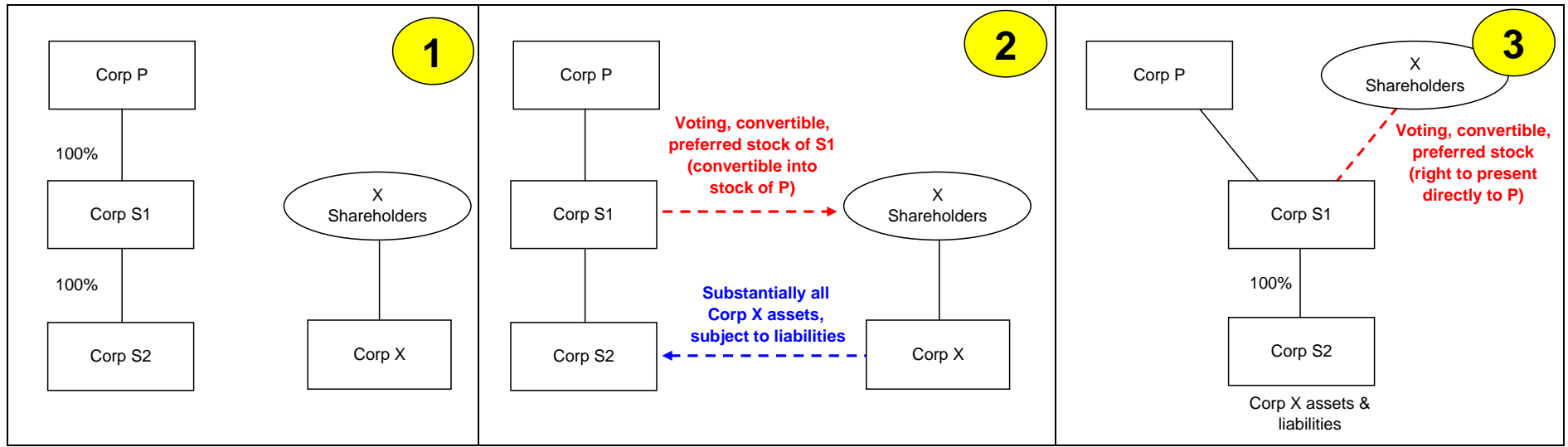


**Stock Convertible Into Parent Shares
Busted Triangular C Reorganization**

Initial Structure

Purported Triangular C Reorganization

Ending Point



Corporation S2 was the wholly-owned subsidiary of corporation S1 which in turn was the wholly-owned subsidiary of corporation P. Pursuant to a plan of reorganization that was intended to meet the definition of a reorganization in section 368(a)(1)(C), S2 proposed to acquire substantially all the assets, subject to the liabilities, of corporation X, an unrelated company, in exchange for voting convertible preferred stock of S1. The voting preferred stock of S1 was convertible into common stock of P at the election of the shareholders at any time after five years from the date of the reorganization. After the transaction, S1 was still in control of S2 as defined in section 368(c). Section 368(a)(1)(C) provides that a reorganization includes the acquisition by one corporation of substantially all the assets of another 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. The question was whether the right to convert the stock issued in the transaction is a right that should be considered property other than voting stock (i.e., "boot"). If the right in these circumstances is boot, then section 368(a)(1)(C) will not be satisfied.

The agreement provided that the shareholders of S1 (other than P) could present their voting convertible preferred stock of S1 directly to P which would issue its voting common stock directly to the shareholders in exchange for their stock of S1. Since S1 did not in this situation own any stock of P, it could not issue stock convertible into stock of P, unless P had granted to S1 the right to do so. Pursuant to the agreement P granted to S1 the right to have S1 stock converted into stock of P on the conversion date. S1 in turn distributed to the X shareholders the right granted by P to convert its stock to stock of P. Thus S1 issued to the shareholders of X its own stock plus the right that P granted to S1 to have such stock converted to the stock of P. The additional right obtained from P to convert the S1 stock to the stock of P represented boot when distributed by S1 to the shareholders of X. Thus, the assets of X were not acquired by S2 solely for voting stock of its parent S1. Accordingly, in this case, the transaction is not a reorganization within the meaning of section 368(a)(1)(C).