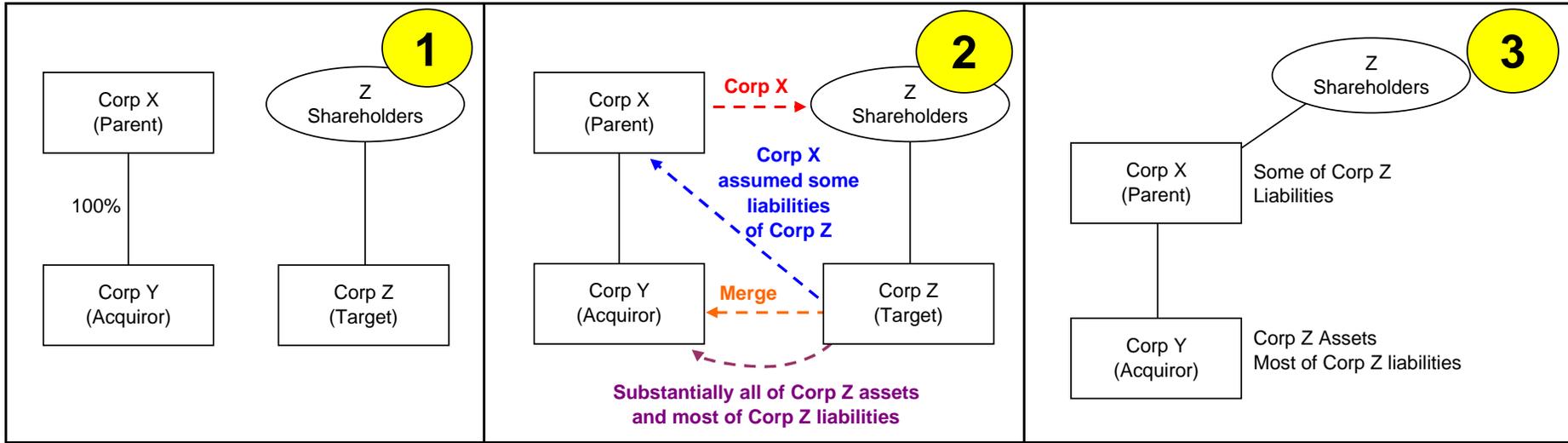


Forward Triangular Merger With Liabilities Assumed by Parent & by Subsidiary

Initial Structure

Forward Triangular Merger

Ending Point



Corporation Y, a wholly owned subsidiary of corporation X, desired to acquire all of the assets of corporation Z, an unrelated corporation. This acquisition was effectuated by the merging of Z into Y in exchange for stock of X. No stock of Y was used in the transaction. In the merger Y received substantially all of the assets of Z and assumed most of the liabilities of Z, while X, for a bona fide business purpose, assumed the remaining liabilities of Z. All of Z's outstanding liabilities at the time of the merger had been incurred in the ordinary course of its business. If Z had been merged into X, the merger would have qualified under the provisions of section 368(a)(1)(A) as a statutory merger.

Section 368(a)(1)(C) permits only the "acquiring corporation" to assume the liabilities of the acquired corporation. See Rev. Rul. 70-107. In contrast, neither section 368(a)(1)(A) nor section 368(a)(2)(D) contains a limitation on which a corporation (the acquiring corporation or its parent) may assume such liabilities in a statutory merger. There is no provision in either section 368(a)(1)(A) or section 368(a)(2)(D) that would prohibit both the acquiring corporation and its parent from assuming the liabilities of the acquired corporation (although section 368(a)(2)(D) does prohibit the issuance of stock of both the parent and the subsidiary). Accordingly, liabilities of Z may be assumed by both X and Y without disqualifying the reorganization under section 368(a)(2)(D) and thus the merger of Z into Y meets the requirements of sections 368(a)(1)(A) and (a)(2)(D).

The question arises as to whether the assumption of the liabilities by X should be treated as if money or other property were received by Z from X, resulting in the recognition of gain to Z under section 361(b), or whether section 357(a) is applicable preventing the recognition of gain by Z. Since the term "a party to a reorganization" applies to X under section 368(a)(2)(D), by virtue of section 368(b), X must also be considered a "party to the exchange" as such term is used in section 357(a). Thus, since subsections (b) and (c) of section 357 are not applicable to the transaction, section 357(a) applies. Accordingly, the assumption by X of liabilities of Z will not be treated as the receipt of money or other property by Z by virtue of section 357(a). Thus, the exchange by Z of substantially all of its assets in return for X stock is within the provisions of section 361(a) and no gain or loss will be recognized to Z on the exchange.