Revenue Ruling 63-234

Two Step Exchange Did Not Qualify As B Reorganization (Remote Continuity)

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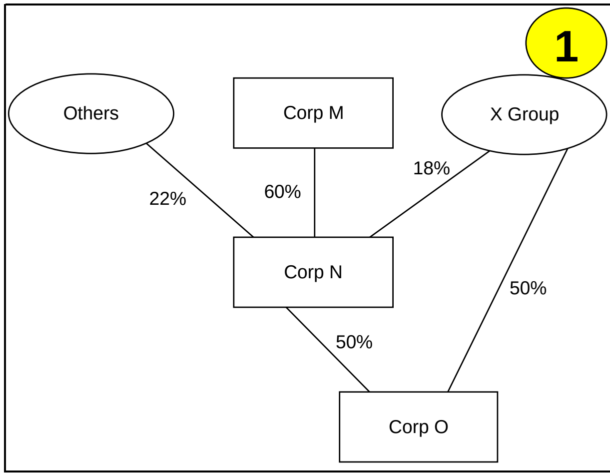
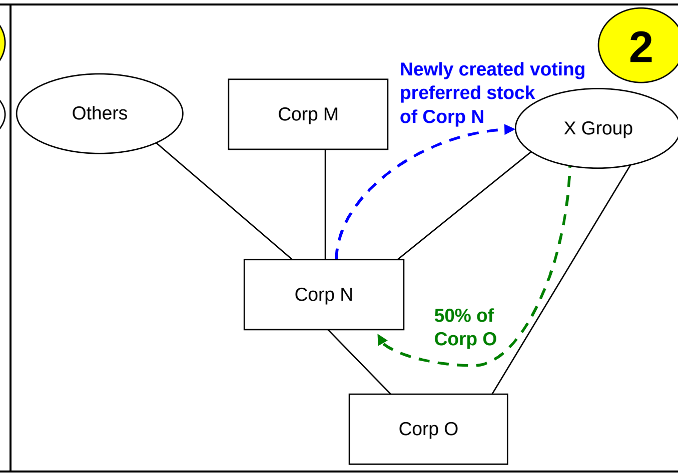
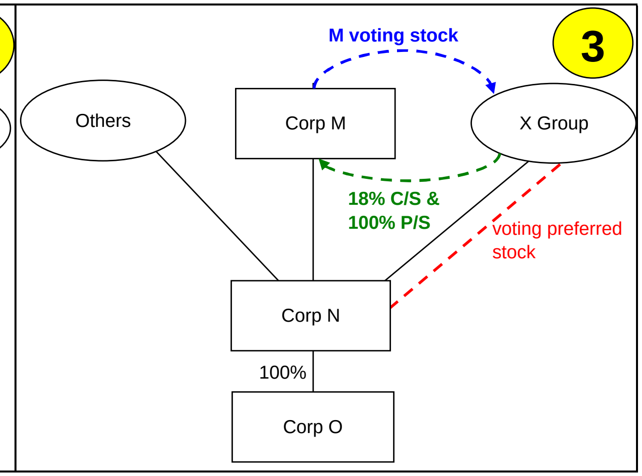
Initial Structure



1st Stock for Stock Exchange



2nd Stock for Stock Exchange

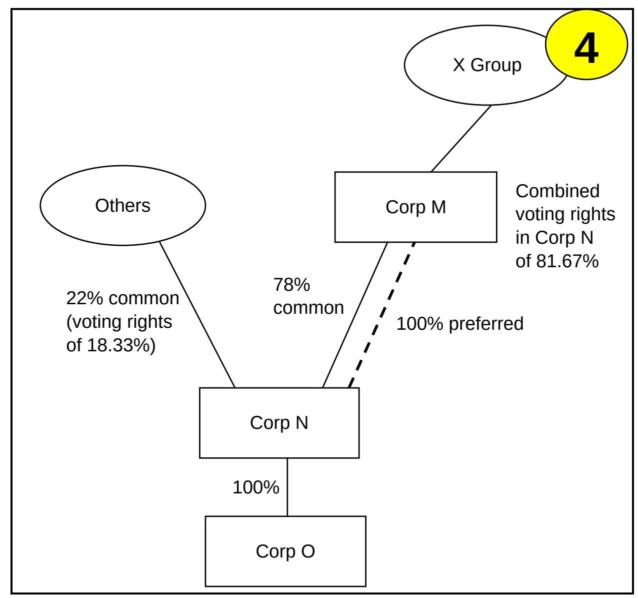


Corp M owned 60% of the outstanding shares of Corp N's voting common stock. A group of taxpayers, the X group, owned 18% of N's voting stock, and the remaining 22% were held by other shareholders. Among the assets of Corp N was 50% of the voting stock of the Corp O. The remaining 50% of O's voting stock was owned by members of the X group. A plan of reorganization was adopted pursuant to which the following actions were taken: (1) The charter of the Corp N was amended to enlarge its board of directors from 10 to 12 members and to provide that the two new members of the board would be elected by the owners of a newly authorized class of preferred stock, (2) Newly created preferred stock of the Corp N was issued to the members of the X group in exchange for all their holdings of Corp O's voting stock, and (3) Immediately thereafter, the X group transferred all of its stock of Corp N (18% of the common and 100% percent of the preferred) to the Corp M in exchange for the latter's voting common stock.

The voting power of Corp N preferred stock confers upon the holders of such stock the right to significant participation in the management of the affairs of the corporation. This preferred stock is therefore "voting stock" within the meaning of the reorganization provision. The voting rights of Corp M respecting the affairs of Corp N, when properly weighted, totaled 81.67% of the "voting power" of all classes of "voting stock" of Corp N. Thus, Corp M acquired "control" of Corp N within the meaning of section 368(c). Taking into account all the facts and circumstances, it is concluded that the two exchanges of corporate stock were but successive steps in the execution of the single plan adopted earlier by the parties. When the component steps in the plans are combined it becomes apparent that the X group exchanged its stock in Corp O for stock of Corp M, which did not thereafter directly own either stock of Corp O or its assets. The receipt of Corp N preferred shares by the X group may be disregarded for purposes of the reorganization provisions since the X group's holding of such shares was "transitory and without real substance."

Under the principles established by the Supreme Court in Groman v. Commissioner, 302 U.S. 82 (1937), and Helvering v. Bashford, 302 U.S. 454(1938), the stock of Corp M does not provide the X group with the requisite continuity of interest in Corp O stock transferred to Corp N because the group had only an indirect interest in the O stock following the transaction. The transfer by the X group of its shares in Corp O to Corp N in exchange for the latter's newly issued preferred stock and the subsequent transfer of the newly acquired preferred shares of N to Corp M in exchange for voting stock in M does not qualify as a section 368(a)(1)(B) reorganization. The exchange of Corp N stock owned by the X group before any of the exchanges described above for voting common stock of Corp M constitutes a section 368(a)(1)(B) reorganization.

Ending Point



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