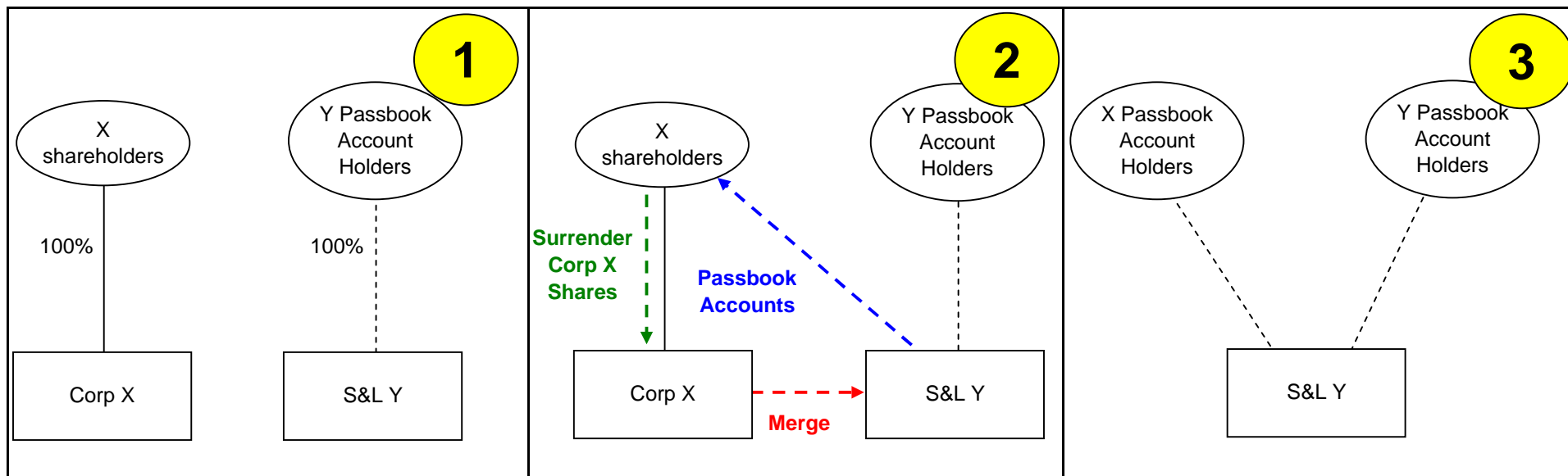


**No COI for Merger of Stock S&L
into Non-Stock S&L**

Initial Structure

Merger

Ending Point



X is a state chartered savings and loan association having permanent shares of stock outstanding. The stock of X has a fair market value of 25x dollars per share. It proposes to merge, under the laws of its state of incorporation and of the United States, into Y, a federally chartered nonstock membership savings and loan association owned entirely by its share account holders. The share accounts are evidenced by passbooks in the association. Each X shareholder who consents to the merger will exchange his stock for a voting membership in the form of a voting share account of Y evidenced by a passbook in an amount equal to the number of his shares in X multiplied by 25x dollars. Following the merger, X will be dissolved.

Section 368(a)(1)(A) provides that the term “reorganization” includes a statutory merger or consolidation. Section 368(a)(1)(C) describes a reorganization as the acquisition by one corporation, “in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation),” of substantially all the properties of another corporation.

The courts in interpreting the above sections of the Code have held that an otherwise qualified transaction does not constitute a reorganization within the meaning of the Code unless those persons who were shareholders prior to the transaction have a substantial continuing proprietary interest in the enterprise after the transaction. The continuity of interest requirement, under which the owners of an acquired corporation must receive a substantial proprietary or equity interest in the acquiring corporation, is necessary in order to distinguish sales transactions from reorganizations.

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The continuing proprietary interest of the owners of the transferor in the assets of the transferee must represent a substantial part of the value of the property transferred. See *Southwest Natural Gas Co. v. Commissioner*, 189 F. 2d 332 (5th Cir. 1951), certiorari denied, 342 U.S. 860, where the fact that less than one percent of the total consideration received by the transferor consisted of stock of the transferee disqualified the transaction as a merger under section 112(g)(1)(A) of the Internal Revenue Code of 1939.

In the instant case it is necessary to ascertain the nature of the consideration to be received by the shareholders of X in exchange for their stock. Y's entire equity interest, including the right to vote on matters affecting Y, the right to share in current earnings and the right to share in its assets upon liquidation, is vested in the share account holders who, as members of Y, own passbooks evidencing their interests. The rights of a share account holder in a federally chartered mutual association include a proprietary interest. See sections 7701(a)(7) and (8) of the 1954 Code; Rev. Rul. 54-624, C.B. 1954-2, 16.

However, Revenue Ruling 66-290, C.B. 1966-2, 112, holds that for purposes of section 1.334-1(c)(4)(v) of the regulations dealing with the allocation of basis to assets received in certain liquidations the phrase "cash and its equivalent" includes share accounts in savings and loan associations. Thus, share accounts in a Federal association also include cash equivalents in the face amounts of the account balances. See section 1.451-2 of the regulations dealing with amounts credited to the accounts of shareholders of savings and loan associations.

The members of a Federal nonstock mutual association have a dual relationship to the association: (1) as members of a mutual association they possess proprietary interests therein, and (2) as share account holders they possess withdrawable deposits which are the equivalent of cash. In the instant case Y's obligation to deliver cash deposits to X's shareholders is not severable from its obligation to deliver them a proprietary interest. Both the cash equivalents and the proprietary interests are evidenced by passbooks.

Only minimal value can be assigned the proprietary interests in Y received by the X shareholders inasmuch as the principal property received by them consists of withdrawable cash deposits as reflected by their passbook balances. Since their rights as members are insignificant in value as compared to the cash equivalent received by the X shareholders, the passbooks distributed to them do not constitute solely "stock" within the meaning of section 368(a)(1)(C), nor is there a sufficient continuity of interest on the part of the X shareholders to qualify the transaction as a reorganization within the meaning of section 368(a)(1)(A). The transfer by X of all of its assets to Y will be considered a sale by X of all of its assets to Y.

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