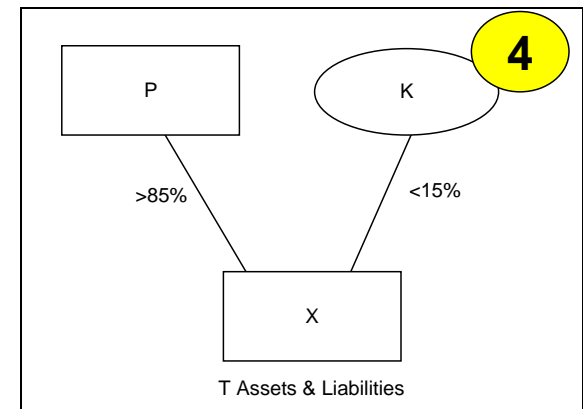
Merger



P, T, and X are domestic corporations. A and K, individuals unrelated to P, own 85 and 15 percent, respectively, of the stock of T. P owns all of the stock of X. P purchases all of A's T stock for cash in a QSP. P does not make an election under section 338(g) with respect to its acquisition of T stock. Shortly after the acquisition date, and as part of the same plan, T merges under applicable state law into X in a transaction that, but for the question of continuity of interest, satisfies all the requirements of section 368(a)(1)(A). In the merger, all of T's assets are transferred to X. P and K receive X stock in exchange for their T stock.

By virtue of section 338, for the purpose of determining whether the continuity of interest requirement of §1.368-1(b) is satisfied, P's T stock acquired in the qualified stock purchase represents an interest on the part of a person who was an owner of T's business enterprise prior to the transfer that can be continued in a reorganization through P's continuing ownership of X. Thus, the continuity of interest requirement is satisfied and the merger of T into X is a reorganization within the meaning of section 368(a)(1)(A). Moreover, by virtue of section 338, the requirement of section 368(a)(1)(D) that a target shareholder control the transferee immediately after the transfer is satisfied because P controls X immediately after the transfer. In addition, all of T's assets are transferred to X in the merger and P and K receive the X stock exchanged therefor in pursuance of the plan of reorganization. Thus, the merger of T into X is also a reorganization within the meaning of section 368(a)(1)(D).

Ending Point



T recognizes no gain or loss in the merger. P recognizes no gain or loss on the exchange. Because K is not the purchasing corporation (or an affiliate thereof), section 354 cannot apply to K's exchange of T stock for X stock in the merger of T into X. Under general principles of tax law applicable to reorganizations, the continuity of interest requirement is not satisfied because P's stock purchase and the merger of T into X are pursuant to an integrated transaction in which A, the owner of 85 percent of the stock of T, received solely cash in exchange for A's T stock. See, e.g., §1.368-1(e)(1)(i); Yoc Heating v. Commissioner, 61 T.C. 168 (1973); Kass v. Commissioner, 60 T.C. 218 (1973), aff'd, 491 F.2d 749 (3d Cir. 1974). Thus, the requisite continuity of interest under §1.368-1(b) is lacking and section 354 does not apply to K's exchange of T stock for X stock. K recognizes gain or loss, if any, pursuant to section 1001(c) with respect to its T stock.