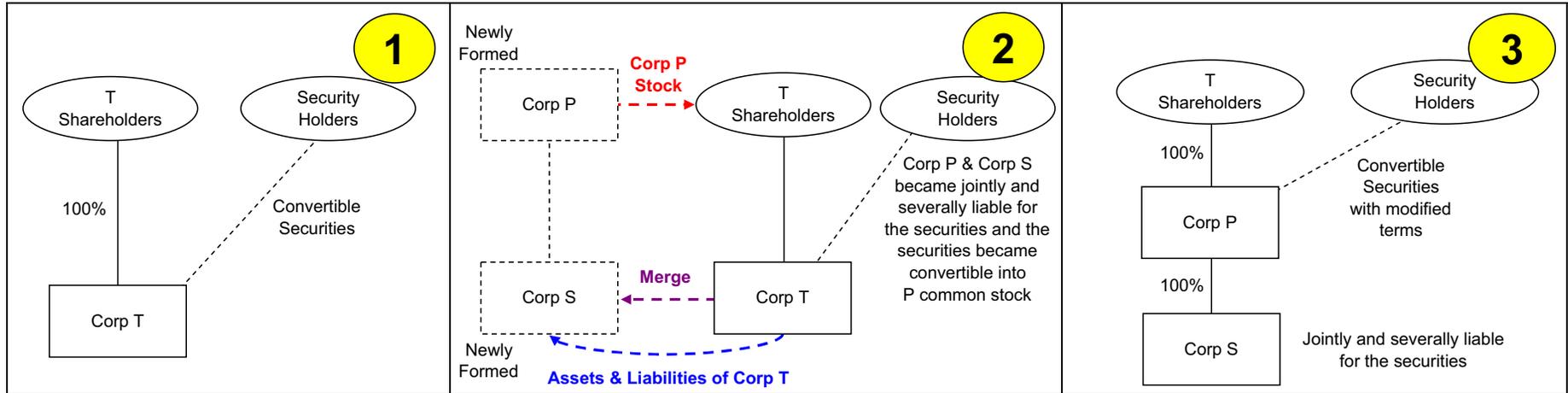


Initial Structure

Forward Triangular Merger

Ending Point



Corporation T, had outstanding one class of common stock and 8 percent convertible securities in the principal amount of 50,000x dollars with a maturity date of July 1, 1995. The terms of the securities contained a provision that they were convertible into T common stock, but did not impart to the holders thereof any rights or liabilities as shareholders of T. The security holders owned no T stock. In order to have the stock of T owned by a holding company, and to enable joint sharing of the liability for the convertible securities, corporation P and its wholly-owned subsidiary, S, were incorporated in state A to effect a merger of T into S. T merged into S in exchange for the stock of P, and S received all of the assets of T and assumed all of T's liabilities. The shareholders of T exchanged their T stock for P common stock. If T had merged into P the merger would have been a reorganization under section 368(a)(1)(A).

As part of the plan of reorganization, negotiations were entered into with the T security holders, whose consent was a precondition to the merger. An agreement was reached pursuant to which P and S became jointly and severally liable for the convertible securities; the securities became convertible into P common stock; the security holders obtained the right to convert the securities into S common stock if P disposed of its S stock, although there was no plan on the part of P to do so; the interest rate on the securities was increased to 9 percent; the maturity date was changed to July 1, 1990; and the T security holders consented to the merger. The principal amount of the outstanding securities remained unchanged. Subsequent to the merger, certain holders of the convertible securities exercised their rights and converted their securities into P common stock.

The transaction is a reorganization as defined in section 368(a)(2)(D). The convertible debentures of T do not confer upon the holders thereof rights or liabilities as shareholders of S unless and until P divests itself of its S stock and subsequently the security holders elect to convert their securities into S stock. Moreover, there was no intention on the part of P to divest itself of its S stock at the time of the merger. Thus, S stock is not deemed to have been issued upon the merger of T into S. See Rev. Rul. 69-91. Further, no gain or loss is recognized to T upon the assumption by P and S of the liability for the convertible securities. See section 357 and section 1.368-2(b)(2). See also Rev. Rul. 73-257.