X corporation, a state chartered banking corporation, had outstanding 2,000x shares of common stock which were publicly held. In order to better promote its growth and to provide expanded financial services for its customers, X decided that its stock should be owned directly by a corporation. Accordingly, the following steps were taken: (1) Incorporators representing X formed Y corporation in the same state as X. For organizational purposes each incorporator was issued one share of Y common stock in exchange for cash at $100 per share. Each share issued to an incorporator was subject to repurchase by Y at the issuance price. (2) Five persons acting as incorporators organized Z corporation, under the banking laws of the same state, solely for the purpose of merging X into Z. Ten x shares of Z stock were subscribed for by each of the five organizers-directors at $15 per share. At the same time, to meet the minimum state capitalization requirements, Y subscribed for 200x shares of Z stock at the same price per share. The funds used by Y to capitalize Z were provided to Y for this purpose through a demand loan from X. (3) X was merged with and into Z pursuant to applicable state law, with Z acquiring substantially all of the net assets of X and assuming all of X’s liabilities. (4) The outstanding stock of X was exchanged by the X shareholders for common stock of Y on a share-for-share basis, and 2,000x shares of Z common stock were issued by Z to Y. Immediately after the merger and as part of the plan of reorganization, the following additional steps were taken: (1) Z repurchased for cash at $15 per share all of the 200x shares of its common stock previously issued to Y and the 50x shares previously issued to its directors as qualifying shares for organizational purposes. (2) Y repaid Z, as the survivor of X, all funds advanced for the initial capitalization of Z which were provided by the demand loan from X. (3) The shares of Y common stock issued for organizational purposes were redeemed by Y for the same price at which they were issued.

The cash borrowed by Y from X which was transferred to Z in purchase of 200x shares of Z’s stock, then returned by Z to Y in repurchase of the 200x shares of the Z stock held by Y, and thereafter returned by Y to Z, as the survivor of X in repayment of the demand loan, is disregarded and has no federal income tax consequence as an investment in the Z stock or as a redemption of the 200x shares of Z stock held by Y. The cash transferred by the organizing directors to Y and Z and returned to them upon surrender of the Y and Z stock in the transaction is likewise disregarded.

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