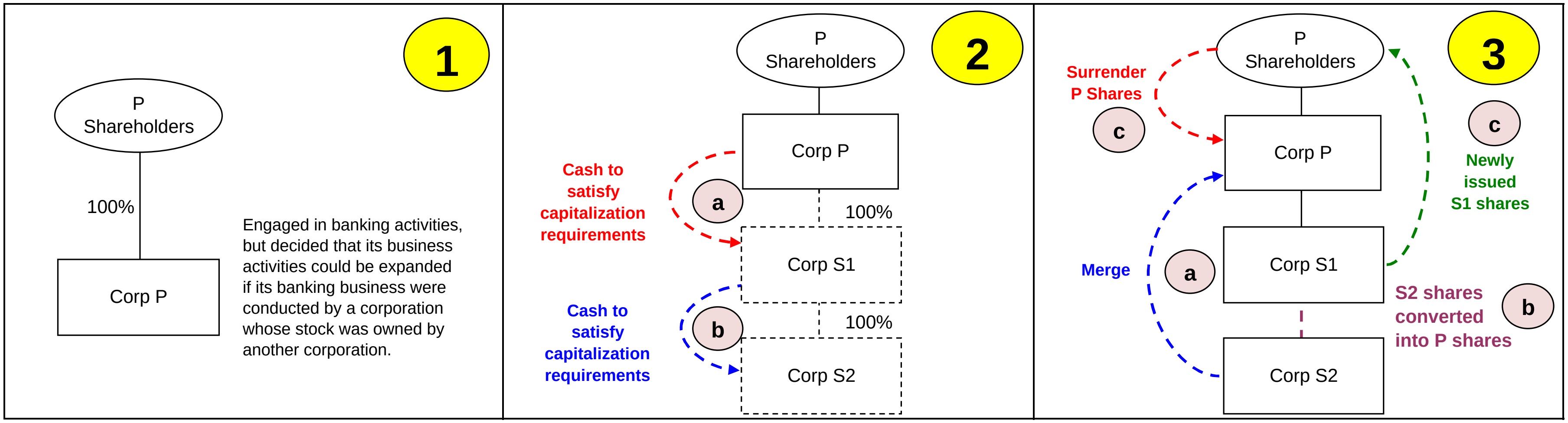
Revenue Ruling 77-428
Situation 2

Upstream Reverse Triangular Merger

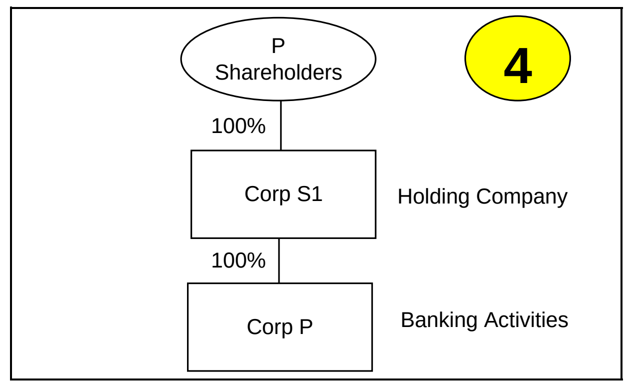
Initial Structure | **Creation of Subsidiaries** | **Upstream Reverse Triangular Merger**



P is a corporation chartered under state law that has been engaged in the commercial banking business for a number of years. P, for good business reasons, decided that its business activities could be expanded if its banking business were conducted by a corporation whose stock was owned by another corporation. The other corporation could then engage in related nonbanking activities, such as selling insurance to borrowers and leasing personal property, activities that could not be engaged in directly by P under state law. To accomplish this, P caused corporation S1 to be organized as a wholly owned subsidiary. S1 then caused corporation S2 to be organized as a wholly owned subsidiary. Other than the cash received from P to satisfy capitalization requirements, the only asset of S1 was the stock of S2, and the only asset of S2 was the cash received from S1 to satisfy capitalization requirements.

Pursuant to a plan of merger, S2 merged with and into P under the applicable state laws with P being the surviving corporation. On the effective date of the merger the S2 stock held by S1 was converted, pursuant to state law, into stock of P and each outstanding share of P stock not held by S1 exchanged for a share of S1 stock. Thus, as a result of the merger P became a wholly owned subsidiary of S1 and the former P shareholders became the shareholders of S1. After the merger, P held all of its assets and all the assets of S2.

Ending Point



Section 368(a)(2)(E) provides, in part, that a transaction otherwise qualifying as a statutory merger under section 368(a)(1)(A) will not be disqualified by reason of the fact that stock of a corporation which before the merger was in control of the merged corporation is used in the transaction if, after the transaction, the corporation surviving the merger holds substantially all of its properties and the properties of the merged corporation, and in the transaction, former shareholders of the surviving corporation exchanged, for an amount of voting stock of the controlling corporation, an amount of stock in the surviving corporation that constitutes control of such corporation.

The committee reports, H.R. Rep. No. 91-1778, 91st Cong., 2nd Sess. (1970), and S. Rep. No. 91-1533, 91st Cong., 2d Sess. (1970), 1971-1 C.B. 622, indicate that section 368(a)(2)(E) was enacted to allow as a tax-free reorganization a transaction identical to a transaction described in section 368(a)(2)(D) except that the surviving corporation was the acquired rather than the acquiring corporation. Since, as concluded in Situation 1, a corporation may form first- and second-tier subsidiaries and then merge into the second-tier subsidiary under section 368(a)(2)(D), a reverse merger of the second-tier subsidiary into the "grandparent" is permissible under section 368(a)(2)(E).